CREDIT MANAGEMENT AND PERFORMANCE OF LOAN PORTFOLIO IN COMMERCIAL BANKS IN BUJUMBURA, BURUNDI

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Oct, 2017

DECLARATION

I declare that this thesis is my original work and has not been submitted for any other award of a degree and published at any institution of higher learning.

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Irakoze Ornella **Date**

APPROVAL

I declare that this thesis has been done by the student under my supervision and is ready for any other further examinations

.... 07/11/2017

Dr. Emenike, O. Kalu **Date**

DEDICATION

I dedicate this piece of work to my father, Mr. Sinzinkayo, my mother, Hatungimana, and my siblings: Arakaza , Iteriteka, and Iradukunda

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My profound gratitude goes to the Almighty God for the gift of life and wisdom that He gave me throughout my studies.

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LISTS OF ACRONYMS AND ABBREVIATIONS

BANCOBU	Banque Commerciale du Burundi
BCB	Banque de Crédit de Bujumbura
CVI	Content Validity Index
FIs	Financial Institutions
IBB	Interbank Burundi
SACCOs	Savings and Credit Cooperatives
SPSS	Statistical Package for Social Sciences
KYC	Know Your Customer

TABLE OF CONTENTS

LIST OF TABLES

Visua

ABSTRACT

The purpose of this study was to investigate the effect of credit management on the performance of loan portfolio among commercial banks in Bujumbura, Burundi. The following objectives guided the study: i) to determine the effect of credit appraisal on the performance of loan portfolio of commercial banks in Bujumbura, Burundi; ii) to establish the effect of credit risk control on the performance of loan portfolio of commercial banks in Bujumbura, Burundi; and iii) to find out the effect of collection policy on the performance of loan portfolio of commercial banks in Bujumbura, Burundi. The study used cross sectional research design with emphasis on quantitative approach. The sample size of the study was 60 participants comprising of credit managers and loan officers, however, only 52 questionnaires were retrieved. The validity of the instrument was 0.89 and the reliability was 0.852 for credit management and 0.812 for performance of loan portfolio. The study revealed a significant effect of credit appraisal on the performance of loan portfolio (R^2=0.409; p=0.000). The null hypothesis was rejected and the alternative hypothesis upheld. Furthermore, the study revealed a significant effect of credit risk control on the performance of loan portfolio (R^2=0.469; p=0.000). The null hypothesis was rejected and the alternative hypothesis upheld. In addition, the study revealed that loan collection policy significantly affected the performance of loan portfolio (R^2=0.566; p=0.000). The null hypothesis was rejected and the alternative hypothesis upheld. The study concluded that credit management significantly affects the performance of loan portfolio of commercial banks in Bujumbura. The study recommended that commercial Banks in Burundi should enhance their collection policy by adapting a more stringent policy to a lenient policy for effective debt recovery, the study also recommended the need for commercial Banks in Burundi to enhance their client appraisal techniques so as to improve the performance of their loan portfolio. In addition, the study recommended the need for commercial banks in Burundi to enhance their credit risk control. This would help in decreasing default levels as well as their non-performing loans.

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

1.1.1 Historical Perspective

World over, credit has proved to be the most critical of all risks faced by banking institutions. A study of bank failures in New England found that, of the 62 banks in existence before 1984, which failed from 1989 to 1992 in 58 cases it was observed that loans and advances were not being repaid in time (Caprio & Kilngbiel, 2012). Credit management in our banking sector today has taken a different dimension from what it used to be. The banking industry has adopted a lot of strategies in checking credit management in order to stay in business. Though the banking industry over the years has lost large amount of money as a result of the turning source of credit exposure and taken interest rate position. Commercial banks world over are now being required in the market because of their competence to provide transaction efficiency, market knowledge and funding capability. To perform these roles, the banks act as the most important participants in their transaction process of which they use their own balance sheet to make it easier and making sure that their associated risk is absorbed (Besley, 2008).

In sub-Saharan Africa, the Central Bank of Nigeria established a credit act in 1990 which empowered banks to render returns to the credit risk management system in respect to its entire customers with aggregate outstanding debit balance of one million naira and above (Funso, Kolapo & Kolade, 2012). This made Nigerian banks to universally embark on upgrading their control system and risk management because this coincidental activity is recognized as the industry physiological weakness to financial risk.

In Kenya, Gatuhu (2013) found that the biggest risk for financial institutions is lending money and not getting it back. Hence, the issue of credit management has a profound implication both at the micro and macro level. When credit is allocated poorly it raises costs to successful borrowers, erodes the fund, and reduces banks flexibility in redirecting towards alternative activities. Moreover, the more the credit, the higher is the risk associated with it. The problem of loan default, which is resulted from poor credit management, reduces the lending capacity of a bank. It also denies new applicants' access to credit as the bank's cash flow management problems augment in direct proportion to the increasing default problem. In other words, it may disturb the normal inflow and outflow of fund a bank has to keep staying in sustainable credit market. Adequately managing credit in financial institutions (FIs) is critical for the survival and growth of the FIs. In the case of banks, the issue of credit management is of even greater concern because of the higher levels of perceived risks resulting from some of the characteristics of clients, business conditions and economic environment in which they find themselves (Gatuhu, 2013).

In Burundi, the first commercial bank (Banque de credit de Burundi) was started in 1922 during the colonial rule of the Belgium. In 1960, another commercial bank (Banque Commercial de Burundi) was established. However, for most of the post-independence period (1970s-1980s), several commercial banks came into play (Nkurunziza & Ngaruko, 2005). With financial liberalization in the late 1980s and early 1990s, Burundi's financial sector became more diversified with a series of commercial banks both foreign and local, with the latest establishment being Kenya Commercial Bank and Cooperative Rural and Development Bank both in 2012 (Bank of the Republic of Burundi, 2015). However, the country has no stock market and no dynamic informal financial markets, implying that most financial transactions are carried out through banks. Financial institutions are concentrated in Bujumbura, the capital city, but the main banks have branches in a number of provinces.

Commercial banks implement very important functions in country's financial system and whole economy, so to reduce the likelihood of financial instability, the National Bank of the Republic of Burundi has introduced prudential regulation frameworks, making banking one of the most heavily regulated industries. However the recent statistics of the Bank of the Republic of Burundi (2015) revealed doubtful and nonperforming credits in loan portfolios of commercial banks. It is against this background that this study investigated the effect of credit management on the performance of loan portfolio among commercial banks in Bujumbura, Burundi.

1.1.2 Theoretical Perspective

This study was guided by Asymmetric Information Theory. Information asymmetry refers to a situation where business owners or manager know more about the prospects for, and risks facing their business, than do lenders (PWHC, 2002) cited in Eppy (2005). It describes a condition in which all parties involved in an undertaking do not know relevant information. In a debt market, information asymmetry arises when a borrower who takes a loan usually has better information about the potential risks and returns associated with investment projects for which the funds are earmarked. The lender on the other hand does not have sufficient information concerning the borrower (Edwards and Turnbull, 1994).

This study was also guided by Transactions Costs Theory by Schwartz (1974). This theory conjectures that suppliers may have an advantage over traditional lenders in checking the real financial situation or the credit worthiness of their clients. Suppliers also have a better ability to monitor and force repayment of the credit. All these superiorities may give suppliers a cost advantage when compared with financial institutions. Three sources of cost advantage were classified by Petersen and Rajan (1997) as follows: information acquisition, controlling the buyer and salvaging value from existing assets. The first source of cost advantage can be explained by the fact that sellers can get information about buyers faster and at lower cost because it is obtained in the normal course of business. That is, the frequency and the amount of the buyer's orders give suppliers an idea of the client's situation; the buyer's rejection of discounts for early payment may serve to alert the supplier of a weakening in the credit-worthiness of the buyer, and sellers usually visit customers more often than financial institutions do.

1.1.3 Conceptual Perspective

Credit management is defined by Hosna et al. (2009) as the executive responsibility of determining customer's credit ratings as part of the credit control function. According to Myers and Brealey (2003), credit management are methods and strategies adopted by a firm to ensure that they maintain an optimal level of credit and its effective management. Brigham et l. (1999) defined credit management as the process of granting credit, the terms it is granted on and recovering this credit when it is due. According to Gitman (2009), credit management is a function performed within a company to improve and control credit policies that will lead to increased revenues and lower risk including increasing collections, reducing credit costs, extending more credit to creditworthy customers, and developing competitive credit terms. In this study, credit management was operationalized as credit appraisal, credit risk control, and collection Policy.

Loan portfolio refers to the total amount of money given out in different loan products, to the different types of borrowers, this may be comprised of: salary loans, group guaranteed loans, individual loans and corporate loans (Santomero, 2013). Loan portfolio performance, on the other hand, refers to the rate of profitability or rate of return of an investment in various loan products (Puxty et al, 1991). In this study, loan portfolio performance was operationalized as compliance with regulatory requirements and recovery of loans.

1.1.4 Contextual Perspective

As of 2015, the banking sector comprised of ten commercial banks all located in Bujumbura, Burundi. The banking sector is highly concentrated with the two mature banks, the Banque de Crédit de Bujumbura (BCB) and the Banque Commerciale du Burundi (BANCOBU) accounting for a commanding share of the market. In 2015, these two banks accounted for 43 percent of deposits, 42 percent of total assets, and 42 percent of credit allocated. Together with the Interbank Burundi (IBB) created in 1993, the three largest banks represented 76 percent of total assets, 74 percent of credit, and 79 percent of deposits in 2015 (Nkurunziza et al. 2015).

State ownership in the banking sector is low, representing only 3.6 percent of total capital of commercial banks. However, the government still has substantial influence in the banking sector through its public entities that own up to 31.6 percent of the capital of all banks combined. The government is also a majority shareholder in two out of the three most important banks (BANCOBU and BCB). Hence, the government is still able to influence the management of banks through the nomination of its representatives to the board of directors. The government's presence also has implications in the allocation of credit, directly through borrowing by state entities and indirectly through political pressure on bank management ((Nkurunziza et al. 2015).

1.2 Problem Statement

Credit management is one of the most important activities in any company and cannot be overlooked by any economic enterprise engaged in credit irrespective of its business nature. It is the process to ensure that customers will pay for the products delivered or the services rendered. It is for this reason that several studies related to credit management and the performance of loan portfolio have been done in neighboring countries such as Rwanda, Kenya, Uganda, and Tanzania and they include among others: Kagoyire and Shukla (2016); Gichuki and Kagiri (2015); Mulema (2011). These studies were done to check the performance of loan portfolio using credit management.

Similar studies have been done in Burundi as well; however, the problem of noncompliance with regulatory requirements and poor loan recovery is still evident among commercial banks in Bujumbura. A study by Nkurunziza, et al. (2015) revealed that out of ten (10) commercial banks, only 4, that is less that, 50% of the surveyed commercial banks complied with central bank regulatory requirements while 64% of the same banks were unable to recover their loans in the same year (2015). It is against this background that this study investigated the effect of credit management on the performance of loan portfolio of commercial banks in Bujumbura, Burundi.

1.3 Purpose of the Study

To determine the effect of credit management on the performance of loan portfolio of commercial banks in Bujumbura, Burundi.

1.4 Objectives of the Study

i. To determine the effect of credit appraisal on the performance of loan portfolio of commercial banks in Bujumbura, Burundi.
ii. To establish the effect of credit risk control on the performance of loan portfolio of commercial banks in Bujumbura, Burundi.
iii. To find out the effect of loan collection policy on the performance of loan portfolio of commercial banks in Bujumbura, Burundi.

