UNIVERSITY OF CAPE COAST

ASSESSMENT OF THE CREDIT RISK MANAGEMENT PRACTICES OF KAKUM RURAL BANK LIMITED

BY

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DECLARATION

Candidate's declaration

I hereby declare that this thesis is the result of my original work and that no part of it has been presented for another degree in this university or elsewhere.

Candidate's Signature………………………… Date…………………………

Candidate's Name: **RICHARD SYLVESTER NSIAH-AGYEMAN**

Supervisor's declaration

We hereby declare that the preparation and presentation of the thesis were supervised in accordance with the guidelines on supervision of thesis laid down by the University of Cape Coast.

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ABSTRACT

Laxed or poor credit management is identified as a major cause for the collapse of many a rural bank in Ghana. Kakum Rural Bank Ltd., as one of the few rural banks to stand the test of time, established way back in 1982, continues to post significant profits year after year. However, in 2003, an on-site report into the operations of the bank by Bank of Ghana showed that the ratio of overdue and non-performing loans to advances was unhealthy and alarming. As a result, the bank was tasked to closely supervise its credit risk management practices to bring the situation under control.

The purpose of this study was, therefore, to assess the efficiency of the credit risk management practices of Kakum Rural Bank Ltd. from 2005 to 2009. Both primary and secondary data sources were used. In obtaining information from the primary data, a survey questionnaire and interviews were employed and administered to selected members of staff, whiles a simple random sampling technique was employed to select 300 customers of the bank. The bank's financial reports and ARB Apex Bank reports were used in obtaining information from the secondary data source.

The results of the study show that KRB has put in place a sound credit department equipped with the requisite skills and expertise to effectively handle and operate the credit function of the bank. KRB does not conform to the credit allocation guidelines stipulated by the Bank of Ghana, which has led to the bank achieving a recovery rate averaged about 85% over the five-year period (2005-

2009). The Board of Directors also do play an active role in the credit risk management of the bank.

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DEDICATION

I dedicate this work to my wife Mary M. Nsiah-Agyeman and children Benedicta Nsiah-Agyeman, Bridget Nsiah-Agyeman, Richard Nsiah-Agyeman and Raphael Nsiah-Agyeman.

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CHAPTER ONE

INTRODUCTION

Background to the study

The survival of banks depends largely on their ability to mobilize enough funds, disburse these funds in the form of credits and also ensure timely repayment of the credit with an eye for profit. Fundamentally, this crystallizes the business of banking and is the primary basis on which banks' quality and performance are judged (Allen & Santomero, 2001; Antwi-Asare & Addison, 2000). Once credit is made, however, there is a probability that the borrower or counterparty will fail to meet their obligations in accordance with agreed terms. Credit risk is, therefore, inherent in banking. The magnitude of credit risk depends on the likelihood of default by the counterparty, the potential value of outstanding contracts, the extent to which legally enforceable netting arrangements allow the value of offsetting contracts with that counterparty to be netted against each other or the value of the collateral held against the contracts (Basel Committee on Banking Supervision, 1999; 2001; Macharaju, 2004).

Credit management, therefore, constitutes one of the major functions of banks all over the world. Indeed, the issue of effective risk and credit management is at the heart of every bank. Many a bank's business philosophy is premised on the fact that their success as an ongoing entity depends on whether the risks they take are sufficiently calculated, reasonable and within their financial resources and competence. Surprisingly, empirical studies of banking crises are unanimous in identifying poor loan quality as the most common factor in the failure of banks (Allen & Santomero, 2001; Basel Committee, 2001; Fergusson, 2001). Unfortunately, the task of management of credit risk is rendered difficult by government controls, political pressures, production difficulties, financial restrictions, and frequent instability in the business environment which undermines the financial condition of the borrowers.

In Ghana, the problem of loan portfolio deterioration and high credit risk, particularly among the public sector banks, emerged in the early 1960s when, largely as a result of the adoption of the socialist development strategy, the government begun its direct involvement in bank ownership and operations in the entire banking industry. This was worsened by other financial policies such as (i) administrative control of the structure of interest rates in favour of priority sectors without regard to loan maturities and risk, (ii) imposition of a variety of controls on asset allocation, (iii) deterioration in prudential regulation and supervision, and (iv) macroeconomic instability, due largely to fiscal indiscipline (Mensah, 1997). By the early 1980s, all the public sector banks were rendered insolvent via non-performing assets (NPAs) which included non-performing loans (NPLs), foreign exchange exposures, letters of credit and equity investments which yielded no income.

These irregularities were addressed through the implementation of the Financial Sector Adjustment Programme (FINSAP) in 1988-9 as part of the Economic Recovery Programme in 1983. The gains of this programme have been consolidated by the Financial Sector Strategic Plan (FINSSP) in 2003. However, the lack of a credit referencing bureau in Ghana should always remind banking market players of the dangers of high exposure to credit risk. They should be in a position to draw useful lessons from past experiences. They must have the competence to identify, measure, monitor and control credit risk to secure the survival of banks.

Statement of the problem

In pursuit of its socialist development ideology, the Government of Ghana (GoG), in the 1960s, adopted a two-pronged strategy to addressing the development financing needs of specific sectors of the economy: firstly, the establishment of development finance institutions (DFIs) such as the National Investment Bank (NIB) and the Agricultural Development Bank (ADB), and secondly, the development of a rural banking industry. By the 1970s, however, it had become evident that the ADB which was designed to provide a vehicle for reaching small-scale farmers lacked the capacity to provide adequate rural coverage (Mensah, 1997). This realization led to the emphasis on the development of a rural banking system, modelled on the rural banking system in the Philippines.

As a result, the first rural bank was set up on 5th July, 1976 at Agona Nyakrom in the Central Region. By December, 1987, there were 117 rural banks.

Currently, there are 123 rural banks with a total of 450 agencies across the country (ARB Apex Bank, 2008). Paradoxically, the origins and development of these rural banks occurred when banks, particularly publicly-owned banks, were reeling under severe loan portfolio deterioration due largely to NPAs which included NPLs and were undergoing radical restructuring. The root cause being their overexposure to high credit risk, the astronomical increase in the number of rural banks in just a decade has cumulatively increased systemic risk and made credit management such an intractable problem for rural banks.

It is, therefore, not surprising that there have been many cases of failures of prominent rural banks in Ghana and, despite the regulatory measures adopted by the BoG and the ARB Apex Bank, rural and community banks (RCBs) continue to experience increasing loan loss. No wonder the BoG, in its report on the performance of rural and community banks, has singled out poor management of credit in the form of appraisals, monitoring, evaluating and recovery and lack of adequate training for credit officers as pivotal factors contributing to the collapse of rural banks; and warns of imminent collapse of RCBs who fail to put in place effective credit risk management practices.

Due to the tremendous increase in the demand for credit by both rural and urban sectors over the past decade and the intense competition in the banking market, Kakum Rural Bank (KRB) Ltd, established on 9th February, 1980 at

Elmina in the Komenda-Edina-Eguafo-Abrem (KEEA) Municipality of the Central Region, like most RCBs, has gone beyond its core mandate by extending credit facilities to the urban population as well. The bank now operates 10 branches in five out of the 13 administrative assemblies in the Central Region and had 29,224 depositors and 9,554 loan customers as at December, 2008, with total loans increasing by 4004% from GH¢133,085 in December, 1999 to GH¢5,461,724.00 in July, 2009. These statistics suggest strongly that KRB has inevitably been exposed to high risk customers.

It came as no surprise that the BoG on-site examination report on KRB dated 30th April, 2003 revealed that the ratios of overdue and non-performing loan to total loans/advances were 14.59% and 11.82% respectively. This situation resulted in the booking of additional provision of GH¢153,261.00 as bad debt. The BoG charged the Board of Directors (BoD) and top management to supervise the bank's credit risk management practices and to ensure that effective controls and monitoring mechanisms are in place to recover overdue and non-performing loans. What strategies, then, have KRB adopted to manage its credit risk? To what extent has KRB complied with the mandatory sectoral credit allocation set by the Bank of Ghana for rural banks? To answer these and many other pertinent questions, the study investigates the credit risk management practices of KRB from 2005 to 2009.

Objectives of the study

The main purpose of this study is to examine the credit risk management policies and practices of Kakum Rural Bank Ltd. Specifically, the study seeks to:

1. Evaluate Kakum Rural Bank's loan granting, evaluation and monitoring processes.
2. Ascertain the constraints, if any, faced by Kakum Rural Bank in conforming to the guidelines for sectoral allocation of credit issued by the Bank of Ghana.
3. Assess Kakum Rural Bank's credit or loan recovery rate from 2005 to 2009.
4. Assess the role of the Board of Directors of Kakum Rural Bank in managing the bank's exposure to credit risk.

Research questions

The study intends to answer several key questions regarding the credit risk management practices of KRB Ltd. These, inter alia, include the following:

1. What are the processes for granting, evaluating and monitoring loans granted by Kakum Rural Bank Ltd?
2. What are the constraints that Kakum Rural Bank Ltd face in conforming to Bank of Ghana's guidelines for sectoral allocation of credit issued to rural and community banks?

3. What factors account for the recovery rate for the various categories of loans advanced by Kakum Rural Bank Ltd?

4. What has been the role of the Board of Directors of Kakum Rural Bank in managing the exposure of the bank to credit risk?

Scope of the study

Kakum Rural Bank Ltd has 10 branches in five districts in the Central region. It is located in an area where the predominant occupations are fishing, salt-mining, farming and trading. The study period is limited to 2005-2009 as the period saw the largest advances of loans by KRB Ltd. Generalisation of the findings of the study must, therefore, be limited to the operations of the bank within the study period.

Significance of the study

The study will serve as a reference material to other researchers. It will enable Rural and Community Banks identify the peculiar circumstances of their credit operations and come out with measures to curb the menace of credit failure and the effect of various policies targeted at managing the credit risk facing the rural banking sector. It will also assist managers of rural banks, particularly Kakum Rural Bank to identify the causes of increasing loan default and redirect their policies based on the findings of this study in order to maintain sound and effective credit management practices.

The general public, shareholders and customers (depositors or borrowers) of rural banks will also be educated on the causes of loan delinquency. This will enable them impress on the management of rural banks, in which they have financial interests, to ensure that appropriate measures are taken to protect their investment.

Limitation of the study

Data for the study was limited to the period 2005-2009. This period was chosen bearing in mind the time BOG tasked the management of the bank to beef-up its credit operations management to improve on the bank's loan recovery rate. Any analysis from the findings should therefore be limited to this study period in order to prevent any inconsistent findings and misleading conclusions. The study subjects chosen for the study was again limited to only customers who have accessed any of the bank's credit facilities. It should however be recognised that KRB deals with other categories of customers apart from the loan customers. The views of these other customers on the credit operations of KRB may be different from those of the loan customers.

Organization of the study

The rest of the study is organized as follows: chapter two reviews literature related to credit risk management and the key concepts relevant to the study. The methodology is featured in chapter three which embodies the research design and the data collection method. Chapter four discusses the findings of the study, whiles a summary, conclusion and recommendations of the study are presented in chapter five.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

Introduction

Every business undertaking involves risk. Since the objective of every business is to maximize profit or shareholders' value, it is the duty of management to ensure that this objective is achieved with minimum risk. Credit risk management is therefore one very important function of every bank. Even though credit risk is one of numerous risks facing banks, its management has received much attention because of the basic fact that the main business of banking is to accept deposits and make commercial loans (i.e. giving credit)

This review will begin by looking at some basic definitions relating to credit risk management; the total risk facing banks; banks' credit risk management and reporting systems, concentrating particularly on the credit environment, credit granting processes, credit monitoring and enforcement of protective covenants.