1.5 Research Questions

i. What is the effect of credit appraisal on the performance of loan portfolio of commercial banks in Bujumbura, Burundi?
ii. What is the effect of credit risk control on the performance of loan portfolio of commercial banks in Bujumbura, Burundi?
iii. What is the effect of loan collection policy on the performance of loan portfolio of commercial banks in Bujumbura, Burundi?

1.6 Hypothesis

i. $H0_1$: credit appraisal has no significant effect on the performance of loan portfolio of commercial banks in Bujumbura, Burundi.
ii. $H0_2$: credit risk control has no significant effect on the performance of loan portfolio of commercial banks in Bujumbura, Burundi.
iii. $H0_3$: loan collection policy has no significant effect on the performance of loan portfolio of commercial banks in Bujumbura, Burundi.

1.7 Scope of the Study

1.7.1 Geographical Scope

This study was conducted in Bujumbura among commercial banks. Bujumbura is the capital city of Burundi. This choice of the capital is because it headquarters majority of commercial banks so it will be easier for the researcher to access the respondents. The researcher intends to do her study in all the commercial banks in Bujumbura; they are ten in total and include the following: Kenya Commercial Bank; InterBank Burundi; EcoBank; BCB (Banque de credit de Burundi); BANCOBU (Banque Commercial de Burundi), CRDB (Cooperative Rural and Development Bank), Diamond Trust Bank, FinBank, BBCI (Banque Burundaise Pour Ie Commerce et I'investment), and BGF (Banque de Geshon et de Financement).

1.7.2 Theoretical Scope

This study was guided by two theories; the Transactions Costs Theory by Schwartz (1974), and the Asymmetric Information Theory by Altman (1971).

1.7.3 Content Scope

This study was confined to credit management (independent variable) measured using credit appraisal, credit risk control, and loan collection policy. Performance of loan portfolio (dependent variable) was confined to compliance with regulatory requirements and recovery of loans.

1.7.4 Time Scope

This study reviewed a period of 5 years, that is, from 2012-2016 to establish the trends in the performance of loan portfolio vis-à-vis credit management among commercial banks in Buuumbura. The actual study took a period of 11 months, that is, from December, 2016 to October, 2017. This period helped the researcher to write her proposal, do data collection, write final thesis and do viva voce.

1.8 Significance of the Study

The findings of this study may be resourceful to the following groups.

Management of Commercial Banks

The findings of the study may help management in identifying potential risks rising out of the banks prevailing lending rates and their impact on loan portfolio performance in order to strengthen its internal control system and design. This may balance and contain overall loan portfolio risk by anticipating and controlling exposure to various identified markets, customers and operational conditions.

Employees

The study findings may help employees to be in better position to adhere to loan portfolio management policies and procedures to avoid fraud, defaults and job negligence that result into incurring losses in the bank so as to improve performance.

Customers

The findings may help customers of commercial banks to be more responsible and comply with the agreements of borrowing by providing the authentic documents and making payments as agreed to help the bank reduce losses that result from loan defaulters.

Academicians and professionals

The study findings may also be of practical significance to both academicians and general practitioners by providing a better insight into the understanding of the role credit management in mitigating credit risk to avoid losses in commercial banks. The findings may also add to the pool of knowledge on the shelves of university libraries and act as a ground for further research in the same areas.

Theoretical Knowledge

The findings of this study will help in testing whether Asymmetrical Information Theory is the best suited for explaining credit management and performance of loan portfolio.

1.9 Operational Definition of Terms

Credit Management: refers to methods and strategies adopted by a firm to ensure that they maintain an optimal level of credit and its effective management.

Performance: refers to the accomplishment of a given task measured against preset known standards of accuracy, completeness, cost, and speed.

2.2.2 Transactions Costs Theory

First developed by Schwartz (1974), this theory conjectures that suppliers may have an advantage over traditional lenders in checking the real financial situation or the credit worthiness of their clients. Suppliers also have a better ability to monitor and force repayment of the credit. All these superiorities may give suppliers a cost advantage when compared with financial institutions. Three sources of cost advantage were classified by Petersen and Rajan (1997) as follows: information acquisition, controlling the buyer and salvaging value from existing assets. The first source of cost advantage can be explained by the fact that sellers can get information about buyers faster and at lower cost because it is obtained in the normal course of business. That is, the frequency and the amount of the buyer's orders give suppliers an idea of the client's situation; the buyer's rejection of discounts for early payment may serve to alert the supplier of a weakening in the credit-worthiness of the buyer, and sellers usually visit customers more often than financial institutions do.

According to Douglass (2012), transaction cost theory tries to explain why companies exist, and why companies expand or source out activities to the external environment. The transaction cost theory supposes that companies try to minimize the costs of exchanging resources with the environment, and that companies try to minimize the bureaucratic costs of exchanges within the company. Companies are therefore weighing the costs of exchanging resources with the environment, against the bureaucratic costs of performing activities in-house.

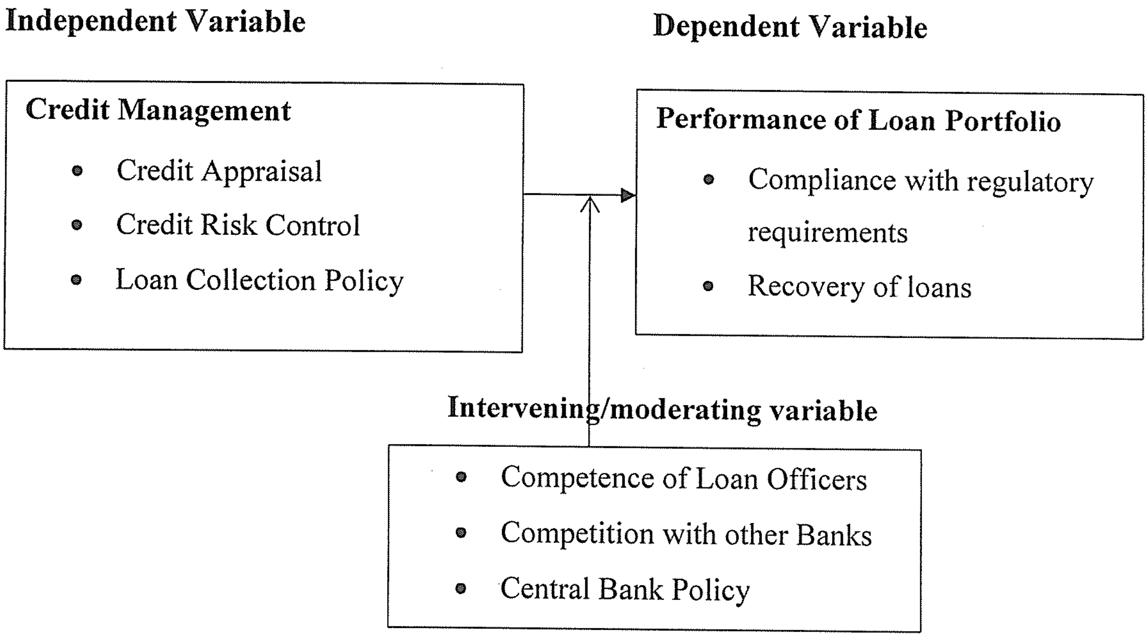
According to Douma and Schreuder (2012), the theory sees institutions and market as different possible forms of organizing and coordinating economic transactions. When external transaction costs are higher than the company's internal bureaucratic costs, the company will grow, because the company is able to perform its activities more cheaply, than if the activities were performed in the market. However, if the bureaucratic costs for coordinating the activity are higher than the external transaction costs, the company will be downsized.

According to Ronald Coase (2014), every company will expand as long as the company's activities can be performed cheaper within the company, than by e.g. outsourcing the activities to external providers in the market. According to Williamson (2015), a transaction cost occurs "when a good or a service is transferred across a technologically separable interface". Therefore, transaction costs arise every time a product or service is being transferred from one stage to another, where new sets of technological capabilities are needed to make the product or service.

Aboody and Lev (2015) posit that the transaction costs related to the exchange of resources with the external environment could be reflected by the following factors: environmental uncertainty, opportunism, risks, bounded rationality, and core company assets. The factors above will all potentially increase the external transaction costs, where it may become rather expensive for a company to control these factors. Therefore, it may very well be more economic to maintain the activity in-house, so that the company will not use resources on e.g. contracts with suppliers, meetings, supervision etc. Therefore, if companies see the environmental uncertainty as high, they might choose to not outsource or exchange resources with the environment.

For example, if a company is thinking about outsourcing its production of a given product, it may assess the costs related to such a transaction with the environment. If the company sees it as difficult to formulate a contract that controls the uncertainties related to the exchange, the company may regard it as too costly to outsource the production. This is because the transaction costs of monitoring the exchange are perceived to be higher, than the bureaucratic costs of performing the activity in-house. Managers must therefore weigh the internal transaction costs against the external transaction costs, before the company decides whether or not to keep some activity in-house, or to e.g. outsource the activity to the environment.

2.2 Conceptual Framework



Source: Adapted from Nakayiza (2013).

Figure 2.1: Conceptual framework showing the relationship between credit management and loan portfolio performance among commercial banks in Bujumbura, Burundi

Figure 2.1 shows credit management as the independent variable measured using credit appraisal, credit risk control, and loan collection policy; while the dependent variable was performance of loan portfolio measured using compliance with regulatory requirements and recovery of loans. The effect of the independent variable on the dependent variable is that through credit appraisal which in most cases is concerned with assessing the credit worthiness of loan borrowers, the commercial banks will be securing commendable ways of recovering their loans. On the other hand, exercising credit risk control and have loan collection policies by the commercial bank is an act of complying with regulatory requirements stipulated by the central bank.

2.3 Empirical Studies

2.3.1 Credit Management

Credit management is one of the most important activities in any company and cannot be overlooked by any economic enterprise engaged in credit irrespective of its business nature. It is the process to ensure that customers will pay for the products delivered or the services rendered. Myers and Brealey (2003) describe credit management as methods and strategies adopted by a firm to ensure that they maintain an optimal level of credit and its effective management. It is an aspect of financial management involving credit analysis, credit rating, credit classification and credit reporting. Nelson (2002) views credit management as simply the means by which an entity manages its credit sales. It is a prerequisite for any entity dealing with credit transactions since it is impossible to have a zero credit or default risk.

The higher the amount of accounts receivables and their age, the higher the finance costs incurred to maintain them. If these receivables are not collectible on time and urgent cash needs arise, a firm may result to borrowing and the opportunity cost is the interest expense paid. Nzotta (2004) opined that credit management greatly influences the success or failure of commercial banks and other financial institutions. This is because the failure of deposit banks is influenced to a large extent by the quality of credit decisions and thus the quality of the risky assets. He further notes that, credit management provides a leading indicator of the quality of deposit banks credit portfolio.

According to Inkumbi (2014), credit risk management helps credit expert to know when to accept a credit applicant as to avoid destroying the banks reputation and making decision in order to explore unavoidable credit risk which gives more profit. Controlling a risk results in encouraging rewards that give internal audit more technical support service and customized training in banks or financial institutions.

Kariuki (2010) assert that the key requirement for effective credit management is the ability to intelligently and efficiently manage customer credit lines. In order to minimize exposure to bad debt, over-reserving and bankruptcies, companies must have greater insight into customer financial strength, credit score history and changing payment patterns. Turyahebwa

(2013) goes on to point out that credit management starts with the sale and does not stop until the full and final payment has been received. It is as important as part of the deal as closing the sale. In fact, a sale is technically not a sale until the money has been collected. It follows that principles of goods lending shall be concerned with ensuring, so far as possible that the borrower will be able to make scheduled payments with interest in full and within the required time period otherwise, the profit from an interest earned is reduced or even wiped out by the bad debt when the customer eventually defaults. JoEtta (2011) posits that credit management is concerned primarily with managing debtors and financing debts. The objectives of credit management can be stated as safe guarding the companies' investments in debtors and optimizing operational cash flows. Policies and procedures must be applied for granting credit to customers, collecting payment and limiting the risk of non-payments (JoEtta, 2011).

Credit management is an aspect of financial management involving credit analysis, credit rating, credit classification and credit reporting. A proper credit management will lower the capital that is locked with the debtors, and also reduces the possibility of getting into bad debts (Gisemba, 2010). According to Ogilo (2011), unless a seller has built into his selling price additional costs for late payment, or is successful in recovering those costs by way of interest charged, then any overdue account will affect his profit. In some competitive markets, companies can be tempted by the prospects of increased business if additional credit is given, but unless it can be certain that additional profits from increased sales will outweigh the increased costs of credit, or said costs can be recovered through higher prices, then the practice is fraught with danger.

On the same note, Reilly and Brown (2011) explain that most companies can readily see losses incurred by bad debts, customers going into liquidation, receivership or bankruptcy. The writing-off of bad debt losses visibly reduces the Profit and Loss Account. The interest cost of late payment is less visible and can go unnoticed as a cost effect. It is infrequently measured separately because it is mixed in with the total bank charges for all activities. The total bank interest is also reduced by the borrowing cost saved by paying bills late. Credit managers can measure this interest cost separately for debtors, and the results can be seen by many as startling because the cost of waiting for payment beyond terms is usually ten times the cost of bad debt losses. Effective management of accounts receivables involves designing and documenting a credit policy. Many entities face liquidity and inadequate working capital problems due to lax credit standards and inappropriate credit policies (Reilly & Brown, 2011).

Therefore, sound credit management is a prerequisite for a financial institution's stability and continuing profitability, while deteriorating credit quality is the most frequent cause of poor financial performance and condition. According to Gitman (2007), the probability of bad debts increases as credit standards are relaxed. Firms must therefore ensure that the management of receivables is efficient and effective. Such delays on collecting cash from debtors as they fall due has serious financial problems, increased bad debts and affects customer relations. If payment is made late, then profitability is eroded and if payment is not made at all, then a total loss is incurred. On that basis, it is simply good business to put credit management at the 'front end' by managing it strategically (Gitman, 2007).

The Basel accords on credit management are recommendations on banking issued by the Basel committee on banking. The main objective of the Basel accords is to create an international standard that banking regulators would use when creating regulations in their own countries. These accords are about how much capital the bank should hold to cushion itself against financial and operational risks that they face. The foundation of the Basel accords I is the Cooke ratio. This ratio is defined as the amount of capital to risk weighted assets which must be at least 8%.The risk weighted assets relates to the amount lend by the bank multiplied by the risk weight. Basel I accords allows banks to use their own internal models in measuring credit, hence making it easier for banks use (Basel I, 1999). This simplicity however has opened windows to some unanticipated credit risk that are being experienced globally today. Consequently, a new more risk sensitive capital- adequacy framework was issued in 2002. Basel II accord made some improvements over the focus on the three pillars of risk minimization. These are: minimum capital requirement that is expected to determine the amount of capital requirements given the level of: credit risk, market risk and operational risks that the banks are exposed to.

Pillar II is on supervisory review-It provides a framework for dealing with all other risks that the bank may face. These includes: systematic risk, concentration risk, strategic risk and reputation risk. Pillar III focuses on market discipline- designed to allow the financial community have a better picture of the overall risk position of the bank by allowing competitors to price and deal effectively (Basel II, 2002).

Although the new accord aims at boosting the safety of the banking system, It is feared by many Central banks worldwide for it may target only internationally active banks with 20% of the business from international operations and significant banks which are defined as those whose market share in total assets of domestic banking exceed 1%. However Basel II accord remains a challenge to the entire banking industry. Banks should be conceptually and academically ready to adopt the new norms. This involves a paradigm shift in the direct supervisory focus away to the implementation issue in many parts of the world. Much of the Basel accords have been instrumental in providing some effective credit management framework thereby avoiding some credit crises. It has become apparent that, some risk measurements have to be strengthened so as to reduce high incidences of nonperforming loans. These risks are: risk of corporate governance, special or uncalculated risks caused by factors beyond the expectations of risk undertaking and overheads (Somoye, 2010).

This study measured credit management using credit appraisal, credit risk control, and collection policy. The following section provides details of the variables.

2.3.1.1 The Effect of Credit Appraisal on the Performance of Loan Portfolio

Credit Appraisal is the process by which a lender appraises the technical feasibility, economic viability and bankability including creditworthiness of the prospective borrower (Arnold, 2003). Credit appraisal process of a customer lies in assessing if that customer is liable to repay the loan amount in the stipulated time, or not. Here bank has their own methodology to determine if a borrower is creditworthy or not. It is determined in terms of the norms and standards set by the banks. Being a very crucial step in the sanctioning of a loan, the borrower needs to be very careful in planning his financing modes. However, the borrower alone doesn't have to do all the hard work. The banks need to be cautious, lest they end up increasing their risk exposure. All banks employ their own unique objective, subjective, financial and non-financial techniques to evaluate the creditworthiness of their customers (Brigham et al. 2009).

While assessing a customer, the bank needs to know the following information: Incomes of applicants and co-applicants, age of applicants, educational qualifications, profession, experience, additional sources of income, past loan record, family history, employer/business, security of tenure, tax history, assets of applicants and their financing pattern, recurring liabilities, other present and future liabilities and investments (if any). Out of these, the incomes of applicants are the most important criteria to understand and calculate the credit worthiness of the applicants (Saunders, 2002). As stated earlier, the actual norms decided by banks differ greatly. Each has certain norms within which the customer needs to fit in to be eligible for a loan. Based on these parameters, the maximum amount of loan that the bank can sanction and the customer is eligible for is worked out. The broad tools to determine eligibility remain the same for all banks. We can tabulate all the conditions under three parameters (Brigham et al. 2009).

According to Abedi (2002), the first step in limiting credit risk involves screening clients to ensure that they have the willingness and ability to repay a loan. Finance institutions should use the 5Cs model of credit to evaluate a customer as a potential borrower. The 5Cs help finance institutions to increase loan performance, as they get to know their customers better. These 5Cs are: character, capacity, collateral, capital and condition.

The 5Cs need to be included in the credit scoring model. The credit scoring model is a classification procedure in which data collected from application forms for new or extended credit line are used to assign credit applicants to "good" or "bad" credit risk classes (Dorfman, 1997). Inkumbi (2014) notes that capital (equity contributions) and collateral (the security required by lenders) as major stumbling blocks for entrepreneurs trying to access capital. This is especially true for young entrepreneurs or entrepreneurs with no money to invest as equity; or with no assets they can offer as security for a loan.

There are 7 Cs used in the credit appraisal model to enable banks achieve the "know your customer" norms (KYC). This goes down in reducing the level of default risk banks are subjected to in the credit management process. The 7Cs are: character, capacity, collateral, contribution, conditions, control and common sense (MacDonald & Timith, 2006).

Character: This is the general impression made on the potential borrower based primarily on past experience on the current lender or other lenders. A good deal of such information comes from credit bureaus. Issues in line with the character of the borrowers have attracted great attention to banks. Honesty and goodwill of the client are the most paramount factors in a successful loan. Dishonest borrowers do not feel committed to repay the loan though they are very determined to get the loan using any means at their disposal including misrepresentation. Loan officers have to spread their time over many loan relationships; they may not leave time to uncover the elaborate schemes of such individuals who are out to defraud the bank (McGoven, 2014).

According to Hempel et al. (1994), the bank has a duty of protecting its interests and hence it must protect itself from dishonest, incompetent or overly subjective borrowers through investigating their credit background. Other sources of information that can be used in assessing the borrowers' character are: records held by suppliers and past banking relationship with the customers. Where the client promptly services principal and interest, it is likely that the future loan balance will be adequately repaid. Where the client has been late in servicing past debts, the reason should be sought. Where previous creditors have experienced losses, the loan officer should almost out rightly reject the application (Hempel, et al. 1994).

Capacity: This is measured using information related to income/stability in relation to loan repayments. The bank will always be interested in knowing exactly how the customer intends to repay the loan (MacDonald & Timith, 2006). Under this circumstance the banks analysts accounting, legal and finance skills are crucial in determining the ability of the borrower to repay the loan from the cash flows generated by the business. For a seasonal working capital loans, cash flows are generated by means of orderly liquidation of built up of inventories and receivables. For term loans, cash flows are generated from earnings and noncash expenses such as depreciation and depletion charged against earnings. MacDonald and Timith, (2006) argues that the analyst must determine the timing and sufficiency of the cash flows and evaluate the risk of the cash flows falling short. Any other source of repayment other than cash flows from the operations should be viewed with a lot of suspicion or caution. The borrower may plan on a future injection of investor capital to repay the loan, but where the firm fails to produce attractive profits, outsiders would definitely withhold future investment in the firm. Where the borrower may be planning to borrow funds from another bank to repay the loan, unless a formal commitment exists from that bank, the source suffers the same limitation as that of planned equity injection. The future sale of a fixed asset is not a reliable source of loan repayment. If the borrower is unwilling or unable to sell the asset at the time of the loan, a future possibility of forced sale of the asset to repay the loan is highly speculative (MacDonald & Timith, 2006).

Collateral: These are additional forms of security or guarantee that are provided by the borrower to the bank. They represent those assets the borrower has pledged to the bank that can be sold if he defaults and collection efforts have become futile. Though cash flows from the business operation are deemed to be the main source of loan repayment, where sufficient cash flows fail to materialize, the bank can mitigate loss if it has secured a secondary source of repayment (collateral). Yeager (2009) explain that giving a lender collateral means that you pledge an asset you own, such as your home, to the lender with an agreement that it will be the main repayment source in case you cannot repay the loan. A guarantee on the other hand is just that; someone else signs a guarantee document promising to repay the loan if the borrower fails. However, collections from guarantors often require expensive litigation and results in bad blood between the bank, borrower and guarantor. It should be noted that strong collateral should not generally overcome deficiencies in either character or capacity. Banks avoid foreclosing on collateral because foreclosure entails much time and expense. Collateral value should cover the loan amount and the interest due, legal costs of foreclosure and interest during foreclosure proceedings (Yeager, 2009).

Contribution: According to Abedi (2002), some customers expect their banker to provide a substantial part of the capital required in a business, though the customer may be endowed with the skills, drive, knowledge and an original idea, but with little cash. The customer approaches the bank instead of colleagues or the market for the capital. Prospective lenders/bankers expect the business before asking them to commit any funding, the more of your own money you invest as a down payment or capital the more likely that you will do all you can to maintain your payment obligation (Abedi, 2002). It is not definitely the function of a modern bank to find the capital or invest in the clients business and usually the major stake should be that of long-term lenders. An excessive stake in business implies that the bank is accepting undue risk at the rates too fine to repay such a high risk.