Risk

According to Calomirus & Engel (2004), risk is a potential variation in outcomes. Risk is present in almost every human endeavour. When risk is present the outcome cannot be forecasted precisely. Therefore the presence of risk is assumed whenever the outcomes of an act give room for uncertainty. Exposure to risk is created whenever an act gives rise to possible gain or loss that cannot be predicted (Machiraju, 2004).

The terms “risk exposure” and “risk” are often used interchangeably and may be used in the sense of an object, a situation, or a category of activities giving rise to outcomes that cannot be predicted. For the purpose of this study, the two terms will be used interchangeably, and will generally be used to mean exposure to credit risk. According to Machiraju (2004) risk could take the form of pure or speculative, diversifiable and non-diversifiable risk.

Pure versus speculative risk

Traditionally, writers on risk management have distinguished between pure and speculative risks. Pure risk exists when there is a chance of a loss but no chance of a gain and a speculative risk exists when there is a chance of gain as well as a chance of loss (Mowbray, 2001).

According to Calomirus & Engel (2004), banks, like any other business organization, have the object of maximizing return on shareholders’ investments, after meeting all its obligations to other stakeholders. The main product of banks is credit; they then receive interest in return for the use of their credit. Banks, therefore, face speculative risk since they may gain by receiving both interest and principal or lose either/both principal and interest.

Diversifiable versus non-diversifiable risks

Some risks affect nearly all humans and firms at the same time, other risks are faced almost in isolation. Unless the manifestation of a risk affects individuals and organizations in the same way and at the same time, it is possible for the affected entities to reduce their exposure to risks through pooling or sharing arrangements (Mowbray, 2001). A risk is diversifiable if it is possible to reduce it through pooling or sharing arrangements. A risk is non-diversifiable if pooling arrangements are ineffective in reducing it for the participants in the pool. In finance literature these distinction are often used – "systematic and non-systematic" or "market and unique" risk – and is very important in risk management because it affects the effectiveness of pooling or risk sharing arrangements.

Banks' overall risk

Banks, like other business entities, are susceptible to various risks but they face higher and more versatile risk because banks are highly geared and over 90% of their assets are loans that are, by themselves, subject to other risks such as interest rates risk and default risk. According to Sinkey (1998) bank risk management focuses on three key areas, namely, credit risk, interest rates risk and liquidity risk. These risks arise from unexpected changes in the borrower's ability to repay loans, unexpected changes in interest rates and unexpected changes in balance sheet flows respectively.

Even though all these risks need to be managed, the focus of this study will be on "the management of credit risk"**.** This does not mean the relegation of the other risks especially interest rates and liquidity risks management since, as Sinkey (1998) posits, the nexus between credit risk and interest rates risk is one that deserves careful managerial and regulatory scrutiny, especially for large banks that have the flexibility to change portfolio position quickly and aggressively.

Credit risk

Credit (or default risk) refers to the probability of borrowers not repaying their loans. Since a great percentage of bank assets are in the form of loans, credit risk is the major risk a bank faces, and the credit decision represents a critical bank function (Adams & Mehran, 2004).

Primarily, banks' credit risk is divided into two parts, each of which has the following sub-parts:

1. Portfolio Risk

a. Intrinsic risk

b. Concentration risk

2. Transaction Risk

a. The bank’s credit organization with which it administers the credit function.

b. The bank’s credit investigation and analysis system

c. The banks standard for underwriting loans

Managing credit risk will have to be complemented with the identification and measurement of credit risk. McNaughton (2001) asserts that to calibrate the default risk exposure of its credit and investment decision, as well as to assess its credit risk exposure in off-balance sheet contractual arrangements such as loan commitments, a financial institution’s manager needs to measure the probability of borrower default. The ability to do this largely depends on the amount of information the financial institution has about the borrower.

With the advent of computers and modern methods of data collection and storage, the measurement of credit risk is gradually becoming less expensive (McNaughton, 2001). It is quite easy to obtain information about organizations than for individuals, especially in Ghana as in most developing countries characterised by poor record keeping. This makes the use of borrowers’ information to measure credit risk a little problematic. In measuring credit risk facing a bank, the manager, especially managers of rural banks must be able to measure both individual loan risk and loan portfolio or loan concentration risk.

Credit risk management and reporting systems

Credit risk is most simply defined as the potential that a bank borrower or counter party will fail to meet his obligations in accordance with agreed terms

(Adams & Mehran, 2004). Boateng (2004) asserts that the goal of credit risk management is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters of not more than five (5%) of default rate. Banks therefore need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Banks should also consider the relationships between credit risk and other risks. According to Machiraju (2004) the effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization.

The Basel Committee on Banking Supervision (1999; 2000; 2001) having assessed the challenges associated with banks management of credit globally, issued some guidelines that have come to be regarded as benchmark credit risk management practices in order to promote sound practices for managing credit risk. The report of the Basel Committee on Banking Supervision (2000) on credit risk focused on some four main areas as critical in every credit management process. These areas are:

a. Establishing an appropriate credit environment.

b. Operating a sound credit granting process.

c. Ensuring adequate controls over credit risk.

d. Evaluation and enforcement of protective covenants.

Establishing an appropriate credit environment

According to Wheehem & Hunger (2008), the controlling and directing mind of every organization is the board of directors. As with all other areas of a bank's activities, the board of directors has a critical role to play in overseeing the credit granting and credit risk management functions of the bank. The board of directors, according to the report of the Basel Committee (2000) should have responsibility for approving and periodically (at least annually) reviewing the credit risk strategy and significant credit risk policies of the bank. According to Saunders (2005), these strategies should reflect the bank's tolerance for risk and the level of profitability the bank expects to achieve for incurring various credit risks.

Each bank should develop a credit risk strategy or plan that establishes the objectives guiding its credit-granting activities and adopt the necessary policies and procedures for conducting such activities (Machiraju, 2004). The board needs to recognize that the strategy and policies must cover the many activities of the bank in which credit exposure is a significant risk.

The strategy should include a statement of the bank's willingness to grant credit based on exposure type (for example, commercial, consumer, real estate), economic sector, geographical location, currency, maturity and anticipated profitability (Matyszak, 2007). This might also include the identification of target markets and the overall characteristics that the bank would want to achieve in its credit portfolio (including levels of diversification and tolerances).

Again, Boateng's (2004) study shows that the credit risk strategy of a bank should give recognition to the goals of credit quality, earnings and growth. Every bank, regardless of size, is in business to be profitable and, consequently, must determine the acceptable risk-return trade-off for its activities, factoring in the cost of capital. A bank's board of directors should approve the bank's strategy for selecting risks and maximizing profits. The board should periodically review the financial results of the bank and, based on these results, determine if changes need to be made to the strategy. The board must also determine the degree of the bank's capital adequacy (Boateng, 2004).

According to Wilson (1998), the credit risk strategy of any bank should provide continuity in approach. Therefore, the strategy will need to take into account the cyclical aspects of the economy and the resulting shifts in the composition and quality of the overall credit portfolio. Although the strategy should be periodically assessed and amended, it should be viable in the long-run and through various economic cycles (Machiraju, 2004).

Fotoh (2005), states that the credit risk strategies and policies should be effectively communicated throughout the organization. All relevant personnel should clearly understand the bank's approach to granting and managing credit and should be held accountable for complying with established policies and procedures. The board should ensure that senior management is fully capable of managing the credit activities conducted by the bank and that those activities are done within the risk strategy, policies and tolerances approved by the board (Basel Committee, 2001). The board should also regularly (i.e. at least annually), either within the credit risk strategy or within a statement of credit policy, approve the bank's overall credit-granting criteria (including general terms and conditions). In addition, it should approve the manner in which the bank will organize its credit-granting functions, including independent review of the credit granting and management function and the overall portfolio (Wilson, 1998).

While members of the board of directors, particularly outside directors, can be important sources of new business opportunities for the bank, once a potential credit is introduced, the bank's established processes should determine how much and at what terms credit is granted (Machiraju, 2004). In order to avoid conflicts of interest, as asserted by Wilson (1998), it is important that board members do not override the credit-granting and monitoring processes of the bank.

Fotoh (2005) states that once the board of directors has come out with a sound credit management environment, senior management, led by the Chief Executive Officer, should have responsibility for implementing the credit risk strategy approved by the board of directors and for developing policies and procedures for identifying, measuring, monitoring and controlling credit risk. Such policies and procedures should address credit risk in all of the bank's activities and at both the individual credit and portfolio levels. Senior management of a bank is responsible for implementing the credit risk strategy approved by the board of directors. The responsibility for implementing the strategy includes ensuring that the bank's credit-granting activities conform to the established strategy, that written procedures are developed and implemented, and that loan approval and review responsibilities are clearly and properly assigned. Senior management must also ensure that there is a periodic independent internal assessment of the banks credit-granting and management functions.

According to Boateng (2004), a cornerstone of safe and sound banking is the design and implementation of written policies and procedures related to identifying, measuring, monitoring and controlling credit risk. Credit policies establish the framework for lending and guide the credit-granting activities of the bank. Credit policies should address such topics as target markets, portfolio mix, price and non-price terms, the structure of limits, and approval authorities (Basel committee, 2001). Such policies, according to Harper (2008), should be clearly defined, consistent with prudent banking practices and relevant regulatory requirements, and adequate for the nature of the bank and this may be difficult for very small banks. However, there should be adequate checks and balances in place to promote sound credit decisions. The policies should be designed and implemented within the context of internal and external factors such as the bank's market position, trade area, staff capabilities and technology. Policies and procedures that are properly developed and implemented enable the bank to: (i) maintain sound credit-granting standards, (ii) monitor and control credit risk, (iii) properly evaluate new business opportunities; and (iv) identify and administer problem credits (Machiraju, 2004).