Abedi (2002) argues that the liquidity position of any potential borrower demands that close assessment and the greater the bank debt, actual or prospective, in relation to the capital resources of the business the weaker inherently must be the financial position of the borrower who employs a portion of the short term funds to buy fixed assets. As a general rule, a banker will rarely lend more than the amount of the proprietor's capital, but there are exceptions to this tendency. For instance brokers dealing with marketable produce in good demand may borrow several times more than their own capital on occasion from banks against the security of the produce, with or without security/collateral support, however, this should be treated as distinct exceptions to a general rule. Lack of capital in business may be overcome from the banking stand point by the deposit of adequate personal security by the proprietors. Instead of investing directly in their business, they support the bank with their own private assets (Abedi, 2002).

Conditions: Some thoughts must be given to the nature and prospects of the business of the borrower with particular reference to the prevailing economic conditions. The natural optimism of every potential borrower has to be discounted and the real prospects of the venture addressed in light of known conditions; allied to this enquiry is the desirability of the advance. Here the field is limited to the possibility of success or otherwise of the venture for which finance is sought from the bank (MacDonald & Timith, 2006). With the experience or otherwise of the borrower, is the project likely to succeed? If it fails, the bank is likely to fall back on its security to recover its advances and the lending will fundamentally be misound. If it succeeds, will the development problems be overcome? Would anyone contendly lend to a factor to market ice cream to Eskimos or woolen vests to equatorial natives. Between the extremes there is much to be considered by the banker in any proposal for accommodation required by a customer. It should be noted that there are no tram lines demanding a prescribed course. It is only a question of considering the business and its prospects in conjunction with all other factors and as it were a vote for or against the proposal (MacDonald & Timith, 2006).

Control: While financial analysis of the loan applicant is important in capacity analysis other factors also come in play. These include: the quality of management and the operating effectiveness of the information systems used by the borrowers in managing (Thygerson, 2005). The management experience in the field and understanding of the business are key factors considered in evaluation/appraisal of the credit. One of the reasons why banks specialize in lending to certain industries is that they have developed the necessary expertise to evaluate the quality of management in those industries. A key question in lending is "How will the borrower repay"? In commercial lending, the loan applicant's business plan is a big part of the answer to this question. The business plan covers both the use of the loan proceeds and the plans for repayment. This also provides evidence of how well management understands and is able to control the business activities (Thygerson, 2005).

Not all borrowers have good internal financial and operating systems. This can lead to unexpected problems with meeting cash flow requirements. The lender and the investor must be assured that the firms accounting system is effective, that the firm meets all the regulatory and other legal requirements and that its management information systems are adequate to manage effectively. Control aims at serving the dual purpose of increasing sales revenue by extending credit to customers who are deemed a good credit risk and minimizing risk of loss from bad debts by restricting or denying credit to customers who are not a good credit risk. Effectiveness of credit control lies in procedure employed by judging prospectus creditworthiness, rather than in procedures used in extracting owned money (Yeager, 2009).

Common sense: Common sense is the natural ability to make good judgment and behave in a practical and sensible way. This calls for prudence and reasonableness in analysis, presentation and using data and all other data in relation to the business and processing them into useful information. Common sense can also be perceived as the reasonableness of the financial information provided to support the case for financing a project as an indication of the ability of the project to generate sufficient cash flows to pay for itself (Mutwiri, 2013).

The above factors should be considered jointly when any loan appraisal process is being undertaken. A good report on each of these factors reduces the risk of defaults in loan repayment. The use of the 7Cs model in credit appraisal enables banks to monitor their level of exposure with respect to existing and potential customers hence reducing the number of non-performing advances.

Owusu (2008) on credit practices in rural banks in Ghana found out that the appraisal of credit applications did not adequately assess the inherent credit risk to guide the taking of appropriate credit decision. He also found out that the drafted credit policy documents of the two banks lacked basic credit management essentials like credit delivery process, credit portfolio mix, basis of pricing, management of problem loans among others to adequately make them robust. In his recommendations he stated that credit amount should be carefully assessed for identified projects in order to ensure adequate funding. This situation provides the required financial resources to nurture projects to fruition, thus forestalling diversion of funds to other purposes, which may not be economically viable.

2.3.1.2 The Effect of Credit Risk Control on the Performance of Loan Portfolio

Key credit controls include loan product design, credit committees, and delinquency management (Churchill & Coster, 2001).

Loan product design: banks can mitigate a significant portion of default risk by designing loan products that meet client needs. Loan product features include the loan size, interest rate and fees, repayment schedule, collateral requirements and any other special terms. Loan products should be designed to address the specific purpose for which the loan is intended (Churchill & Coster, 2001).

Credit Committees: Establishing a committee of persons to make decisions regarding loans is an essential control in reducing credit (and fraud) risk. If an individual has the power to decide who will receive loans, which loans will be written off or rescheduled, and the conditions of the loans, this power can easily be abused and covered up. While loan officers can serve on the credit committee, at least one other individual with greater authority should also be involved. The credit committee has the responsibility not only for approving loans, but also for monitoring their progress and, should borrowers have repayment problems, getting involved in delinquency management (Churchill & Coster, 2001).

Delinquency Management: To minimize such delinquency banks can use the following delinquency management methods Institutional Culture: A critical delinquency management method involves cultivating an institutional culture that embraces zero tolerance of arrears and immediate follow up on all late payments. Banks can also remind clients who have had recent delinquency problems that their repayment day is approaching (Churchill & Coster, 2001).

Client Orientation: A logical first step toward developing a zero-tolerance institutional culture is to communicate this concept to each new client before she receives a loan (Churchill & Coster, 2001).

Staff Incentives: Creating staff involvement in discouraging delinquency, through a staff incentives system, can be effective. Delinquency Penalties: Clients should be penalized for late payment. This could include delinquency fees pegged to the number of days late and limiting access to repeat loans based on repayment performance (Churchill & Coster, 2001).

Loan Rescheduling: Given the vulnerability of the target market, it is common for borrowers to be willing but unable to repay. After carefully determining that this is indeed the case it may be appropriate to reschedule a limited number of loans. Only done under extreme circumstances, this may involve extending the loan term and/or reducing the installment size (Churchill & Coster, 2001).

Soke and Yusoff (2009), in their study on credit risk control of selected financial institutions in Malaysia, found that the majority of financial institutions and banks losses stem from outright default due to inability of customers to meet obligations in relation to lending, trading, settlement and other financial transactions. Credit risk emanates from a bank's dealing with individuals, corporate, financial institutions or sovereign entities. A bad portfolio may attract liquidity as well as credit risk.

Achou and Tenguh (2008) also conducted research on bank performance and credit risk management and found that there is a significant relationship between financial institutions performance (in terms of profitability) and credit risk management (in terms of loan performance). Better credit risk management results in better performance. Thus, it is of crucial importance that financial institutions practice prudent credit risk management and safeguarding the assets of the institutions and protect the investors' interests.

Nagarajan (2011) in his study of risk management for microfinance institutions in Mozambique found that risk management is a dynamic process that could ideally be developed during normal times and tested at the wake of risk. It requires careful planning and commitment on part of all stakeholders. It is encouraging to note that it is possible to minimize risks related losses through diligent management of portfolio and cash-flow, by building robust institutional infrastructure with skilled human resources and inculcating client discipline, through effective coordination of stakeholders.

2.3.1.3 The Effect of Loan Collection Policy on the Performance of Loan Portfolio

There are various policies that an organization should put in place to ensure that credit management is done effectively, one of these policies is a collection policy which is needed because all customers do not pay the firms bills in time. Some customers are slow payers while some are non-payers. The collection effort should, therefore aim at accelerating collections from slow payers and reducing bad debt losses (Kariuki, 2010).

Effective management of accounts receivables involves designing and documenting a credit policy. Many entities face liquidity and inadequate working capital problems due to lax credit standards and inappropriate credit policies. According to Pike and Neale (1999), a sound credit policy is the blueprint for how the company communicates with and treats its most valuable asset, the customers. Scheufler (2002) proposes that a credit policy creates a common set of goals for the organization and recognizes the credit and collection department as an important contributor to the organization's strategies.

2.3.2 Loan Portfolio

According to the Financial Dictionary (n.d), portfolios are loans that have been made or bought and are held for repayment. Loan portfolios are the major asset of banks, thrifts, and other lending institutions. The value of a loan portfolio depends not only on the interest rates earned on the loans, but also on the quality or likelihood that interest and principal will be paid. The loan portfolio is typically the largest asset and the predominate source of revenue. As such, it is one of the greatest sources of risk to a bank's safety and soundness. The level of interest risk attributed to the bank's lending activities depends on the composition of its loan portfolio and the degree to which the terms of its loans (e.g. maturity, rate structure, and embedded options) expose the bank's revenue stream to changes in rates (Jasson, 2012).

Whether due to lax credit standards, poor portfolio risk management, or weakness in the economy, loan portfolio problems have historically been the major cause of losses and failures. Effective management of the loan portfolio and the credit function is fundamental to commercial banks' safety and soundness. Loan portfolio management (LPM) is the process by which risks that are inherent in the credit process are managed and controlled. Because review of the LPM process is so important, it is a primary supervisory activity (Chijoriga, 2011).

Assessing LPM involves evaluating the steps the management takes to identify and control risk throughout the credit process. The assessment focuses on what management does to identify issues before they become problems (Essendi, 2013). The identification and management of risk among groups of loans may be at least as important as the risk inherent in individual loans. For decades, good loan portfolio managers have concentrated most of their effort on prudently approving loans and carefully monitoring loan performance. Although these activities continue to be mainstays of loan portfolio management, analysis of past credit problems, such as those associated with oil and gas lending, agricultural lending, and commercial real estate lending in the 1980s, has made it clear that portfolio managers should do more. Traditional practices rely too much on trailing indicators of credit quality such as delinquency, nonaccrual, and risk rating trends (Richardson, 2014).

Effective loan portfolio management begins with oversight of the risk in individual loans. Prudent risk selection is vital to maintaining favorable loan quality (Essendi, 2013). Therefore, the historical emphasis on controlling the quality of individual loan approvals and managing the performance of loans continues to be essential. But better technology and information systems have opened the door to better management methods. A portfolio manager can now obtain early indications of increasing risk by taking a more comprehensive view of the loan portfolio (Gisemba, 2010). To manage their portfolios, bankers must understand not only the risk posed by each credit but also how the risks of individual loans and portfolios are interrelated. These interrelationships can multiply risk many times beyond what it would be if the risks were not related. Until recently, few banks used modern portfolio management concepts to control credit risk. Now, many banks view the loan portfolio in its segments and as a whole and consider the relationships among portfolio segments as well as among loans. These practices provide management with a more complete picture of the bank's credit risk profile and with more tools to analyze and control the risk (Sinkey, 2015).

Specific measurable goals for the portfolio are established by loan portfolio objectives. They are an outgrowth of the credit culture and risk profile (Comptroller's Hand Book, 2008). The board of directors must ensure that loans are made with the following three basic objectives in mind: to grant loans on a sound and collectible basis; to invest the bank's funds profitably for the benefit of shareholders and the protection of depositors; and to serve the legitimate credit of their communities. Banks require that senior management and the board of directors develop medium- and long- term strategic plans to meet objectives for the loan portfolio. These strategies should be consistent with the strategic direction and risk tolerance of the institution. They should be developed with a clear understanding of their risk/reward consequences. They should be reviewed periodically and modified as appropriate (Comptroller's Hand Book, 2008).

Loan portfolio performance, on the other hand, refers to the rate of profitability or rate of return of an investment in various loan products thus broadly, it looks at the number of clients applying for loans, how much they are borrowing, timely payment of installments, security pledged against the borrowed funds, rate of arrears recovery and the number of loan products on the chain. The loan products may comprise of; Salary loans, Group guaranteed loans, Individual loans and corporate loan (Puxty et al. 2011).

Since one of the main tasks of commercial banks is to offer loans and their main source of risk is credit risk, that is, the uncertainty associated with borrowers' repayment of these loans. A non- performing loan (NPL) may be defined as a loan that has been unpaid for ninety days or more (Greenidge & Grosvenor, 2010). Such loans unpaid affect the bank loan portfolio performance. For effective loan portfolio performance banks should pay attention to several factors when providing loans in order to curtail the level of impaired loans (Khemraj & Pasha, n.d). Specifically, commercial banks need to consider the international competitiveness of the domestic economy since this may impair the ability of borrowers form the key export oriented sectors to repay their loans which in turn would result in higher nonperforming loans. These lending institutions should also take the performance of the real economy into account when extending loans given the reality that loan delinquencies are likely to be higher during periods of economic downturn. Finally, banks should constantly review the interest rates on loans since loan delinquencies are higher for banks which increase their real interest rates.

2.3.2.1 Compliance with Regulatory Requirements

Pyle (1997), in his study on bank risk management held that banks and similar financial institutions need to meet forthcoming regulatory requirements for risk measurement and capital. However, it is a serious error to think that meeting regulatory requirements is the sole or even the most important reason for establishing a sound, scientific risk management system. It was held, managers need reliable risk measures to direct capital to activities with the best risk/reward ratios. They need estimate of the size of potential losses to stay within limits imposed by readily available liquidity, by creditors, customers and regulators. They need mechanisms to monitor positions and create incentives for prudent risk taking by divisions and individuals.

According to the credit policy (2005) on restrictions and concentrations;

a) Bank of the Republic of Burundi regulations stipulate that aggregate loans to a single borrower or related group of the borrowers (as defined in the Financial Institutions Act (FIA)) shall be limited to no more than 25% of the core capital. Whereas this requirement remains, as an internal control mechanism to ensure that the commercial banks penetrate the commercial/corporate sector cautiously, the maximum amount of loan for one single individual borrower or group of related borrowers shall be limited to no more than 1 billion for new borrowers and 1.5 billion for recurrent borrowers with excellent performance. The board will consider raising the limit upon recommendation by management from time to time.

b) The bank shall comply with all regulations stipulated in the FIA 2004, notwithstanding the above internal limits.

(i) The bank shall not grant or promise to grant to a single person or to a group of related persons any advance or credit accommodation which is more than 25% of its capital.

(ii) Notwithstanding the above however, the Bank may grant advance or credit facility in excess of 25% but not more than 50% of its capital if the facility is self-liquidating, and its maturity or expiry does exceed three years and is adequately secured by: Burundi Government Securities to be pledged to the bank or Fixed Deposits held by the bank.

(iii) In addition to but without derogation from sub sections (a-b) above, the bank shall not have large exposures, which in aggregate exceed 80% of the total capital.

(iv) Notwithstanding sub sections (a) and (b) above, the bank may grant to another financial institution an advance or credit facility:- shall not exceed fifty percent of the Bank's total capital, shall not have a maturity exceeding one year, and shall immediately be reported to the central bank.

(v) Where the advance or credit facility by the bank to another financial institution exceeds one year, it shall be secured in accordance with sub section (iii) above

(c) Advances or credit facilities to a single borrower shall mean all loans and credit accommodation made by the bank to one or more persons with common interest. A common interest shall be deemed to exist between persons for the purposes of this section if:- i) The exposure to those persons constitutes a single exposure because of the fact that one of them directly or indirectly exercises control over the others; ii) Although the persons to whom the bank is exposed are different entities, they are so interconnected that if on one of them experiences financial difficulties, another one or all of them are likely to experience lack of liquidity; iii) The persons are affiliates within the meaning of this sub section; iv) Those persons are related persons within the meaning of this subsection; v) Those persons have common control; and vi) Those persons are associated within the meaning of this subsection

2.3.2.2 Loan Recovery

In finance, the term recovery refers to collection of amount due. The normally recovery depends on the purpose, time and condition, business running process, etc. Normally loan amount will be recovered on installment basis. The manager can fix installment period on the basis of nature of their business. The credit policy (2005) puts forward the following work out strategies; that each problem loan is different and no routine is universally applicable. A problem loan can be resolved in any of the following ways:- provide a debt restructuring/rescheduling program, additional collateral/guarantees, injection of additional funds, liquidation of collateral, liquidation of other assets, calling on guarantors to repay, arranging for joint venture partner and capital contribution, working with management to define problems and potential solutions, arranging sale of operating company to third party or replacing management.

Silikhe (2008) conducted a study on credit risk management in microfinance institutions in Kenya and found out that despite the fact that MFI's have put in place strict measures to credit risk management, normal loan recovery was still a challenge to majority of the institutions. This explains the reasons why most financial institutions are either not growing or about to close down.

2.3.3 Relationship Between Credit Management and Loan Portfolio

Kagoyire and Shukla (2016) carried out a study on the effect of credit management on performance of Commercial Banks in Rwanda in Equity Bank Rwanda Ltd. The study found that client appraisal, credit risk control and collection policy had effect on financial performance of Equity bank. The study established that there was strong relationship between financial performance of Equity bank and client appraisal, credit risk control and collection policy. The study established that client appraisal, credit risk control and collection policy significantly influenced financial performance of Equity bank. Collection policy was found to have a higher effect on financial performance and that a stringent policy was more effective in debt recovery than a lenient policy. The study recommended that Equity bank should enhance their collection policy by adapting a more stringent policy to a lenient policy for effective debt recovery.

Gichuki and Kagiri (2015) carried out a study to examine the factors that influence credit management as a strategy in the performance of SACCOs in Nairobi City County. The study found out that restriction of loan guarantee creates friction among members. The analysis of the data showed that most members suggested that SACCOs should open the loan guarantee and include other collaterals to secure the loans. The study recommends education to SACCO members to immediately address the credit management issues by encouraging members to save regularly, borrow wisely for productive purposes and repay their loans promptly. The study also recommended that credit policy should be reviewed by SACCOs from time to time to reflect the economic trends due to the changing world of business; hence efforts on credit management strategy would be enhanced.

Mulema (2011) in his study on credit policy and loan portfolio performance in Microfinance Institutions, found out a significant relationship ($r = 0.951$) between credit policy and loan portfolio performance. The study further indicated that credit policies if not clearly designed could negatively impact on the performance of micro finance institutions. The study made the following recommendations: the organization should improve on credit policies that are in place and train its employees on how to deal with the credit policies set by the organization; the organization should always review the credit controls to make sure that

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter covers the research design, study population, sample size, sampling techniques, data sources, data collection methods, research instruments, validity and reliability, data collection procedure, ethical considerations and limitations of the study.

3.1 Research Design

This study adopted a cross-sectional study. This is because it is a type of study that analyses data collected from a population, or a representative subset, at a specific point in time. Furthermore, cross-sectional design allows for the study of the population at one specific time and the difference between the individual groups within the population to be compared. It also provides for the examination of the co-relationship between the study variables (Amin, 2005). The study relied more on quantitative approach. Quantitative approach is predominantly used as a synonym for any data collection technique (such as a questionnaire) or data analysis procedure, such as: graphs or statistics that generates or uses numerical data.

3.2 Target Population

This study's target population included all the commercial banks in Bujumbura, Burundi. The participants included cred risk managers and loan officers of ten (10) commercial banks in Bujumbura, Burundi. The respondents included credit risk managers and loan officers, making a total of 60 respondents.

3.3 Sample Size

Given the small number of respondents, the target population remained 60 respondents. Table 3.1 gives the detailed representation of the sample size.

Table 3.1: Sample Size

Commercial Banks	Category of Respondents	
	Credit Risk Managers	**Loan Officers**
Kenya Commercial Bank	1	5
InterBank Burundi	1	5
EcoBank	1	5
BCB (Banque de credit de Burundi	1	5
BANCOBU (Banque Commercial de Burundi)	1	5
BGF (Banque de Geshon et de Financement)	1	5
BBCI (Banque Burundaise Pour Ie Commerce et I'investment)	1	5
FinBank	1	5
Diamond Trust Bank	1	5
CRDB (Cooperative Rural and Development Bank)	1	5
Subtotal	**10**	**50**
Overall total	**60**	

3.4 Sampling Technique

This study used census sampling method due to the small population size. The census sampling method is used when all potential participants are included in the study; in other words, it is used to collect complete information from all participants.

3.5 Data Source

This study used primary and secondary sources of data collection which included the use of questionnaires and document review.

3.6 Data Collection Methods

The study adopted survey questionnaires data collection method.

3.6.1 Surveys

The study used survey method of data collection. The researcher preferred to use survey method because it is good for gathering descriptive data, relatively easy to administer, cost effective and time saving. This method was used to collect data on credit management and performance of loan portfolio using structured questionnaires.

3.7 Research Instruments

This study used questionnaires as its main research instrument.

3.7.1 Questionnaires

The researcher used structured questionnaires to collect data about credit management and performance of loan portfolio using structured questionnaires. The researcher preferred to use questionnaires because large amounts of information can be collected from a large number of people in a short period of time and in a relatively cost effective way.

A five Likert scale was used to assess the extent to which a respondent agrees or disagrees with a statement of an attitude, belief or judgment. It required the researcher to first identify all sub-areas of the topic or variable being measured for questions to be asked for one to agree or disagree with. The table 3.2 gives the interpretation of the mean values.

Table 3.2: Interpretation of the Mean Values

#	Mean Range	Response Mode	Interpretation
5	4.01-5.00	Strongly Agree	Very satisfactory
4	3.26-4.00	Agree	Satisfactory
3	2.51-3.25	Undecided	Fairly satisfactory
2	1.76-2.50	Disagree	Unsatisfactory
1	1.00-1.75	Strongly Disagree	Very Unsatisfactory

The questionnaire was structured into three sections; the first section captured information regarding the demographic characteristics of the respondents; the second section captured information about credit management which was measured using credit appraisal (5-items), credit risk control (6-items), loan collection policy (5-items); the last section captured performance of loan portfolio measured using compliance with regulatory requirements (6-items), and loan recovery (5-items).

3.8 Validity and Reliability

3.8.1 Validity Test

This study used Content Validity Index so as to establish the degree to which a sample of items, taken together, constitutes an adequate operational definition of a construct. The researcher achieved this by involving experts in the field of finance and banking. According to Beck and Gable (2001), to examine the content validity, professional subjective judgment is required to determine the extent to which the scale was designed to measure a trait of interest. This is because content validity is a subjective judgment of experts about the degree of relevant construct in an assessment instrument. The researcher made use of the research supervisor and members of the defence panel and adjust the instruments accordingly. Content validity index was used to establish the validity of the instruments, using formula:

$$CVI = \frac{Items\ declared\ relevant\ by\ experts}{total\ number\ of\ items}$$

Where CVI=Content Validity Index. According to Amin (2005), if the CVI ≥ 0.70, then the items will be considered as valid.

The result of this study was as follows:

$CVI = \frac{24}{27}$=**0.89**

The above CVI shows that the items of the instrument used in the study were valid.