According to Sinkey (1998), banks consider the involvement of the Chief Executive Officer (CEO), information generation and processing, and supervision as key elements of their risk management and reporting systems. The components of a bank's overall risk management and reporting system focuses on such factors as:

1. Corporate organization structure
2. Organization of risk management
3. Organization of lending
4. Approval process
5. Credit administration
6. Risk management function
7. Loan quality reporting

The Chief Executive Officer must be involved in the formulation and implementation of credit policies that should incorporate the overall risk management and reporting system of the bank. According to Sinkey (1998), every bank must have a credit policy that will guide the credit activities and thereby reduce credit risk and improve profitability. Generally, a loan policy consists of five major components:

1. General Policies

a. Management
b. Trade area
c. Balance loan portfolio
d. Portfolio administration

e. Loan-to-deposit ratio

f. Legal loan limit

g. Lending authority

h. Loan responsibility

i. Interest Rates

j. Loan repayment

k. Collateral

l. Credit information and documentation

m. Delinquency ratio

n. Loan loss Reserves

o. Charge-offs

p. Extensions of renewals of past due loans

q. Consumer laws and regulations

2. Specific Loan Categories

a. Commercial loans

b. Agricultural loans

c. Mortgage loans

d. Instalment and branch bank loans

e. VISA and revolving credits

f. Mortgage banking subsidiary

g. Personal loans

3. Miscellaneous Loan Policies

a. Loan to Executive Officers, directors and shareholders

b. Employee loans

c. Mortgage- Banking subsidiary

d. Conflict of interest

4. Quality Control

a. Credit Department

b. Loan Review Department

c. Recovery Department

5. Committees

a. Directors loan committee

b. Officers loan committee

c. Loan Review Committee

Operating a sound credit granting process

The Basel Committee (2000; 2001) assert that in order to maintain a sound credit portfolio, a bank must have an established formal transaction evaluation and approval process for the granting of credits. Approvals should be made in accordance with the bank's written guidelines and granted by the appropriate level of management. There should be a clear audit trail documenting that the approval process was complied with and identifying the individual(s) and/or committee(s) providing input as well as making the credit decision (Boateng, 2004). According to Wilson (1998), banks often benefit from the establishment of specialist credit groups to analyze and approve credits related to significant product lines, types of credit facilities and industrial and geographic sectors. Banks should invest in adequate credit decision-making resources so that they are able to make sound credit decisions consistent with their credit strategy and meet competitive time, pricing and structuring pressures (Khambata, 1996).

Each credit proposal should be subjected to careful analysis by a qualified credit analyst with expertise commensurate with the size and complexity of the transaction. According to Boateng (2004), an effective evaluation process establishes minimum requirements for the information on which the analysis is to be based. There should be policies in place regarding the information and documentation needed to approve new credits, renew existing credits and/or change the terms and conditions of previously approved credits.

According to Machiraju (2004), one of the management principles that banks have employed in their customer information gathering process is screening. Screening involves the process of identifying only reliable and creditworthy customers from a pool of numerous applicants for financial assistance. Banks screen “good” credit risk from “bad” ones so as to make profitable loans. Screening is usually carried out before a loan is granted. Effective screening requires banks to collect accurate and reliable information from potential borrowers. The aim is to evaluate the default risk of their customers. The potential borrower is normally required to supply the loan officer with information about their background, income and net worth.

Different credit risk models ranging from qualitative to quantitative ones may be used to facilitate the screening process to arrive at an informed decision.

Schonbucher (2000) and Machiraju (2004) assert that banks have traditionally focused on the principles of five Cs to estimate borrowers' creditworthiness.

These five C's are:

i. Character. This refers to the borrower's personal characteristics such as honesty, willingness and commitment to pay debt. Borrowers who demonstrate high level of integrity and commitment to repay their debts are considered favourable for credit.

ii. Capacity. This also refers to borrowers' ability to contain and service debt judging from the success or otherwise of the venture into which the credit facility is employed. Borrowers who exhibit successful business performance over a reasonable past period are also considered favourable for credit facility.

iii. Capital. This refers to the financial condition of the borrower. Where the borrower has a reasonable amount of financial assets in excess of his financial liabilities, such a borrower is considered favourable for credit facility.

iv. Collateral. These are assets, normally movable or unmovable property, pledged against the performance of an obligation. Examples of collateral are buildings, inventory and account receivables. Borrowers with a lot more assets to pledge as collateral are considered favourable for credit facility.

v. Condition. This refers to the economic situation or condition prevailing at the time of the loan application. In periods of recession borrowers find it quite difficult to obtain credit facility.

In addition to the five Cs, Machiraju (2004) asserts that bankers and analysts have employed many different models to assess the default risk on loans and bonds. These vary from relatively qualitative to highly quantitative models. Further, these models are not mutually exclusive, in that a financial institutions manager may use more than one to reach a credit pricing or loan quantity rationing decision.

The information received will be the basis for any internal evaluation or rating assigned to the credit and the accuracy and adequacy of the information are critical to management for making appropriate judgments about the acceptability of the credit. Banks must develop a corps of credit risk officers who have the experience, knowledge and background to exercise prudent judgment in assessing, approving and managing credit risks. A bank’s credit-granting and approval process should establish accountability for decisions taken and designate who has the absolute authority to approve credits or changes in credit terms.

Ensuring adequate controls over credit risk

In order to ensure adequate controls over credit, Ganesan (2000) asserts that there must be credit limits set for each officer whose duties have something to do with credit granting. Material transactions with related parties should be subject to the approval of the board of directors (excluding board members with conflicts of interest), and in certain circumstances (e.g. a large loan to a major shareholder) reported to the banking supervisory authorities.

Banks must also consider the time frame for granting credit since time is of particular importance to borrowers. Borrowers usually require credit within a given time, and for such credits to be worthwhile they must be granted within the period the facility is required. According to Hubbard (2000), if a borrower requires a credit within, say, one month, the lending bank must meet such time period without undue delays. This implies that lending institutions must make known in unequivocal terms to the borrowers the terms and conditions to granting the credit. Having granted credit there is the need for maintaining an appropriate credit administration, measurement and monitoring process. Again, banks must establish a system of independent, continuous assessment of clients' operational results, looking out for early warning signs of operational difficulties (Mueller, 1998; Rachev, Schwartz & Khindanova, 2000).

Protective covenants of banks

In considering potential credits, banks must recognize the necessity of establishing provisions for identified and expected losses and holding adequate capital to absorb unexpected losses. The bank should factor these considerations into credit-granting decisions as well as into the overall portfolio risk management process. Banks can utilize transaction structure, collateral and guarantees to help mitigate risks (both identified and inherent) in individual credits but transactions should be entered into primarily on the strength of the borrower's repayment capacity.

Protective covenants are provisions for protection contained in loan agreements. A bank that advances credit to its customers will definitely expect repayment later. The customers' repayment ability depends on many factors. The most important is financial condition, which may be subject to risk. To safeguard banks credit, the lender requires the borrower to maintain its financial condition and, in particular, its current position at a level at least favourable as when the commitment was made.

The important protective covenant of a loan agreement may be classified into general provisions, routine provisions and specific provisions.

1. General provisions:-General provisions are more or less universal in their use by lenders. They include:

    a. Working capital requirement.
    b. Dividend and share repurchase restriction.
    c. Capital expenditure limitation.
    d. Limitation on other indebtedness.

2. Routine provisions:-Routine provisions include routine restrictions, usually invariable provisions found in most loan agreements. They include:

    a. Furnishing the bank with financial statements.
    b. Maintaining adequate insurance.

c. Restriction on the sale of a significant portion of the lenders assets.
d. Payment of taxes and other liabilities when due, except those it contests in good faith.
e. Pledging or mortgaging any of the borrower's assets to the bank.
f. Not to discount or sell receivables.
g. Prohibition from entering into any lease arrangement of property that will result in annual rental payment exceeding a certain amount.
h. Restriction on other contingent liabilities.
i. Restriction on the acquisition of other companies.

3. Specific provisions:-Specific provisions are special provisions used by banks to achieve a desired total protection of its loans. They include:

a. "Keyman" life insurance policy on executives who are essential to a firm's effective operations.
b. Management clause under which certain key individuals must remain actively employed in the company during the time that the loan owes.
c. Restriction on aggregate executive salaries and bonuses.
d. Restriction on salary increases by large shareholders who are officers of the company.

Restriction provisions are formulations to ensure the overall liquidity and ability to pay the loan. Since no one provision is able by itself to provide the necessary safeguards, the formulation of different restrictive provisions should be tailored to the specific loan situation.

One important protective covenant that banks have utilized is collateralization of the borrowers' asset to the lending bank. Collateral is any asset used as security for a loan. In the words of Mishkin (2001) "collateral is property promised to the lender if the borrower defaults". However, collateral cannot be a substitute for a comprehensive assessment of the borrower or counterparty, nor can it compensates for insufficient information. It should be recognized that any credit enforcement actions (e.g. foreclosure proceedings) could eliminate the profit margin on the transaction.

In addition, banks need to be mindful that the value of collateral may well be impaired by the same factors that have led to the diminished recoverability of the credit. Banks should have policies covering the acceptability of various forms of collateral, procedures for the ongoing valuation of such collateral, and a process to ensure that collateral is, and continues to be, enforceable and realizable. With regard to guarantees, banks should evaluate the level of coverage being provided in relation to the credit quality and legal capacity of the guarantor. Banks should be careful when making assumptions about implied support from third parties such as the government.

Assets used as collateral securities must be properly valued by professionals who are well knowledgeable in such valuations (Brigham & Ehrhardt, 2002). Lending banks must again ensure that all the legal procedures that must be followed in ensuring the transfer of interest in collateral securities moves from the borrower to the lender are fully exhausted. This, according to Teich (1997), will help forestall any future legal impediments when the collateral crystallizes. Banks must place emphasis on the force sale values rather than the market values of collateralized assets (Ferguson, 2001). Finger (2000) and Bielecki (2000) assert that banks are highly secured where the force sale value of an asset is equal or more than the loan amount granted. An experienced, dedicated and a very efficient legal department is a pre-requisite for enforcing protective covenants.

Lending policies of rural and community banks

Recognising the high level of risk faced by rural banks in their lending operations, the BoG, which is the highest regulatory body for bank and non-bank financial institutions in Ghana, has prepared lending policy guidelines, for rural and community banks. The purpose of the lending policy guidelines according to Atta-Bronya (1997), is to promote rural development through certain carefully selected priority areas deemed critical to rural development as well as minimize the credit risk exposure of rural banks. The important sectors identified are agricultural sector, cottage sector and trade and transport in that order of priority, determined by the BoG.

As enshrined in the operational manual of rural banks (BoG, 1985), the sectors determined by the Bank of Ghana in their order of priority for credit allocations are:

Agricultural sector	50%
Cottage sector	30%

Trade and transport	20%

These priority areas largely depend on the weather which in most cases is not favourable, thereby resulting in high default rate by such sector participants. Owusu (2006) states that most of the operators in the identifiable priority credit areas have little or no formal education. It therefore makes it difficult to obtain information for a proper risk assessment to be made. Again, many farmers after obtaining financial help or facilities fail to repay whenever their produce does not do well. There is also the problem of loan diversion for purposes other than the intended purpose.

Provision for bad debts

The Bank of Ghana (1995) asserted that banks' advances can be classified into four categories, depending on their performance in terms of possibility of repayment. These categorizations are:

1. Current advances. Advances in these categories are those for which the borrower is up-to-date with repayment of both principal and interest. Indications that an overdraft or loan is current indicate regular activity on the account with no sign that a hardcore of debt is building up. BoG (1995) asserts that a minimum of 1% of the aggregate outstanding balance of current advances should be provided against possible future defaults. This enables the bank to set aside part of current profits or earnings to off-set any future default by beneficiaries of current advances.

2. Substandard advances. Substandard advances display well-defined credit weaknesses that jeopardize the liquidation of the debt. These categories of advances are advances for which the borrower's cash flow is not significant enough to meet current maturing debt, as well as the borrower lacking sufficient working capital to meet his operating needs. For substandard advances, a provision of about 25% of the aggregate net unsecured outstanding amount should be provided against current profit (BoG, 1995).

3. Doubtful advances. These categories of advances exhibit all the weaknesses inherent in advances classified as substandard with the added characteristics that the advances are not well secured and the weaknesses make collection or liquidation in full on the basis of current facts, conditions and values highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the advance, its classification as an estimated loss is deferred until its exact status is determined. Non-performing loans which are at least 180 days overdue, but less than 540 days are classified as doubtful. In this regard, BoG (1995) states that as much as 50% of the aggregate net unsecured outstanding balance of doubtful advances should be provided against current profits to off-set future defaults.

4. Loss advances. Advances classified as loss advances are classified uncollectible and of such little value that their continuation as recoverable advances is not worthwhile. Non-performing advances which are overdue for 540 days are classified as loss advances. According to the BoG (1995), as much as 100% of the aggregate net unsecured outstanding balance be provided for against current profits.

CHAPTER THREE

METHODOLOGY

Introduction

This chapter considers the various techniques used in collecting and analysing data for this research. There are five major areas of concern for the proper execution of this study, namely:

i. Profile of Kakum Rural Bank Ltd
ii. Research design
iii. Data collection instruments
iv. Population, sample size and procedures
v. Data analysis analysis and presentation

Profile of the KRB

Kakum Rural Bank (KRB) Ltd was established in February, 1980. It was formally known as Edinaman Rural Bank Ltd until 1990 when it was rechristened Kakum Rural Bank Ltd. The name Kakum was chosen to reflect a common feature of the bank's catchment area, as the River Kakum flows through the operational areas of the bank. The bank has its headquarters in Elmina, and has grown from a humble beginning to its present state as the number one rural bank in the Central Region.

The bank operates in five 5 districts in the Central region, namely; Komenda-Edina-Eguafo-Abrem, Abura-Asebu-Kwamankese, Mfanstiman and Twifo Hemang-Lower Denkyira districts and the Cape Coast metropolis. The Bank has 10 branches, namely, Head Office Branch, Elmina Main, Mankessim, Kotokuraba, Abura/Pedu, Mpoben, Abrem Agona, Jukwa, Moree and Abakrampa. The first five branches are fully networked whilst the remaining five branches are at various stages of the computerization process.

KRB's mission statement is to "facilitate the socio-economic development of the catchment area through the provision of innovative, customer-centered, financial and non- financial products and services to economically active individuals and corporate entities using a team of dedicated and reliable staff". The Vision of KRB is to become "the first choice bank for reliable and efficient financial services".

The corporate goals of the bank are:

- To further develop the bank's traditional lending base in microfinance.
- To offer a high degree of personal service.
- To provide innovative financial assistance tailored to meet each client's financial requirements and capacity.

- To ensure compliance with the Banking Act and other regulations that may from time to time be passed by the Bank of Ghana and ARB Apex Bank.
- To operate the bank's affairs in accordance with:
    - i. Acceptable principles of financial management; and
    - ii. The achievement of a level of profitability that will allow a yield on shareholders' funds which exceeds the average for the RCB industry and provides for the continued growth of the bank's asset base.

Products and services of KRB

The bank delivers affordable and efficient banking products and services which include:

i. Deposits Products: savings, demand, fixed, Klassic, Mbofra Daama, Enyidado Susu, Church Development and Asormba Mpuntu Savings accounts.

ii. Loans Products: short, medium and long term loans, overdraft facilities, Group and Microfinance loans.

iii. Funds Transfer Products: Inward money transfer through International Commercial Bank (ICB), 1st African, Express Funds, Western Union, Vigo and Samba Money Transfer are the bank's foreign money transfer products.

iv. Domestic Funds Transfer "APEX LINK" product connects customers to all corners of Ghana.

Organisational chart of KRB

The structure and order of authority of KRB is depicted in figure one (1).

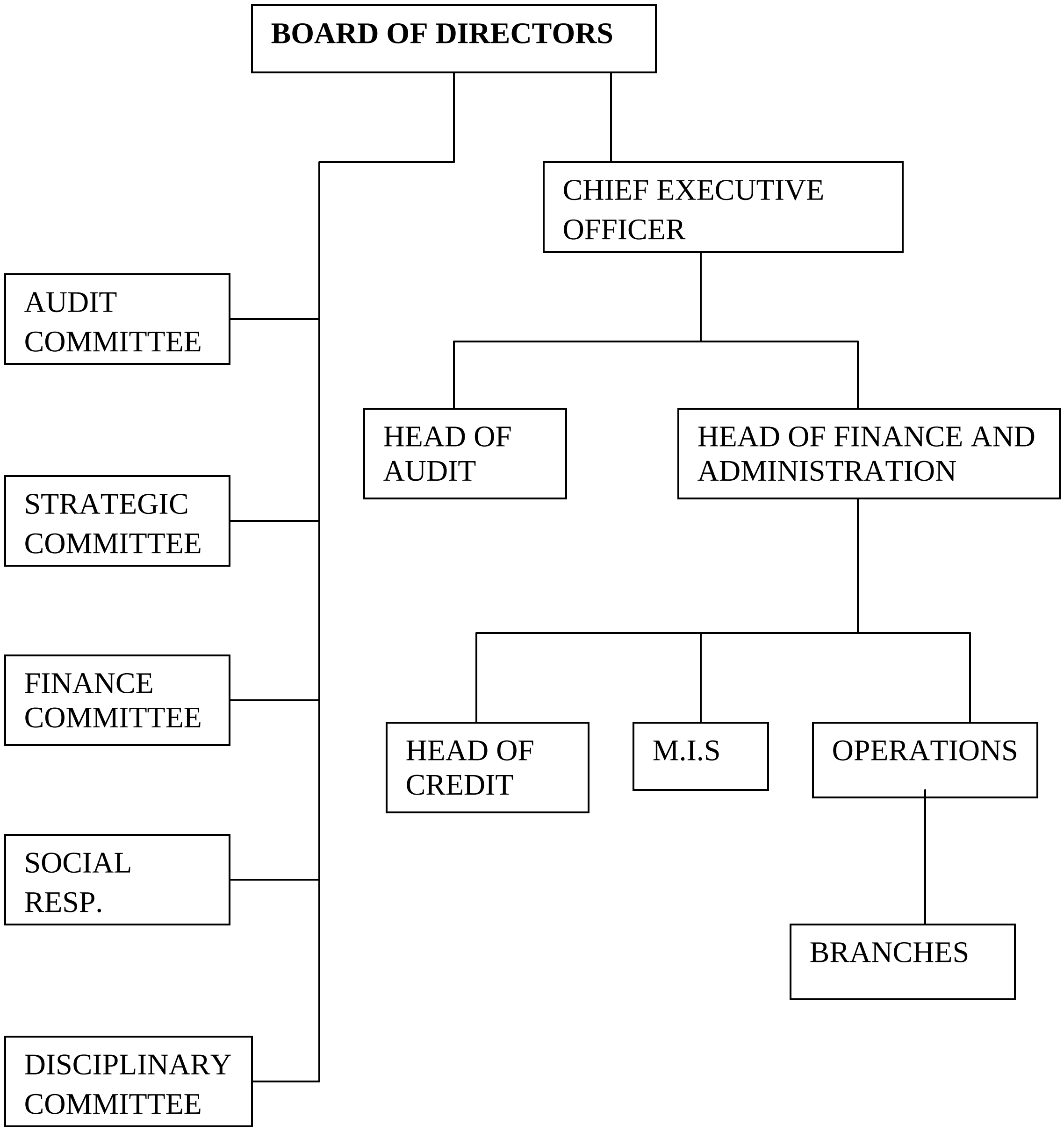

Figure 1: Organisational chart of KRB

Board composition

The bank is managed by an 11-member Board of Directors and one Ex-Officio member. The board meets once every month to deliberate upon the affairs of the bank. There are five sub-committees of the board, namely, Strategic, Audit, Finance, Social Responsibility and Disciplinary that meet regularly to ensure that the business of the bank is running smoothly.

Management team

The management team of the bank is charged by the board to oversee the day-to-day operations and policy decisions of the board. The bank's management team is made up of six members:

1. The management team is headed by the Chief Executive Officer who is responsible for implementing the policies, rules and regulations of the bank formulated by the Board of Directors.
2. Manager in charge of Internal Audit-Responsible for instituting effective and efficient system of internal controls to safeguard the financial, material and other assets of the bank.
3. Manager in charge of Finance and Administration-Responsible for the day-to-day administration of the bank and ensuring system development through computer programming for the bank and also responsible for advising management about investment opportunities for the bank as well as management of the bank's liquidity.

4. Assistant Manager in charge of Operations-Responsible for the preparation and collation of accounting and financial records for management and other stakeholders.
5. Assistant Manager in charge of Marketing and Research-Responsible for the marketing activities of the bank to maintain its competitive edge.
6. Head of Credits-Responsible for providing technical advice and disseminating useful and practical information and innovations to the bank and its customers in relation to the administration of advances.

The bank has staff strength of 126 performing different duties in the ten branches and the head office.

Research design

The research design employed in collecting, analysing and interpreting the data is the survey strategy. The survey method of data collection was adopted because of its rich potential as a source of information gathering. Again the choice of survey strategy is considered as appropriate as it is common strategy in business and management research (Sanders, Lewis & Thornhill, 2007).

Data collection instrument

This study made use of both primary and secondary data sources of data collection. Primary, data for the study was collected using questionnaire and interview. The questionnaire was administered to some selected members of staff of Kakum Rural Bank whose schedule involves the granting and administration of credit. This allows respondents who are considerably knowledgeable in credit management to answer the questionnaire.

The purpose for administering the questionnaire to the staff is to determine how they view the credit operations of the bank and whether their opinion, the bank encounters any problems in undertaking their credit operations activities. Besides the use of questionnaire, in-depth interviews are conducted with top management and credit officers of the bank to gather more information to buttress those obtained through the questionnaire.

Data from the secondary sources involved the gathering of information on credit operations from BoG reports, ARB Apex reports, journals, financial and management reports of Kakum Rural Bank Ltd. These secondary sources provided some useful statistics and information used in supporting the literature review and has been appropriately acknowledged.

Population, sample size and procedure

The target population of the study comprises all staff of Kakum Rural Bank Ltd. whose schedules have something to do with the credit operations of the bank and clients of the bank. The staff of the bank include all credit officers and management of the bank (including the finance committee and the Board of Directors). These individuals or staff number twenty (20). The credit officers are 10 in number, and are stationed at the various branches of the bank. The head of credit, who supervises the credit officers, is stationed at the bank's head office.

Top management staff of the bank comprises the Chief Executive Officer, the Manager in-charge of Audit and the Manager in charge of Finance & Administration. In addition to top management, the head of credit and three non-executive Board members (including the chairman of the Board) make up the Finance Committee of the Board. The chairman of the Board of Directors and the Chief Executive are purposively selected to represent the Board of Directors and top management respectively. All the Credit Officers and their Supervisor (i.e. the head of credit) are also purposively included in the survey.

The bank, as at 31st December, 2009, had a customer population of about 19,000 customers of which 9500 loan customers across its 10 branches, namely; Elmina main, Kotokoraba, Abura, Jukwa, Abakrampa, Moree, Agona and Mankesim, Mpobean and Sika fie (also as the Head Office). A sample of 300 customers is selected using simple random sampling technique in relation to the proportion of the number of customers of each branch to the total customer base of the bank. A list of the bank's customers for each of the branches is compiled. Pieces of paper are numbered from one to the last number of the branches' customers. These numbered papers are placed in a bowl and shaken to mix them up. Next, one of the pieces of paper is randomly selected. This process is repeated until the required sample size for each of the branches is obtained. The purpose of the simple random sampling technique was to give each of the bank's customers an equal chance of being selected as part of the sample. Again, the use of the simple random sampling technique makes it possible for the findings of the study to be generalised about the entire customer population of the bank.