3.8.2 Reliability

In order to ensure that the research instrument is reliable and can consistently produce reliable data when administered, the researcher determined its reliability by measuring the internal consistency of the instrument. This reliability analysis was conducted on the piloted survey instruments prior to official data collection so as to ensure that the instruments provide reliable data for the study. Test- retest method of measuring reliability was used by the researcher to ensure the instruments could provide consistent measurements. Five (5) different samples (loan officers from KCB) were used and the instruments were administered on them twice with a two weeks' interval, and the obtained results were correlated using Pearson Linear Correlation Coefficient (PLCC). The Pearson correlation coefficient results were found to be reliable because they were 0.84 and 0.83 in the first and second test respectively. Furthermore, Cronbach's alpha was used to determine the reliability of the instruments. Cronbach's alpha measures the internal consistency, that is, how closely related a set of items are as a group. The higher the α-value, the more reliable the instruments would be considered. According to Amin (2005), if α ≥ 0.70, then the items will be considered as reliable. The results of this study indicated higher internal consistency, signifying that the Cronbach's results were reliable. Table 3.3 gives the summary of Cronbach's results.

Table 3.3: Cronbach's Results

Items	No of Items	Cronbach's alpha	Interpretation
Credit management	16	0.852	High internal consistency
Loan portfolio	11	0.812	High internal consistency

3.9 Data Gathering Procedure

An introduction letter was obtained from the College of Economics and Management of Kampala International University Uganda for the researcher to solicit approval to conduct the study from the management of the commercial banks. During the administration of the research instruments to the selected respondents; they were properly and adequately oriented on the study and why it was being carried out. The respondents were requested to sign the informed consent form. They were also guided on how to fill the questionnaires, and the importance of answering every item of the questionnaire without leaving any part unanswered. The respondents were requested to kindly respond to the questionnaire on time. After retrieving them back, they were thoroughly checked to ensure that all items are adequately answered by the respondents.

3.10 Data Analysis

After retrieving back the questionnaire and collecting the required data, it was then prepared for analysis by using Statistical Package for Social Scientists (SPSS, version 22.0) software. In this process, the data underwent these processes i.e. data editing which involved checking the filled questionnaires for any omissions or mistakes; then data coding which involved giving each item of the questionnaire or variable a code to be used when imputing the data into the computer, and lastly data entry into the computer for analysis (George & Mallery, 2003).

After processing the collected data, the researcher analyzed it. The analysis was conducted in the following manner: The frequency and percentage distribution were used to determine the profile of the respondents; descriptive statistics (mean and standard deviations) were used to describe the responses in the dataset. That is, mean values described the central tendency of the dataset while standard deviation described the dispersions of the datasets.

Linear regression analysis was estimated to achieve the objectives of the study. The Hypotheses were tested using p-value at the 0.05 level of significance. If the p-value is less than 0.05, it will be considered significant, otherwise it is not significant. The decision rule therefore is to reject the null hypothesis if the p-value is less than 0.05 and to accept otherwise.

3.11 Ethical Consideration

This study observed the following ethical considerations:

The researcher sought for informed consent from the respondents and key interview informants. This was done by requesting them to sign the informed consent form before participating in the study.

The researcher respected the confidentiality and anonymity of the research respondents by coding their names in the final report of the study.

The researcher ensured that participating in the study was voluntary, no one was forced or bribed in order to be part of the study. The researcher also ensured voluntary withdrawal from the study in case of change of mind of the respondent or key interview informant.

3.12 Limitations of the Study

This study was limited by unresponsive respondents and those who were uncooperative. The researcher however, mitigated this by including other willing and eligible respondents to close the gap.

The study was limited by company policy where management was not interesting in giving student researchers permission to carry research in their companies. The researcher mitigated this by using the letter from the university and the help of friends who work with some of the commercial banks to give her audience to carry out her study.

Questionnaire retrieval: the stated number of respondents was reached though some questionnaires were not returned due to circumstances beyond the researcher's control.

However, the researcher retrieved 52 questionnaires out of 60 giving a response rate of 87% of the questionnaires which is beyond the minimum return rate of 70% acceptable in social sciences (Amin, 2005).

The researcher had no control over honesty of the respondents and personal biases. However, the researcher tried his best to persuade the respondents to be as honest as possible.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.0 Introduction

This chapter presents the analysis of the data gathered and interpretation thereof. It gives the demographic characteristics of the respondents and variables used.

4.1 Demographic Characteristics of the Respondents

This section determines the demographic characteristics of the respondents. To achieve it, questionnaires were distributed to capture these responses. Frequencies and percentage distribution tables were employed to summarize the demographic characteristics of the respondents in terms of gender, age, education level, and work experience. Table 4.1 gives the summary of the findings.

Table 4.1: Demographic Profiles of the Respondents

Gender	**Frequency**	**Percent (%)**
Male	33	63.5
Female	19	36.5
Total	**52**	**100.0**
Age		
20-29	8	15.4
30-39	32	61.5
40-49	8	15.4
Above 50	4	7.7
Total	**52**	**100.0**
Education		
Diploma	13	25.0
Bachelor Degree	32	61.5
Master's Degree	7	13.5
Total	**52**	**100.0**
Work Experience		
Less than 1 year	8	15.4
1-5 years	24	21.2
6-10 years	11	46.2
Above 10 years	9	17.3
Total	**52**	**100.0**

Source: primary data, 2017

Table 4.2: Showing Mean Values for Credit Management (n=52)

Credit appraisal	Mean	Std. Deviation	Interpretation
In your bank, imposing loan size limits is a viable strategy in credit management.	4.12	.878	Very satisfactory
Your bank has competent personnel for carrying out client appraisal	4.08	.837	Very satisfactory
In your bank, aspects of collateral are considered while appraising clients.	3.90	.913	Satisfactory
In your bank, failure to assess customer's capacity to repay results in loan defaults.	3.88	1.078	Satisfactory
In your bank, client appraisal considers the character of the customers seeking credit facilities.	3.33	1.061	Satisfactory
Average mean	**3.86**	**0.953**	**Satisfactory**
Credit risk control			
In your bank, available collection policies have assisted towards effective credit management.	4.06	1.037	Very satisfactory
In your bank, credit committee's involvement in making decisions regarding loans are essential in reducing default/credit risk.	4.06	.916	Very satisfactory
In your bank, penalty for late payment enhances customer's commitment to loan repayment.	3.96	.969	Satisfactory
In your bank, interest rates charged affect performance of loans in the bank.	3.92	1.045	Satisfactory
In your bank, the use of credit checks on regular basis enhances credit management.	3.85	.872	Satisfactory
In your bank, flexible repayment periods improve loan repayment.	3.79	1.160	Satisfactory
Average mean	**3.94**	**0.999**	**Satisfactory**
Loan Collection Policy			
In your bank, available collection policies have assisted towards effective credit management.	4.06	1.037	Very satisfactory
In your bank, enforcement of guarantee policies provides chances for loan recovery in case of loan defaults.	3.71	.915	Satisfactory
In your bank, staff incentives are effective in improving recovery of delinquent loans.	3.65	1.064	Satisfactory
In your bank, regular reviews have been done on collection policies to improve state of credit management.	3.92	1.082	Satisfactory
In your bank, a stringent policy is more effective in debt recovery than a lenient policy.	3.04	1.357	Fairly satisfactory
Average mean	**3.68**	**1.091**	**Satisfactory**
General Average Mean	**3.83**	**1.014**	**Satisfactory**

Source: Primary Data, 2017

The results presented in table 4.2 revealed that credit management was assessed by respondents as satisfactory (general average mean=3.83, Std=1.014). This implies that credit management is being properly complied with across most of the surveyed commercial banks. This is evident with the fact that all the measures of credit management were assessed by the respondents as satisfactory, that is, credit appraisal, credit risk control and loan collection policy. In order to further understand the results better, they were explained in-depth as below:

The results revealed that *credit appraisal* as a measure of credit management was assessed by the respondents as satisfactory (average mean=3.86, Std=0.953). This was attributed to the fact that majority of the respondents strongly agreed that imposing loan size limits (mean=4.12, Std=0.878) and having competent personnel for carrying out client appraisal (mean=4.08, Std=0.837) were viable strategies in credit management. Furthermore, respondents agreed that aspects of collateral (mean=3.90, Std=0.913) and the character of the customers seeking credit facilities (mean=3.33, Std=1.061) were considered while appraising clients. However, respondents unanimously agreed that failure to assess customer's capacity to repay, results in loan defaults (mean=3.88, Std=1.078).

The above results shows that commercial banks in Bujumbura try their level best to ensure that the customers they are lending to are credit worthy through technical feasibility, economic viability and bankability appraisals. This enables them to know whether the customer in question is liable to repay the loan amount in the time stipulated or not. This therefore implies that while assessing a customer, the bank needs to know the following information: Incomes of applicants and co-applicants, age of applicants, educational qualifications, profession, experience, additional sources of income, past loan record, family history, employer/business, security of tenure, tax history, assets of applicants and their financing pattern, recurring liabilities, other present and future liabilities and investments (if any). However, out of these, the incomes of applicants are the most important criteria to understand and calculate the credit worthiness of the applicants. If all the above are done appropriately, the bank will be able to reduce a significant amount of exposure to risks, hence better loan performance.

Furthermore, the results revealed that *credit risk control* as a measure of credit management was assessed by the respondents as satisfactory (average mean=3.94, Std=0.999). This was attributed to the fact that majority of the respondents strongly agreed that available loan collection policies (mean=4.06, Std=1.037), and the involvement of credit committee in decision making (mean=4.06, Std=0.916) have assisted towards effective credit management and reduction in default/credit risk respectively. In addition, respondents agreed that penalty for late payment (mean=3.96, Std=0.969), flexible repayment periods (mean=3.79, Std=1.160), and credit checks on regular basis (mean=3.85, Std=0.872), imposed by the commercial banks have enhanced customer's commitment to loan repayment, improved loan repayment and enhanced credit management among the banks. However, respondents lamented that the interest rates charged is affecting the performance of loans in the banks (mean=3.92, Std=1.045).

The above results simply imply that the commercial banks in Bujumbura are seriously exercising credit risk controls appropriately. This is because the goal of credit risk control is to maximize a bank's risk-adjusted rate of return by maintaining credit exposure within acceptable parameters. In other words, commercial banks must manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. That is, they should consider the relationship between credit risk and other risks. This is because effective control of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success in any banking organization.

Furthermore, *loan collection policy* as a measure of credit management was assessed by the respondents as satisfactory (average mean=3.68, Std=1.091). This was attributed to the fact that majority of the respondents strongly agreed that available collection policies have assisted towards effective credit management (mean=4.06, Std=1.037). Furthermore, respondents agreed that enforcement of guarantee policies (mean=3.71, Std=0.915), provision of staff incentives (mean=3.65, Std=1.064), and regular reviews of loan collection policies are effective in improving loan recovery, and overall state of credit management in the banks. However, respondents fairly agreed that a stringent policy is more effective in debt recovery than a lenient policy (mean=3.04, Std=1.357).

The above results show how the commercial banks in Bujumbura value the importance of loan collection policies. This is because policies help in guiding commercial banks on how to go about with loan collection so as avoid or reduce bad debts. In other words, clearly written policy on important procedures will ensure consistent and effective accounts receivables management that contributes to realizing the bank's goals. This may include but not limited to: when to contact a customer, how to contact a customer, when to place an account on credit hold, how to resolve disputes, deductions, etc., when to turnover delinquent account to an outside collection agency, when to write an account off to bad debt etc. Therefore, a credit and collection policy creates the structured environment that can safeguard the organization's most precious asset-accounts receivable. Formulating such a policy, however, is not a one-time effort. In order to maintain its relevance and continue to have a positive impact on cash flow and revenues, it must be routinely updated in response to the changing environment, market conditions and competitive environment.