The sample size for the customers is limited to 300 due to time and financial constraints as well as the difficulty of contacting willing customers who are scattered over the wide catchment area of the bank. Table 1 depicts the sample size chosen from each branch, using the simple random sampling technique already described.

Table 1

Sample size selected from each branch

No.	Branch	No. of loan customers	Sample size
1	Kotokuraba	2,010	62
2	Sika Fie	370	11
3	Elmina Main Bank	2,088	65
4	Abura/Pedu	2,496	76
5	Mankessim	1,222	40
6	Jukwa	736	23
7	Moree	182	5
8	Mpoben	113	4
9	Abrem Agona	209	7
10	Abakrampa	227	7
	Total	9,653	300

Source: Highlight of 2009 management accounts

Data analysis

Data obtained from the administration of the survey questionnaires are qualitatively and descriptively analysed.

In assessing the soundness of the credit operations of Kakum Rural Bank Ltd., frequency distribution tables are formulated in relations to the following financial indicators peculiar to the banking industry.

1. Advances against assets i.e. total loan portfolio (loans and overdraft) as a percentage of total assets.
2. Advances against deposit i.e. total loan portfolio as a percentage of total deposits (savings, demand and time deposits).
3. Overdue or non-performing loans as a percentage of advances i.e. provision of bad debts against total loan portfolio.
4. Advances against shareholders equity i.e. total loan portfolio as a percentage of stated capital and reserves.
5. Current assets against current liabilities.

CHAPTER FOUR

ANALYSIS AND DISCUSSION OF RESULTS

Introduction

This chapter presents and discusses the results of the data collected and analysed. The results are described to reflect the objectives of the study stated earlier on in chapter one. The analysis is done in relation to the two main sources of data collection used for this study, that is, primary and secondary data sources. The primary data sources are analysed using frequency distribution tables, whiles the secondary data sources are descriptively analysed using accounting ratios.

Classification of customers of Kakum Rural Bank (KRB)

Survey question three sought to find out the various categories of customers that Kakum Rural Bank deals with. Responses to this question are summarised in Table 2.

Table 2

Category of customers of Kakum Rural Bank

	Category of customers	**No. of customers**	**Percent (%)**
1	Salaried customers	13,692	47
2	Trading	10,118	34
3	Cottage Industries	1,070	3.6
4	Transport	1,358	4.6
5	Agriculture	3,176	10.8
	Total	29,414	100

Source: Highlight of 2009 management accounts

From Table 2, Kakum Rural Bank provides financial assistance or services to different categories of clients classified as salaried workers, traders, transporters and farmers. Salaried workers constitute about 47% of the bank's customers, making them the highest customer category of the bank. They are closely followed by traders with about 34% of the bank's customer base. Transporters constitute about 5% of the total customer base of the bank, making them the least customer category of the bank. Out of the total customer base of the bank that stood at 29,414 as at 31st December, 2009, about 9,653 have accessed some form of loan facility from the bank.

There are three main types of accounts operated and patronised by customers of the bank. These are current account, savings account and fixed or time deposit account. From Figure 2, current account is the most patronised account by clients of the bank with as high as 60% of patronage. This is followed by savings account with about 26% of clients' patronage. The least patronised product or service of the bank is time deposit that has an average of about 14% of client patronage. This reflects a poor savings habit of customers or clients in the bank's catchment area partly due to low income levels and ignorance.

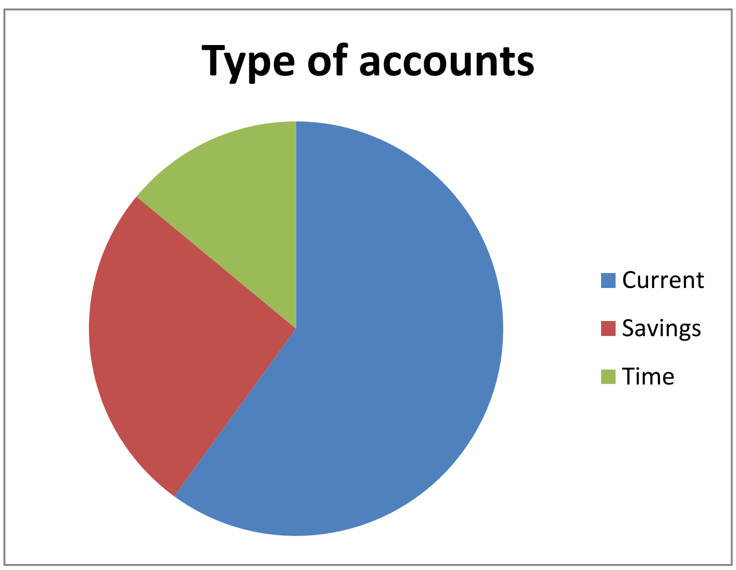

Figure 2. Accounts distribution of KRB

Source: Highlight of 2009 management accounts

Current account is the most highly patronised product because most of the customers of the bank are salaried workers who, as a matter of necessity, require current accounts. Operating a current account affords these customers the opportunity to access their accounts without necessarily visiting the bank in person. Current account holders are able to issue cheques to third parties when they cannot physically visit the bank to make withdrawals. In addition, the bank provides financial assistance in the form of loans and overdrafts to its numerous customers. But for savings account holders to qualify for salary loans and overdrafts, they need in addition to open current account.

Loan granting procedures

The loan-granting procedures of Kakum Rural Bank, as stated by the credit officers and customers of the bank, are as follows:

(i) Acceptance of loan application from customers and completion of a structured application form of the bank by customers. This must be followed by a duly completed guarantors' form guaranteed by the employer of the customer in the case of salaried workers. For non-salaried workers, there must be, at least, two guarantors, one of whom must be a customer of the bank. In addition to the personal guarantors for commercial loans, there must be a fully executed collateral backing the loan application in the case of loans exceeding GH¢10,000.00

(ii) Appraisal of the loan application form by the credit officers.

(iii) Recommendation by the credit officers of the amount of loan that can be granted for onward verification by the Head of Credit at the Headquarters.

(iv) Personal loans not more than GH¢500.00 can be approved and disbursed by the branch manager subject to rectification by the manager in charge of finance and administration. Where the amount involved is more than GH¢500.00 but less than GH¢5,000.00, the manager in charge of finance and administration shall approve and authorise for disbursement. Any amount in excess of GH¢5000.00 but not more than GH¢10,000.00 shall have the approval of the Chief Executive. However, any amount in excess of GH¢10,000.00 must have the approval of the Credit Committee of the Board of Directors (BoD).

(v) Communicating to the prospective borrower of the approval or disapproval of the loan application by the Credit Officers.

This process is religiously followed in every loan application received from customers of the bank. Staff of the bank indicated that the procedure for loan application form is simply designed to allow most of the clients of the bank, who have an average level of education to easily understand and fill without much difficulty. This view was reiterated by about 85% of the clients' surveyed, who regarded the bank's loan application procedures to be simple and straightforward. There was overwhelming support to maintain the bank's loan application procedures. Both staff and clients of the bank did not see the need for any modification to the bank's loan application procedures.

Staff of the bank indicated that it takes an average of two weeks for loans to be appraised, approved and disbursed once the client satisfies to the letter the requirements for loan facilities. Where customers fail to meet the requirements for loan facilities at the initial application level, it takes quite a longer period, in some instances, about two months before the application is finally approved for disbursement. Such applications are returned to the clients to satisfy all the loan application requirements before the application is considered. Close to about 82% of the clients interviewed showed satisfaction with the loan application period and agreed that the bank continues with its hard work and timely manner with which loan applications were worked on.

Back room credit management processes

Every loan application that is received and granted by the bank goes through certain processes at the time of receipt till such a facility is fully recovered. These processes include screening, credit analysis and investigation and credit administration.

Screening. In order to ensure that credits granted are fully recovered with little difficulties, KRB screens by trying to identify good customers with a positive orientation to repay credit extended them. The Bank has two main objectives in its screening process. These are: (i) to prevent problem loans, and (ii) to quickly identify any problems that may occur.

Credit analysis and investigation

Credit analysis and investigation was found to be one of the cardinal processes used in the credit granting-process. The granting or otherwise of credit largely depends on the analysis and investigation part of the credit granting-process. It was realised that KRB uses the principles of the 5Cs in its credit analysis and investigation process. In doing so, capacity of clients to repay loans granted them played the pivotal factor. Character follows capacity closely as the second most important factor or consideration in the credit granting-process. Condition of clients' business is the third most important factor, followed by collateral used as guarantee to secure the credit facility. Capital, that is, the wealth of the client is considered the least factor in the credit-granting process in KRB. This emphasises the importance KRB gives to the concept of the 5Cs in its credit-granting process. This shows that the concept of the 5Cs is very alive in credit risk management in KRB.

Credit analysis involves the Credit Department and the Finance Committee of the Board of Directors (BOD). KRB uses the credit department to undertake its credit analysis. The Finance Committee only comes in when the amount involved is large (that is, above GH¢10,000.00). In some exceptional instances, when the amount involved is colossal, the Supervisory Department of the Bank of Ghana is consulted.

It was realised that KRB runs a centralised credit approval system. All credit approvals are done at the Headquarters. No officials other than the Finance

& Administration Manager, Chief Executive and Finance Committee have the right to approve any credit. Credit officers only furnish information pertaining to the 5Cs of the prospective loan customer and recommend the amount to be granted based on the credit risk assessment. The purpose for centralising the credit approval process is to prevent the perpetuation of fraud by officers of the bank at the blind side of management.

Credit monitoring

KRB monitors the operations of their clients after granting credit. Credit officers and branch mangers monitor loans granted to clients. The frequency of monitoring depends on clients condition and risk profile. However, quarterly monitoring seems popular. The fact is that monitoring can be expensive in terms of the opportunity cost of time required for it. Where the bank is sure of dealing with a safe client, they are more likely to relax the frequency of monitoring. This practice is not too different from the Bank of Ghana (1995) policy on credit administration. According to the report, all banks are to ensure proper monitoring of loans granted. This is to ensure that loan portfolios are performing to avert or reduce non-performing loans.

Loan policy

The responses from the bank indicate that the bank has a written loan policy. The bank, however, views its written loan policy as confidential and as a result, was not willing to give it out to be discussed in this study. However, an in-depth interview with the Chief Executive and credit officers of the bank revealed that the content of the loan policy comprised of three main policies, namely, (i) general credit information, (ii) specific loan categories and (iii) quality controls.

General credit policies are made up of issues such as;

1. The banks' loan-granting objective
2. The amount of loan that can be accessed by the various categories of customers
3. Loan administration
4. Collateral
5. Credit information and documentation.

The general policies of the bank however contained no information on the following issues deemed important by the Basel Committee's (2001) report that must be disclosed in every loan policy:

1. Responsibility for managing the loans.
2. Loan to deposit ratio.
3. Interest rate.
4. Delinquency ratio.

Though policies on these issues are not stated in the bank's loan policy, the bank in practice has benchmarks with respect to these issues. The bank follows the BoG guidelines on loan delinquency ratio and loan to deposit ratio. The responsibility for the management of credit is also entrusted to the BOD. It is, however, the management of the bank, aided by its credit officers, which oversees the day-to-day administration of the bank's credit risk.

Specific loan categories

On the issue of the specific loan categories, the bank's credit policy is explicitly clear on the type of loans entertained and granted by the bank. The types of loans granted are in conformity with the BoG's loan categorisation, including agricultural loans, salaried loans and other personal loans.

Quality control

Regarding quality control over credits, KRB has a well-established credit department that handles all issues with respect to the granting and recovery of credit. This is in conformity with Sinkey's (1998) study that revealed that a good credit policy should have in place a cogent credit department with the requisite human capital to handle credit issues. In addition, the bank's credit policy includes policies on loan reviews. However, the bank has no written policy on recoveries, though in practice it has a loan recovery department.

Miscellaneous loan policies

Again, there are no written policies on miscellaneous loans to board members and staff of the bank. The board, therefore, uses its own discretion in the granting of credit to its board and other staff. There is, therefore, the possibility of abuse of loans to board members and to other staff members.

Credit committees

Sinkey (1998) states that a credit policy should have in place various loan committees which should be empowered to play crucial roles in the loan granting processes. The duties of such committee(s) should be clearly spelt out. KRB in practice has the Finance Committee that reviews and approves credits. However, the credit policy of the bank does not make mention of the existence or establishment of such a committee. The reason accounting for this situation was explained to have arisen due to the fact that the bank's loan policy was written when the current management was not in office. Plans are however far advanced to have a new credit policy to replace the existing one, incorporating various credit committees with responsibilities to review and approve credit.

Sectoral Credit Coverage

Survey question 5 sought to find out the percentage credit allocation to the various types of customers. The data gathered is summarised in Table 3.

Table 3

Sectoral credit allocation

	Category of customers	**2005**	**2006**	**2007**	**2008**	**2009**
1	Salaried customers	30%	32%	40%	49%	53%
2	Trading	26%	33%	35%	29%	25%
3	Service & Hospitality	12%	14%	5%	2%	3%
4	Transport	11%	8%	7%	11%	9%
5	Agriculture	14%	10%	9%	8%	5%
6	Others	7%	3%	4%	1%	5%

Source: Highlight of 2009 annual report of KRB

The category of clients that benefited the most from loans included salaried workers and traders. From Table 3, salaried workers took more than half of the total loan disbursement of the bank in 2009, and almost half of the total loans disbursed in the years 2007 and 2008. Salaried workers again benefited from loans to the tune of 30% and 32% for 2005 to 2006. Traders occupied the second position in terms of credit allocation from 2005 to 2009. Traders took about 26% and 33% for the years 2005 and 2006 respectively before peaking at 35% in 2007. Thereafter, the percentage of the bank's credit allocation to the trading sector decreased to 29% in 2008 and finally to an all-time low of 25% in 2009 within the period under consideration. The agricultural sector has lost its position as the third largest beneficiary of credit allocation in the 2005 to 2007 financial years to the fourth position in the years 2008 and 2009 to the transport sector.

It is clearly shown that, KRB does not conform to the sectoral credit allocation guidelines indicated in the operational manual of the BoG (2004). In this operational manual, the agricultural sector is to be given the utmost priority in rural banks' credit allocation with as high as 50% of total loan disbursement. One of the reasons accounting for the deviation from the Bank of Ghana operational manual was explained by the fact that the priority areas, particularly the agricultural sector is highly risky and prone to high default rate. This is because agriculture in Ghana largely depends on the mercy of the weather.

The chances of the bank recovering loans extended to farmers during periods of bad weather are impaired, which was indeed experienced in the early years of the banks' inception. The bank, therefore, changed its priority sector to salaried workers in order to ensure a much reasonable recovery rate to enhance the wealth of shareholders. It is easier to recover loans extended to salaried workers whose salaries pass through the bank. The decision to deviate from the BoG's credit allocation guidelines is indeed in line with good credit management practice which emphasises on being able to recover loans on time and in full with minimal associated cost.

Loan recovery rate

Good credit management does not end with the granting of advances or loans. The ability to recover loans in a timely manner is an important component of credit management. Table 4 depicts the loan recovery rate of KRB from 2005 to 2009.

Table 4

Loan recovery rate

Years	Loans Granted	Loans Recovered	(%) recovery rate
2005	1,606,283	1,252,900	78%
2006	2,642,690	2,167,005	82%
2007	4,014,756	3,452,690	86%
2008	5,229,806	4,445,335	85%
2009	5,578,336	4,964,719	89%

Source: Highlight of 2009 annual report of KRB

From Table 4, the amount of loan granted in 2005 was GH¢1,606,283 out of which GH¢1,252,900 was recovered. The recovered amount represents about 78% of the total amount of loan granted. In 2007, the total loan granted increased to GH¢4,014,756. Out of this, GH¢3,452,690 were recovered, representing 86% of total loans granted. However, in 2009, the loan recovery rate was about 89% out of the total advances granted. The bank achieved this improved loan recovery rate, averaging about 84% over the five year period under consideration due to its decision to re-channel most of its loan portfolio to salaried workers. The bank over the five-year period achieved a 100% recovery rate with regards to loans granted to salaried workers. This achievement was chalked as a result of the workers' salaries passing through the bank and as such loan repayments were deducted before any balance left credited to the workers' account.

Management of the bank argued that, the default rate recorded was attributed mainly to loans granted to operators in the agricultural (fishing inclusive) and commercial sectors. Respondent customers indicated that, harsh economic conditions, high dependency ratio and high interest rate are some of the reasons accounting for the default. Indeed, if the bank is able to push more to recover advances granted to its customers in the other sectors, such as trading and agriculture, the recovery rate could improve to average about 95%.

All the salaried workers indicated that they had never defaulted in repayment of loans granted them and also expressed satisfaction with the terms and conditions for repayment. They explained that the spread of the repayment period, mostly over 24 months, and its deduction at source makes them comfortable with the terms of the repayment. About 35% of commercial loan beneficiaries had, at a point in time, defaulted in their loan repayment. These customers indicated that their failure to repay their loans were due to factors such as high interest rate and harsh economic conditions. They were, however, of the opinion that it is about time the bank pegged its interest rate with the rates of the traditional banks, like Ghana Commercial Bank and National Investment Bank.

Provisions for loan write-offs

A good business is one which, while being optimistic about gains, also knows that the worst could occur. As a result of this, KRB makes provision for loan write-offs. In terms of loan classification, KRB uses Bank of Ghana's loan performance classification guideline. The most common classification is current, sub-standard, other loans exceptionally mentioned (OLEM) and doubtful. However, the bank does not comply with the BoG's guidelines for loan write offs.

In terms of loan write-offs, the bank has its own internal model used in determining what amount of provision should be made. This model is based on un-recovered debts of the previous years'. The provisions are reviewed quarterly to ensure that targets are achieved or improved. Outcome of the model is used to plot a graph of expected loan loss against total loan portfolio.

Generally, provisions for loan losses are a major factor in the evaluation of a financial institution's ability to absorb credit losses and the accuracy of its financial statements. The allowances for loan losses is a valuation account used to off-set or reduce the gross value of loans or advances on the bank's balance sheet. The amount of loan loss provisions reflects the quality of the bank's loan portfolio. A large provision for loan loss is an indication of poor loan portfolio. Table 5 shows the provisions for loan losses made for the period under view, i.e. 2005 to 2009. The bank's provision for loan losses ranged between 3% and 6% of loans granted within the period under review.

Table 5

Provision for loan losses

Years	Loans Granted	Loans write offs	Percentage
2005	1,606,283	91,745	5.7%
2006	2,642,690	112,173	4.2%
2007	4,041,475	127,299	3.1%
2008	5,229,806	161,879	3.1%
2009	5,578,336	181,757	3.3%

Source: Highlight of 2009 annual report of KRB

For the year 2005, out of a total loan of GH¢1,606,283.00 granted, a provision of GH¢91,745 was made, representing 5.7% for the loan amount. In 2006, the total loan granted had increased to GH¢2,642,690.00 but the provision for loan loss had reduced marginally in percentage terms to 4.2% of the total advances indicating an improvement in the management of credit. Loan loss provisions as a percentage of gross loans further improved to 3.1% in 2007. In 2008, the provision of loan loss as a percentage of total advances was maintained at the 2007 percentage of 3.1%. However, in 2009 the amount of loan loss provision was GH¢181,757 representing 3.3% of the total loan granted. This shows a slight deterioration in the management of credit over the two previous years.

An attempt to evaluate the adequacy or otherwise of the loan loss provision against the rate of non-performing loans indicated that the provision for loan loss was inadequate. In 2005, whilst the rate of non-performing loans was 22%, the provision for loan loss was about 6%. Again, in 2009, when the rate of non-performing loan had reduced from its all-time high in 2005 to 11%, the provision for loan loss was pegged at about 3%. This indicates that for the period under review, there was an average of about 13% of advances not recovered nor written off against profit. The reason for this situation could be attributable to the failure of the bank to comply with the BoG's guidelines on loan write-offs. As such, the bank has, over the period under review, made less provision than required for non-performing loans.

Collateral covenant

As part of its loan policy, KRB demands collateral to serve as security against loans extended to its clients. The form of collateral usually demanded by the bank includes landed properties like leased buildings or leased lands, documents of vehicles comprehensively insured and registered in the joint names of the client and the bank, with the bank as loss payee and institutional guarantors. The type of collateral demanded at each point in time depends on the type of loan in question. The bank indicated, however, that most of the clients find it difficult providing this form of collateral. According to the bank, it also lacks human resources with the requisite skills and expertise to mortgage this collateral to the bank. It is, therefore, difficult for the bank to fully claim ownership of these properties when the loans go bad. As a result of this, the bank, in addition to the collateral, also requires at least two guarantors to severally and jointly guarantee loans. One of these guarantors must necessarily be a customer of the bank. This arrangement applies only to commercial loans.

Collateral demanded for personal loans for salaried workers is in the form of institutional guarantee. The employer of the customer (salaried) undertakes to support the loan application of the employee and pledges to continue to channel the salary of the customer through the bank until such a time that the loan is fully recovered. This has led to almost a 100% loan recovery rate from salaried workers.

Loan review and problem loans

KRB normally carries out loan reviews purposely to identify and handle problem loans. In doing this, three principles are adopted.

These are:

(a) Rescheduling and restructuring of debt repayment. This is the first step embarked upon when the bank is confronted with signals of a loan turning problematic. This action is evidence of the bank's commitment to always keep the flame of the bank and customer relationship burning. Management of the bank sits with clients to rearrange and possibly vary the terms of the loan to make it quite easier for clients to repay without compromising on the bank's objective. The re-structuring of the loan terms is usually done by extending the repayment period thereby reducing the periodic repayment amount. This arrangement has, in most cases, helped reduce client's cash flow problems whiles enabling the bank to also recover loan advances made, though at a longer period than originally scheduled.