4.3 Mean Values for Loan Portfolio

This section captures the descriptive statistics (i.e. mean and standard deviation) of loan portfolio in terms of compliance with regulatory requirements and loan recovery. The mean values will show the central tendencies of the datasets while standard deviations will show the measure of dispersion of the datasets. Table 4.3 gives the summary of the findings.

Table 4.3: Showing Mean Values for the Performance of Loan Portfolio (n=52)

Compliance with regulatory requirements	**Mean**	**Std. Deviation**	**Interpretation**
In your bank, there is high credit risk due to poor portfolio management.	3.77	1.131	Satisfactory
In your bank, lending rates are higher than those set by the central bank.	3.92	1.082	Satisfactory
In your bank, suppression of loan collection is very common.	3.73	1.190	Satisfactory
In your bank, loans officers practice standard loan assessment, analysis and underwriting.	3.90	1.089	Satisfactory
In your bank, there are standard collateral requirements for different loan grades/ classes.	3.40	1.302	Satisfactory
Interest rates are periodically structured to improve on the loan portfolio performance.	3.37	1.121	Satisfactory
Average Mean	**3.68**	**1.153**	**Satisfactory**
Loan Recovery			
In your bank, clients with difficulty in loan payments are usually given an extension period.	3.69	1.229	Satisfactory
In your bank, collateral used for loan acquisition are ably used for payment of problem loans.	3.69	1.112	Satisfactory
In your bank, internal controls have greatly contributed to effective loan repayments.	4.10	.913	Very satisfactory
In your bank, guarantors normally assist in payment of loans defaulted by clients.	3.83	1.098	Satisfactory
Your bank often takes legal action for non-payment of loans.	3.96	.791	Satisfactory
Average Mean	**3.85**	**1.029**	**Satisfactory**
General Average Mean	**3.77**	**1.091**	**Satisfactory**

Source: Primary data, 2017

The results presented in table 4.3 revealed that majority of the respondents assessed the performance of loan portfolio as satisfactory (general average mean=3.77, Std=1.091). This was attributed to the fact that all the measures of loan portfolio were assessed by the respondents as satisfactory, that is, compliance with regulatory requirements and loan recovery. The next paragraph gives the findings of the variables in details.

The finding revealed that compliance with regulatory requirements was assessed by the respondents as satisfactory (average mean=3.68, Std=1.153). This was attributed to the fact that majority of the respondents agreed that loans officers practice standard loan assessment, analysis and underwriting (mean=3.90, Std=1.089), use standard collateral requirements for different loan grades/ classes (mean=3.40, Std=1.302), and periodically structure interest rates so as to improve on the loan portfolio performance (mean=3.37, Std=1.121). However, respondents also agreed that their lending rates are often higher than those set by the central bank (mean=3.92, Std=1.082) which makes suppression of loan collection very common among commercial banks (mean=3.73, Std=1.190).

The above results implied that most of the commercial banks are compliant with most of the regulatory requirements of the Central bank. However, it was revealed that most of the commercial banks had higher interest rates compared to the one set by the central bank. However, following regulatory requirements enabled the banks to manage their loan portfolio performance since regulations provide basics for minimum acceptable standards of loan portfolio management that mitigates credit risk that would otherwise hurt the portfolio returns of the commercial banks. Therefore, it is important that loan officers and managers adhere to credit policies and procedures when engaged in lending activities. If an individual employee, or employees in combination, constantly fail to follow these policies and procedures, or fail to adhere to certain critical procedures, they risk being suspended, interdicted, or terminated from employment with the bank.

Furthermore, the findings revealed that *loan recovery* was assessed by the respondents as satisfactory (average mean=3.85, Std= 1.029). This was attributed to the fact that majority of the respondents strongly agreed that internal controls have greatly contributed to effective loan repayments (mean=4.10, Std=0.913). Similarly, respondents agreed that clients with difficulty in loan payments are usually given an extension period (mean=3.69, Std=1.229) and in case of loan defaulting, guarantors normally assist in payment (mean=3.83, Std=1.098), or collateral used for loan acquisition are ably used for payment of loans (mean=3.69, Std=1.112). However, if there is total noncompliance, commercial banks usually take legal action for non-payment of loans (mean=3.96, Std=0.791).

The results established that although commercial banks have addressed the issue of working out problem loans and loan recovery, there are still gaps in the way the banks handle their internal control policies for minimizing credit loss. This is because the policies not adequately followed which makes it possible to increase on the amount of problem loans.

4.4 The Effect of Credit Appraisal on the Performance of Loan Portfolio Among Commercial Banks in Bujumbura, Burundi

The first objective of this study was to determine the effect of credit appraisal on the performance of loan portfolio among commercial banks in Bujumbura, Burundi. Table 4.4 gives the summary of the findings.

Table 4.4: Results of the Effect of Credit Appraisal on the Performance of Loan Portfolio Among Commercial Banks in Bujumbura, Burundi

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics: R Square Change	F Change	df1	df2	Sig. F Change
1	.640[a]	.409	.397	.49287	.409	34.635	1	50	.000

Model		Sum of Squares	df	Mean Square	F	Sig.
2	Regression	8.414	1	8.414	34.635	.000[b]
	Residual	12.146	50	.243		
	Total	20.560	51			

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t	Sig.
3	(Constant)	1.477	.395		3.736	.000
	Credit appraisal	.595	.101	.640	5.885	.000

a. Dependent Variable: loan portfolio

Table 4.5: Results of the Effect of Credit Risk Control on the Performance of Loan Portfolio Among Commercial Banks in Bujumbura, Burundi

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.685[a]	.469	.458	.46723	.469	44.180	1	50	.000

Model		Sum of Squares	Df	Mean Square	F	Sig.
2	Regression	9.645	1	9.645	44.180	.000[b]
	Residual	10.915	50	.218		
	Total	20.560	51			

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
3	(Constant)	1.032	.417		2.476	.017
	Credit risk control	.693	.104	.685	6.647	.000

a. Dependent Variable: loan portfolio

Table 4.5 revealed how much of the total variation in the dependent variable (performance of loan portfolio), can be explained by the independent variable (credit risk control). In this case, 46.9% can be explained (R Square=0.469, p=0.000). This implies that credit risk control can significantly explain a small portion of the total variation in the performance of loan portfolio. Thus rejecting the null hypothesis that credit risk control has no significant effect on the performance of loan portfolio among commercial banks in Bujumbura, Burundi, and upholding the alternative hypothesis. Furthermore, the regression model 2 revealed that it can statistically predict the outcome variable (i.e. it is a good fit for the data). Similarly, the regression equation: loan portfolio=1.032 + 0.693 (credit appraisal), revealed that every single change in credit risk control, will statistically and significantly predict 68.5% of the total variance in the performance of loan portfolio (Beta=0.685). This implies that a single change in credit risk control affects a large proportion of the performance of loan portfolio.

4.6 The Effect of Loan Collection Policy on the Performance of Loan Portfolio Among Commercial Banks In Bujumbura, Burundi

The third objective of this study was to find out the effect of loan collection policy on the performance of loan portfolio among commercial banks in Bujumbura, Burundi. Table 4.6 gives the summary of the findings.

Table 4.6: Results of the Effect of Collection Policy on the Performance of Loan Portfolio Among Commercial Banks in Bujumbura, Burundi

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.752[a]	.566	.557	.42240	.566	65.230	1	50	.000

Model		Sum of Squares	df	Mean Square	F	Sig.
2	Regression	11.638	1	11.638	65.230	.000[b]
	Residual	8.921	50	.178		
	Total	20.560	51			

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
3 (Constant)	1.008	.347		2.907	.005
Collection policy	.751	.093	.752	8.077	.000

a. Dependent Variable: loan portfolio

Table 4.6 revealed how much of the total variation in the dependent variable (performance of loan portfolio), can be explained by the independent variable (collection policy). In this case, 56.6% can be explained (R Square=0.566, p=0.000). This implies that loan collection policy can significantly explain a moderate portion of the total variation in the performance of loan portfolio. This rejects the null hypothesis that loan collection policy has no significant effect on the performance of loan portfolio among commercial banks in Bujumbura, Burundi and upholds the alternative hypothesis. Furthermore, the regression model 2 revealed that it can statistically predict the outcome variable (i.e. it is a good fit for the data). Similarly, the regression equation: loan portfolio=1.008 + 0.751 (collection policy), revealed that every single change in collection policy, will statistically and significantly predict 75.2% of the total variance in the performance of loan portfolio (Beta=0.640). This implies that a single change in loan collection policy affects a large proportion of the performance of loan portfolio.

Table 4.7: Results of the Effect of Credit Management on the Performance of Loan Portfolio

					Change Statistics				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	R Square Change	F Change	df1	df2	Sig. F Change
1	.795[a]	.632	.624	.38925	.632	85.694	1	50	.000

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	12.984	1	12.984	85.694	.000[b]
	Residual	7.576	50	.152		
	Total	20.560	51			

	Unstandardized Coefficients		Standardized Coefficients		
Model	B	Std. Error	Beta	t	Sig.
1 (Constant)	.348	.373		.931	.356
Credit management	.894	.097	.795	9.257	.000

a. Dependent Variable: Performance of loan portfolio
b. Predictors: (Constant), credit management

Table 4.7 revealed that credit management can explain 63.2% of the total variation in the performance of loan portfolio (R Square=0.632). This implies that credit management explains a large proportion of the total variation in loan portfolio Furthermore, the F-test is highly significant, thus it can be assumed that the model explains a significant amount of the variance in the performance of loan portfolio (p<0.05). In addition, the found that for every 1-unit change in credit management, there will be 79.5% significant variance in the performance of loan portfolio (Beta=0.795). This implies that credit management is a big predictor of the performance of loan portfolio among the selected banks in Bujumbura.

Table 4.8: Multiple Regression of the Effect of Credit Management on the Performance of Loan Portfolio

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.340	.372		.915	.365
Credit appraisal	.190	.110	.204	1.722	.092
Credit risk control	.237	.129	.234	1.835	.073
Loan collection policy	.480	.116	.481	4.126	.000

a. Dependent Variable: loan portfolio

Table 4.8 revealed that loan collection policy is the highest predictor of performance of loan portfolio by 48.1%. In other words, a single unit of change significantly affects the variance in performance loan portfolio by 48.1% (Beta=0.481, p=0.000). On the other hand, credit appraisal and credit risk control do not significantly predict any variation in performance loan portfolio.

CHAPTER FIVE

DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This chapter presents the discussion of the study guided by the study objectives. The discussion of this study finding was done by reviewing related literature, and comparing and contrasting with other previous studies. The study was later concluded and appropriate recommendations accruing from the findings were made.

5.1 Discussion of the Findings

5.1.1 The Effect of Credit Appraisal on the Performance of Loan Portfolio among Commercial Banks in Bujumbura, Burundi

The first objective of this study was to determine the effect of credit appraisal on the performance of loan portfolio among commercial banks in Bujumbura, Burundi. The study revealed a significant effect of credit appraisal on the performance of loan portfolio by 40.9% (R Square=0.409). The null hypothesis was rejected and the alternative hypothesis upheld.