(b) Payment through liquidation of collateral. The bank also enforces repayment through liquidation of collateral as the second major option after rescheduling of problem loans has failed to yield any positive results. The bank makes sure that ownership of properties used as collateral are transferred and vested into the bank. This makes it possible for the bank to exercise lien over the property and take the necessary steps to dispose them off to settle its outstanding loan facilities. In most cases, it takes longer than expected to dispose off collaterals. This is because there is a popular belief among citizens of the bank's catchment area that it is unethical to offer for sale a person's property simply on the basis that he/she could not repay his/her loan. Others are of the belief that they could be attacked spiritually if they acquire other people's properties that are offered for sale on the basis of not honouring their debt obligation.

(c) Taking legal actions to recover loans. This is the last and unpalatable means the bank resorts to recover overdue loans when every other means possible fail. Legal actions have really helped the bank in its loan recovery process. In 2005, as much as GH¢14,364 was recovered through the institution of legal actions. This amount increased GH¢56,788 in 2009 representing an increase of almost about 300%. This means that, these amounts would otherwise have gone bad if legal actions had not been instituted against the defaulting clients.

Early warning signal

Responses show that KRB uses particular early warning signals as a sensor of impending danger in terms of deteriorating customer risk profile. KRB uses deteriorating customer relationship as the first early warning signals. Since customer relationship is crucial, the bank consistently watches it and advises itself whenever there is a sudden change in a customer's attitude. Operational early warning signal is next in importance. The bank watches all aspect of the customers' production, marketing procurement, and inventory management system. Any sign of deterioration suggests that the customer is likely to face financial difficulties. The least in importance of the early warning signals is managerial and financial crises. The reason for placing managerial and financial difficulties as the least important was explained by the fact that audited financial results, for instance, are usually available some two or three months after the financial year end. If the bank depends heavily on a firm's financial status, the bank would probably see the deterioration only months after they have occurred.

Role of the Board of Directors in credit risk management

It is the responsibility of the Board of Directors to manage the bank's credit risk. The Board of Directors does this through various committees and officers of the bank. The credit officers and management of the bank are mandated and empowered to handle and deal with some loan applications without directly referring them to the Board of Directors. These officers are to exercise due diligence regarding such applications since the outcome of their work reflects and binds the bank. But then, for loan applications for which the amount exceeds GH¢10,000.00, the Board of Directors must, as a matter of necessity, be directly involved in its approval and disbursement.

The Board of Directors also gives policy guidance in the granting of credit. This it does through its loan policy guidelines which must be strictly adhered to in every loan application. Again, the Board of Directors has reporting guidelines that requires a quarterly status of all loans disbursed. This affords the Board of Directors the opportunity to detect early non-performing loans for the appropriate strategy to be adopted in recovering such debts.

Though the credit decision is usually result of team work based on available information at the time of the decision and a sound judgment by the decision makers, there is the need for punitive measures to be instituted against officers who give loans that latter turn out to be bad. This will ensure that due diligence and care are taken in the credit-granting process by officers of the bank. The punitive measures could take the form of prohibition from participating in future credit decision-making and reprimand letters. In some circumstance, transfer to other departments could be considered, not to mention demotions in serious situations.

Customers' opinion on Kakum Rural Bank credit operation

Customers of the bank expressed different views concerning the credit operational activities of the bank, particularly on the various challenges they encounter in accessing loans from the bank. The majority of customers surveyed expressed satisfaction with the bank's credit operations. Of the 300 customers surveyed, 79% said they were comfortable and at home with the bank's credit operations. Twelve percent (12%) of respondents raised issues with the various processes that a loan application would have to pass through, opining that it is quite bureaucratic. Two percent (2%) of the sampled respondent also raised issues with delays in disbursing loans. These delays, they argued, sometimes defeat the purpose for which the loan facility was applied for.

About 2% of the sampled customers also expressed difficulties in getting the two guarantors in support of a loan application. This group of sampled customers stated that they were sometimes denied loan facilities because of their inability to get the two personal guarantors, though they possessed sufficient collateral to secure the loan.

Respondents were very grateful to the bank for the numerous financial assistances raging from payment of their wards' school fees, building projects and expansion of their business. They stated that the loans extended to them had gone a long way in meeting most of their economic and social needs. Almost all the respondents were, therefore, of the opinion that the loans taken from the bank had had a positive impact on their ability to meet their economic and social needs

Secondary data analysis

The BoG, in assessing the efficiency of their operations of rural banks, particularly the credit operations, demands prudential monthly returns. These prudential returns are used to analyse and assess banks' performance with regard to their credit operations. For the purposes of this study, the prudential returns are used in conjunction with some significant financial ratios in assessing the efficiency of the credit operations of KRB. These ratios are advances (long-term and short-term loans and overdraft) to total assets, advances to total deposits (savings, demand and time deposits), overdue or non-performing loans to advances, advances to shareholders' equity and current ratio.

Financial ratios

Some significant financial ratios are selected for assessing the performance of the credit operations of KRB for the period under review, i.e. 2005 – 2009.

Table 6

Significant financial ratios

Ratios	2005	2006	2007	2008	2009
Advances to Assets	47%	52%	45%	56%	58%
Advances to deposit	73%	75%	73%	77%	72%
Overdue loans to advances	22%	18%	14%	15%	11%
Advances to shareholders equity	3.4times	3.6times	4.2times	4.5times	4.1times
Current assets to Current liabilities	1.1:1	1.1:1	1.2:1	1.2:1	1.2:1

Source: Highlight of 2009 annual financial report of KRB

Advances to Assets

This ratio measures the relationship between advances in terms of long and short-term loans and overdrafts on one hand and total assets on the other. It is mathematically represented as the ratio of advances to assets. As shown in Table 6, loans and overdrafts granted to customers constitute about 47% of the banks' total assets in 2005. This ratio increased to 52% in 2006 and decreased to 45% in 2007. This ratio again increased to 56% in 2008 and finally peaked at 58% in 2009. This reflects the bank's commitment to making financial assistance available to their customers and also shows the willingness of most of the customers to meeting the loan application requirements.

Advances to deposit

This measures the relationship between advances and deposits (savings, time and demand deposits. This is calculated as the ratio of advances to deposits. Advances in the form of loans and overdrafts granted constituted about 73% of the total deposits (savings, time and demand) mobilized from customers of the bank for the base year 2005. This percentage slightly increased to 75% in 2006 and decreased from the base year to 73% in 2007. In 2008, this ratio experienced an increase of four percentage points over the previous year and decreased to 72% in 2009. This shows that the bank, on the average, has about 26% of mobilised funds as cash in hand or in investment (including those unlended to meeting BoG’s statutory reserves requirement). This is not good enough for the bank in terms of profitability. There is the urgent need for the bank to explore more avenues for granting credit, whiles not compromising on the quality of loans or advances.

Overdue loans to advances

This measures the relationship between overdue loans and advances, calculated mathematically as the ratio of overdue loans to advances. The percentage of overdue loans was 22% of total advances extended to customers for the 2005 year of assessment. The bank was able to bring this down to about 11% in 2009, almost half of the 2005 figure. This is indicative of the fact that the bank is not just interested in granting loans but it is as much interested in recovery.

Advances to shareholders equity

This measures how much of shareholders' equity have been granted as loans. It is calculated as the ratio of advances to shareholders equity. Shareholders' fund, in the period under consideration, has grown significantly from GH¢472,436 in 2005 to GH¢1,360,569 in 2009. The growth in the shareholders' fund came from the backdrop of undistributable profit ploughed back into the company over the years. Over the period under consideration, KRB gave out advances far in excess of owners' equity. In 2005, advances were almost 3.5 times the shareholders' fund. The ratio increased to 4 times in 2007 and in 2008 4.5 times. This ratio finally settled at 4 times in 2009. This trend is a reflection of the nature of the banking industry that depends heavily on external sources of funding its operations. However, it is imperative and in the interest of the bank to increase its capital base to cushion its operations if it wants to be more profitable.

Current ratio

This measures the readiness and preparedness of a firm to meet its immediate financial commitments from its resources without difficulties. It is calculated as the ratio of current assets to current liabilities. KRB showed quite an average current or liquidity ratio in the years under review and demonstrated the ability to meet its current obligations without much challenge. The proportion of current assets to current liabilities stood at 1.1:1 in 2005 and 2006. This increased marginally, though significantly, to 1.2:1 in 2007 through to 2009. This is an indication of the fact that KRB, in the short term, is solvent and in the position of meeting its current commitments as and when they fall due.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Introduction

This chapter presents an overview of the study and its findings, from which conclusions are made and recommendations proffered for improvements in the credit management of Kakum Rural Bank (KRB) Ltd.

Overview of the study

The general purpose of the study was to assess the efficiency in the credit risk management operations of KRB. Specifically, the study was conducted to (i) determine the process for granting credit, (ii) ascertain the constraints, if any, faced by Kakum Rural Bank in conforming to the guidelines for sectoral allocation of credit issued by the Bank of Ghana, (iii) determine the percentage allocation of credit to the various customer categories of KRB, (iv) determine the role of the Board of Directors of KRB in credit risk management.

The survey strategy was employed. This research strategy allowed the gathering of a large amount of data on time from customers across the 10 branches of the bank with minimal cost. In addition to the 10 credit officers, the head of credit, the manager in charge of finance and administration and the CEO of the bank were interviewed. The data was descriptively analysed.

Summary

KRB provides financial assistance to different categories of clients, classified as salaried workers, traders, transporters and farmers. Salaried customers make up the highest customer category of the bank's customers. Transporters are the least customer category of the bank, constituting about 4.6%.

There are three (3) main types of accounts operated by KRB, namely, current accounts, savings accounts and time deposits. About 60% of the bank's clients patronize current accounts. Time deposits account holders constitute about 14%, whiles saving account holders make up about 26%.

KRB has a five-point procedure that must be followed at all times in its loan granting process. These processes are:

- Acceptance of loan application from customers.
- Appraisal of the loan application. The principles of the 5Cs play an important role in appraising the loan application of customers.
- Recommendation by the credit officer.
- Approval of the loan application.
- Communicating to the prospective borrower of the approval or otherwise of the credit facility.

KRB has a written loan policy. The content of the loan policy comprises three (3) main policies, namely, general credit information, specific loan categorisation and quality control. The bank, however, has no written policies on miscellaneous loans and advances.

The category of clients that benefitted most from loans included salaried workers and traders. Salaried workers took more than half of the loans disbursed by the bank in 2009. Traders occupied the second position in terms of credit allocation from 2005 to 2009. The agricultural sector occupied the third position in terms of credit allocation from 2005 to 2007, whiles the transport sector occupied the fourth position. However, in 2008 and 2009, the agricultural sector lost its third position to the transport sector.

The loan recovery rate achieved by KRB averaged about 85% over the five-year period (2005-2009). In 2005, the loan recovery rate was about 78%. This increased to 86% in 2008 before settling to 89% in 2009. According to the management of the bank, the default rate was due to loans granted to the agricultural sector. Respondents identified harsh economic conditions, high dependency ratio and high interest rate as some of the reasons for the default.

KRB makes provisions for loan write-offs. It has its own internal model for determining what amount of provision should be made. The provisions are reviewed quarterly to ensure that targets are achieved or improved. In 2005, the percentage provision for loan loss was about 5.7%. This reduced to about 3.3% in 2009.

KRB demands collateral before credits are granted to customers. There are two main types of collateral demanded, depending on the customer classification. Salaried workers require institutional guarantee in support of loan applications. Traders and the self-employed, however, need landed properties as collateral in addition to two personal guarantors, one of whom must be a customer of the bank in support of loan applications in excess of GH¢10,000.00. However, when the amount involved is less than GH¢10,000.00, the only form of collateral required is the two (2) personal guarantors. The BOD, with the assistance of management and credit officers of KRB, has the ultimate responsibility for the granting of loans and management of credit risk.

The management of credit risk is entrusted to the BoD. This they do through various committees and officers of the bank. However, loan applications in excess of GH¢10,000.00 require, as a matter of necessity, the direct involvement of the BoD.

Majority of the customers surveyed, about 79% of them, expressed satisfaction with KRB’s credit operation. Some customers, however, indicated that they have difficulties getting the two personal guarantors in support of their loan application. On the whole, customers were grateful to the bank for the various forms of financial assistance available to them.

The banks credit or advances as a percentage of its assets have increased from 47% in 2005 to 58% in 2009. Advances as a percentage of deposits could only manage an average of 74% between 2005 and 2009. The percentage of overdue loans to advances reduced drastically from 22% in 2005 to 11% in 2009. Advances were about 3 times of shareholders' equity in 2005, whiles, in 2009, it was about 4 times. Current ratio of the bank hovered around 1.1:1 in 2005. This increased slightly to 1.2:1 in 2009.

Conclusions

KRB has in place a credit department equipped with the requisite skills and expertise to effectively handle and operate the credit function of the bank. The bank, however, lacks the technical know-how on how to effectively handle credit to the agricultural sector deemed a priority sector in rural banks' credit operations. One striking feature of the agricultural sector is that it depends heavily on the mercies of the weather. As a result, KRB does not conform to the credit allocation guidelines stipulated by the Bank of Ghana. Credit to the agricultural sector thus receives little attention in the bank's credit allocation. KRB allocates much of its credit to salaried workers whose loan or credit repayment over the years has been phenomenally exceptional, achieving a 100% recovery rate.

KRB experienced quite a remarkable loan recovery rate over the period. The loan recovery rate was about 78% in 2005, but this increased to 89% in 2009. This is a clear indication that the bank is very much concerned and interested in recovery rather just granting loans.

KRB demands collateral against loans extended to its clients. The form of collateral usually demanded by the bank includes institutional guarantees and landed properties like leased buildings or lands. Salaried workers require institutional guarantee in support of their loan applications, whiles other applicants require landed property as security in support of their loan application in addition to two personal guarantors. Most of the applicants for commercial loans, however, find it difficult providing landed properties as collateral.

KRB, over the period under review, has demonstrated its solvency. The bank has the capacity to meet its short-term commitments without difficulties. However, it is faced with some challenges in conforming with the guidelines for sectoral allocation of credit, particularly to the agricultural sector which has been singled out as a priority area by the Bank of Ghana for rural banks' credit policy. This is due to the relatively high default rate of the sector which is characterized by high exposure to the vagaries of the weather.

Recommendations

Drawing from the findings of the study, the following recommendations are made with the view to improving the management of credit risk by KRB:

- KRB, led by its BoD, should strive to conduct a SWOT (Strengths, Weakness, Opportunities and Threats) analysis of its credit operations. It is important for the bank to continuously assess the markets in which it is comfortable or uncomfortable. This will enable the bank to advance credit facilities to sectors where it is certain of repayment to enhance stakeholders' wealth. The BoD of KRB must, as a matter of necessity, review its credit policy to take cognizance of policies on miscellaneous loans (such as loans to members of the BoD and management and policies on various loan/credit committees). Though the bank has the finance committee that plays a pivotal role in credit management, its existence, role and responsibility should be clearly defined.

- Credit officers play instrumental roles in credit management at KRB. The bank should, therefore, pay particular attention to the recruitment and training of credit personnel. KRB needs to appreciate the fact that the different markets that they operate in require different professional talents, skills and material resources. Based on this, KRB should carefully recruit and groom talented personnel with broad and diversified skills in banks' credit management.

- KRB needs to develop a sound credit culture. In the process, special consideration should be given to timeliness and the spirit of changing the status quo where necessary. The BOD must develop business values and allow those values to flow down to everyone in the bank. A common credit language must be spoken, which must be understood by all those who work in the bank.

- KRB must not relent in its rigorous loan recovery efforts. This will enable the bank to further reduce the loan default rate that stood at 11% of advances as at 2009. The bank should institute rewards systems to motivate credit officers who fully recover credits. It must also put in place punitive measures against officers who recommend credits that turn bad or turn out to be irrecoverable.

- KRB should also consider taking up an insurance cover against credits extended to the agricultural sector in particular. This arrangement would help cushion the bank against any default by the agricultural sector.

- KRB needs to establish an advisory service to help clients of the bank undertake and conform to basic management and record-keeping practices. This will go a long way to enhance the operations of their clients' businesses and make it easier assessing such clients for credit purposes. It will also make it easier for the bank to monitor and ensure that credits granted are used for their intended purposes.

- Last but not least, the bank needs to organise outreach educational programmes in its catchment area to educate its clients on the essence of repaying loans on time. The consequences of loan default should form an integral part of any educational programme.

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APPENDIX 'A'

QUESTIONNAIRE FOR STAFF OF KAKUM RURAL BANK LTD

1. Title of respondent………………………………………………………..
2. Department of respondent………………………………………………..
3. Years at post…………………………………………………………….
4. What type of loans do you grant? Tick as many as applicable

   Short Term Loan ☐

   Medium Term Loan ☐

   Long Term Loan ☐

   Others ☐

5. How long does it take to process a Loan?

Type of loan	**Minimum time**	**Maximum time**
Short-term		
Medium term loan		
Long term loan		

6. Which categories of loan customers do you deal with? Tick as many as applicable

   a. Farming ☐

b. Mining ☐

c. Trading ☐

d. Small scale entrepreneur ☐

e. Contractors ☐

f. Salaried Workers ☐

g. Manufacturing ☐

h. Others ☐

7. Which of these categories of loan customers to you normally give loan?

....

……………………………………………………………………………………

8. Which of the categories of loan customers do you not normally give loan?

……………………………………………………………………………………

……………………………………………………………………………………

9. Please state or outline sequentially, the procedure for granting loans.

…………………………………………………………………...…...………

……………………………………………………………………………………

10. Do you think the loan granting procedure is cumbersome and needs some modifications?

…………………………………………………………………...…...………

……………………………………………………………………………………

…………………………………………………………………...…...……….

11. If yes, why?

…………………………………………………………………...…...………

………………………………………………………………………………

12. How much loan were advanced by the bank to the different categories of customers within the period 2005 – 2009

Category	**2005**	**2006**	**2007**	**2008**	**2009**
Farming					
Mining					
Trading					
Small Scale Entrepreneur					
Contractors					
Salaried Workers					
Manufacturing					
Others					

13. Does the bank demand any collateral security before granting loan to its clients?

Yes ☐ No ☐

14. If yes, is collateral demanded for all types of loan

Yes ☐ No ☐

15. What form or type of collateral does the bank accept

a. Cash ☐

b. Movable property ☐

c. Landed property ☐

16. What measures does the bank take to ensure that its interest is secured with the type of collateral demanded?

…………………………………………………………………...…...………

………………………………………………………………………………

18 Does the bank provide any advisory services to its loan customers?

Yes ☐ No ☐

19. If yes, what form does it take?

…………………………………………………………...…...………………

………………………………………………………………..……………

20. How often do you monitor the business of your clients after granting credits?

Weekly ☐ Monthly ☐

Quarterly ☐ Half-yearly ☐

21. If you monitor, who performs the monitoring?

…………………………………………………………………...…...………

……………………………………………………………………………………

22. How important do you consider the following factors in your credit granting process. Please rank in order if importance,

Where; 1= Most important, 2 = Neither important nor unimportant

3 = Not important

Capacity ☐

Character ☐

Collateral ☐

Condition ☐

Capacity [Capital] ☐

23. Who is responsible for credit analysis in your bank

Loan Officers ☐

Loan Committee ☐

Others [specify] ☐

24. Do you have a written loan policy

Yes ☐ No ☐

25. If yes, which of the following is / are content of the written loan policy?

- General Policies
- Specific loan category
- Miscellaneous loan policy
- Committees
- Quality control policies

26. Do you have a credit department?

Yes ☐ No ☐

27. What is the least period that a member of the credit department has served the bank?

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………………………………………………………………………..………

28. How long has the longest serving staffs of the credit department been with the bank?

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29. What is highest qualification of the members of the Credit Department?

…………………………………………………………………...…...………

……………………………………………………………………………………

30. Is the CEO/MD/GM involved in the credit granting process in your bank?

Yes ☐ No ☐

31. If yes, what are the responsibilities of the CEO in the granting of credits?

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32. Does the bank make provision for loan write offs or bad debts?

Yes ☐ No ☐

33. What are the conditions to be satisfied before loans are written off?

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…………………………………………………………………………………

34. What has been the default rate of loans for the period of 2005 - 2009

Year	**Amount Written Off**	**% Percentage of Bad Debt**
2005		
2006		
2007		
2008		
2009		

35. What do you think account for the default?

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…………………………………………………………………………..………

36. What measures are put in place to recover non-performing loans?

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…………………………………………………………………………………

37. What forms of penalties are there for Officers / Committees that approve credit which later turn out bad?

…………………………………………………………………...…...………

…………………………………………………………………………………

APPENDIX 'B'

QUESTIONNAIRE TO CUSTOMERS OF KAKUM RURAL BANK

1. What is your occupation?

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……………………………………………………………………………………………..

2. How long have you been in this occupation?

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……………………………………………………………………………………………

3. How long have you been a customer of Kakum Rural Bank?

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……………………………………………………………………………………………

4. What type of account do you operate with Kakum Rural Bank?

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……………………………………………………………………………………………

5. Have you ever benefited from any financial assistance from the Bank?

Yes ☐ No ☐

6. If yes, what type of financial assistances?

Short Term ☐

Medium Term ☐

Long Term ☐

7. How long did it take you to access the said financial assistance?

………………………………………………………………………………………

………………………………………………………………………………………

8. Are there any documentation procedures to be followed before accessing any financial assistance from Kakum Rural Bank Ltd.?

Yes ☐ No ☐

9. How would you rate these procedures if any?

a. Cumbersome ☐

b. Easily understandable ☐

10. How would you rate the conditions and repayment period of the facility?

a. Favourable ☐
b. Normal ☐
c. Unfavourable ☐

11. Were you able to repay the facility granted you as scheduled or agreed upon?

Yes ☐ No ☐

12. If no why were you unable to repay your loan on schedule?

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………………………………………………………………………………………

13. Have you ever benefited from an advisory ser vices from Kakum Rural Bank?

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………………………………………………………………………………………

14. If yes, what form or type of did the advise take?

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……………………………………………………………………………………………

15. Does the bank demand any form of collateral before granting your loan?

Yes ☐ No ☐

16. What form of collateral does the bank demand if any?

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…………………………………………………………………………………

17. What in your opinion are difficulties or challenges in accessing Kakum Rural Bank Ltd. Credit facilities?

……………………………………………………………………………………………
……………………………………………………………………………………………

18. What suggestions or recommendations do you give for the improvement of the credit operations of the Bank?

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