The study revealed that commercial Banks in Burundi use client appraisal in Credit Management to a moderate extent. Further it established that client appraisal is a viable strategy for credit, Aspects of collateral are considered while appraising clients, failure to assess customer's capacity to repay results in loan defaults, client appraisal considers the character of the customers seeking credit facilities and that commercial Banks in Burundi have competent personnel for carrying out client appraisal.

This study is in line with that of Inkumbi (2014); and Mutwiri (2013) who found significant effect of credit appraisal on loan performance. This is because credit appraisal implies consideration of fresh or enhancement proposals on the basis of futuristic data. While appraising proposals, banker tries to find out: financial need of the client, end-use of funds, viability of operations and risk involved. In case of proposals involving working capital finance, the banker can ascertain the aforesaid factors only when he/she is supplied with the business plan of the borrower for the ensuing period. Business plan is expressed through operating statement, balance sheet, funds flow, and cash flow statements, all on projected basis.

5.1.2 The Effect of Credit Risk Control on the Performance of Loan Portfolio among Commercial Banks in Bujumbura, Burundi

The second objective of this study was to establish the effect of credit risk control on the performance of loan portfolio among commercial banks in Bujumbura, Burundi. The study revealed a significant effect of credit risk control on the performance of loan portfolio by 46.9% (R Square=0.469). Thus rejecting the null hypothesis and upholding the alternative hypothesis.

The study established that commercial Banks in Burundi use credit risk control in Credit Management to a moderate extent. The study further established that interest rates charged affects performance of loans in the commercial Banks in Burundi, Credit committees involvement in making decisions regarding loans are essential in reducing default/credit risk, the use of credit checks on regular basis enhances credit management, Penalty for late payment enhances customers commitment to loan repayment, and flexible repayment periods improve loan repayment.

This study conquers with the findings of Soke and Yusoff (2009), Achou and Tenguh (2008), Nagarajan (2011) who also found significant effects of credit risk control on loan portfolio performance. This is because the aim of credit risk control is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable boundary. The efficient management of credit risk is a vital part of the overall risk management system and is crucial to each bank's bottom and eventually the survival of all banking establishments. Soke and Yusoff (2009) found that it is important that credit decisions are made by sound analyses of risks involved to avoid harms to bank's profitability. They held that effective management of credit risk is an essential component of a comprehensive technique to risk management and critical to the long-term success of all banking institutions.

This shows that for most commercial banks, loans are the largest and most obvious source of credit risk, including in the banking books and in the trading book, and both on and off the balance sheet. In other words, Banks are increasingly facing credit risk (or counterparty risk) in various financial instruments other than loans, including acceptances, interbank transactions, trade financing, foreign exchange transactions, financial futures, bonds, equities, and in the extension of commitments and guarantees, and the settlement of transactions.

Therefore, since exposure to credit risk continues to be the leading of problems in banks in Burundi, banks and their supervisors should be able to draw useful lessons from past experiences. Banks should now have a keen awareness of the need to identify, measure, monitor and control credit risk as well as determine that they should hold adequate capital against these risks and should be adequately compensated for risks incurred.

According to Basel Accord (1999), banks must establish a system of independent, ongoing assessment of the bank's credit risk management processes and the results of such reviews should be communicated directly to the board of directors and senior management. Furthermore, the Basel accord points out that banks must ensure that the credit-granting function is being properly managed and that credit exposures are within levels consistent with prudential standards and internal limits. That is, banks should establish and enforce internal controls and other practices to ensure that exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.

It is therefore imperative to understand that if Burundi banks should stringent methods of risks control as cited in the Basel accord principles, they risks of loan defaulting and non-performing loans will be greatly reduced.

5.1.3 The Effect of Loan Collection Policy on the Performance of Loan Portfolio among Commercial Banks in Bujumbura, Burundi

The third objective of this study was to find out the effect of loan collection policy on the performance of loan portfolio among commercial banks in Bujumbura, Burundi. The study revealed that loan collection policy significantly affected the performance of loan portfolio by 56.6% (R Square=0.566). The null hypothesis was rejected and the alternative upheld.

The study revealed that commercial Banks in Burundi use loan collection policy in Credit Management to a great extent. Formulation of collection policies have been a challenge in credit management, enforcement of guarantee policies provides chances for loan recovery in case of loan defaults, Staff incentives are effective in improving recovery of delinquent loans, a stringent policy is more effective in debt recovery than a lenient policy, regular reviews have been done on collection policies to improve state of credit management, and finally that available collection policies have assisted towards effective credit management. The finding of this study is consistent with that of Pike and Neale (2009), Scheufler (2012), and Kariuki (2010) who also found significant effect of loan collection policy on performance of loan portfolio. This is because if loans are not repaid as per the contract agreement and when due credit risk is involved, hence the value of the bank 's business will be reduced. In order to continue lending, the bank must be able to collect its outstanding loans on time. Hence, in order to minimize the occurrence of bad loans strict follow up must be carried to the utmost degree and take timely action when necessary.

In other words, in order to ensure the sound execution and operation of businesses, banks should carry out timely follow-up or supervision visits, because they have to ascertain the utilization loans granted is per the purposes for which they were intended to and to ensure timely repayments as planned. The purpose of supervision or follow-up in banks is, to enable loan clients improve their efficiency in business implementation and loan utilization that improves income and loan repayment status. If there is continuous follow up and supervisions to evaluate the loan utilization and repayment, this makes borrowers to observe their obligation and improve the proper utilization of the loan thereby improving repayment performance.

This implies that if the credit policy is correctly formulated, carried out and well understood at all levels of the financial institution, it allows management to maintain proper standards of the bank loans to avoid unnecessary risks and correctly assess the opportunities for business development through efficient loan collection.

5.2 Conclusions

Objective 1: The study found a significant effect of client appraisal on the performance of loan portfolio, an implication that client appraisal is important in establishing the credit worthiness of the loan borrowers and improving the performance of loan portfolio.

Objective 2: Furthermore, the study found a significant effect of credit risk control on the performance of loan portfolio, an implication that controlling avoidable risks before they happen or at their initial stages is of great relevance to the performance of loan portfolio.

Objective 3: Similarly, the study found a significant effect of loan collection policy on the performance of loan portfolio, an implication that having well documented loan collection policy which is compliant with the regulatory requirements of the central bank is a good recipe for improving the performance of loan portfolio.

All in all, credit management significantly affects the performance of loan portfolio of commercial banks in Bujumbura, and therefore measures should be taken to reconsider issues related to credit management vis-à-vis the performance of loan portfolio.

5.3 Contribution to New Knowledge

Several studies assessed and investigated the effect of credit management and performance of loan portfolio but none of the used credit appraisal, credit risk control and loan collection policy. The current study investigated the effect of credit appraisal, credit risk control and loan collection policy on the performance of loan portfolio, and found significant effects, an implication that these variables are to be taken considerably by the commercial banks in ensuring the performance of their loan portfolios.

5.4 Recommendations

Objective 1: The study recommends that commercial Banks in Burundi should enhance their client appraisal techniques by having a database pool where the financial details of clients are stored. This will help them to access the credit history of their borrowers and to know whether they are not defaulters from other commercial banks.

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APPENDIX II: INFORMED CONSENT

I am giving my consent to be part of the research study of Ms Irakoze Ornella on **"credit management and performance of loan portfolio among commercial banks in Bujumbura, Burundi".**

I been assured of privacy, anonymity and confidentiality and that I will be given an option to refuse participation and right to withdraw my participation any time.

I have been informed that the research is voluntary and that the result will be given to me if ask for it.

Initial ....Date ....

APPENDIX III: QUESTIONNAIRES

Dear Respondents;

I am a student of MBA (Banking and Finance) at Kampala International University (Uganda). As part of my requirement for the Degree award, I have to present a thesis. My study is on credit risk management and performance of loan portfolio among commercial banks is Bujumbura, Burundi.

I am now on my field part; collecting data for the thesis and you have considered the best person to answer the questionnaires. Please do kindly respond to the various questions in the questionnaire attached. Your responses will be treated with utmost confidentiality. I shall be grateful for your cooperation in this regard.

Thank you.

Irakoze Ornella

SECTION

PART I: GENERAL INFORMATION

1. Gender

a) Male ☐ b) Female ☐

2. Age

a) 20-29 years ☐ b) 30-39 years ☐

c) 40-49 years ☐ d) Above 50 years ☐

3. Education Level

a) Certificate ☐ b) Diploma ☐

b) Bachelor Degree ☐ c) Master Degree ☐

4. Work Experience

a) Less than 1 year ☐ b) 1-5 years ☐

c) 6-10 years ☐ d) Above 10 years ☐

PART II: CREDIT MANAGEMENT

This section captures information about credit management in your organization. Please using the following scales and rating to provide your opinion about the subject. 1=strongly disagree; 2=disagree; 3=not sure; 4=agree; 5=strongly agree.

#	Credit Management	5	4	3	2	1
A	**Credit Appraisal**					
1	Client appraisal is a viable strategy for credit management in your bank					
2	Your bank has competent personnel for carrying out client appraisal					
3	In your bank, client appraisal considers the character of the customers seeking credit facilities.					
4	In your bank, aspects of collateral are considered while appraising clients.					
5	In your bank, failure to assess customer's capacity to repay results in loan defaults.					
B	**Credit Risk Control**					
1	In your bank, imposing loan size limits is a viable strategy in credit management.					
2	In your bank, the use of credit checks on regular basis enhances credit management.					
3	In your bank, flexible repayment periods improve loan repayment.					
4	In your bank, penalty for late payment enhances customer's commitment to loan repayment.					
5	In your bank, credit committee's involvement in making decisions regarding loans are essential in reducing default/credit risk.					
6	In your bank, interest rates charged affect performance of loans					

PART III: LOAN PORTFOLIO

This section captures information about the performance of loan portfolio in your organization. Please use the following scales and rating to provide your opinion about the subject. 1=strongly disagree; 2=disagree; 3=not sure; 4=agree; 5=strongly agree.

#	Performance of Loan portfolio	5	4	3	2	1
A	**Compliance with Regulatory Requirements**					
1	In your bank, there is high credit risk due to poor portfolio management.					
2	In your bank, lending rates are higher than those set by the central bank.					
3	In your bank, suppression of loan collection is very common.					
4	In your bank, loans officers practice standard loan assessment, analysis and underwriting.					
5	In your bank, there are standard collateral requirements for different loan grades/ classes.					
6	Interest rates are periodically structured to improve on the loan portfolio performance.					
B	**Loan Recovery**	5	4	3	2	1
1	In your bank, clients with difficulty in loan payments are usually given an extension period.					
2	In your bank, collateral used for loan acquisition are ably used for payment of problem loans.					
3	In your bank, internal controls have greatly contributed to effective loan repayments.					
4	In your bank, guarantors normally assist in payment of loans defaulted by clients.					
5	Your bank often takes legal action for non-payment of loans.					

The End

APPENDIX IV: LIST OF COMMERCIAL BANKS IN BURUNDI

Name Of Bank	Year Founded
Kenya Commercial Bank	2012
InterBank Burundi	1993
EcoBank	2008
BCB (Banque de credit de Burundi	1922
BANCOBU (Banque Commercial de Burundi)	1960
BGF (Banque de Geshon et de Financement)	1996
BBCI (Banque Burundaise Pour Ie Commerce et I'investment)	1988
FinBank	2002
Diamond Trust Bank	2009
CRDB (Cooperative Rural and Development Bank)	2012