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ASSESSMENT OF CREDT MANAGEMENT PRACTICE IN

(A CASE STUDY OF AGGAR MICRO FINANCE INSTITUATION IN WLKITE TOWN)

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The Research Paper Submitted to Department of Accounting and Finance in Partial Fulfillment of the Requirement for Bachlor of Art (BA) Degree in Accounting and Finance

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Wolkite, Ethiopia

APPROVAL SHEET

This is to certify that the proposal entitled "Assessment of credit management practice in wolkite town) " has been submitted as part of the requirements for the pursuit of a Bachlor of Arts degree in accounting. This research has been conducted by student Mulugeta Tilahun under my supervision. Therefore, I recommend that the student be permitted to proceed with the undertaking of this research.

Name of Advisor	Signature	Date
Birhanu Yirga (Msc)	________________	_________

Name of Examiner	Signature	Date
___________________	________________	___________

STATEMENT OF DECLARATION

1. Student

I, Mulugeta Tilahun, hereby declare that the research Thesis entitled "Assessment of credit management practice in wolkite town" is my original work and has not been submitted for any other degree or qualification at any other institution. I affirm that all sources of information and data used in this research have been properly acknowledged and cited. I understand the importance of academic integrity and pledge to adhere to ethical standards throughout the research process.

Name: ________________________

Signature: ____________________ Date: _________________

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Abstract

My study assessed the credit management practices at aggar micro finance institution in Wolkite town and their effect on performance. The main objectives of the study were to identify the credit management practices at Aggar micro finace institution and their effect on performance. The descriptive survey method was used for the study. The sample size comprised of 12 respondents who were purposively selected in order to obtain the kind of data that was required for the study. Questionnaires were distributed in order to gather the primary data together with an interview guide.The analysis of the data revealed that the institution doesn't collect its credit on specified period, rather they mostly after the due date and also there are clients with default. Therefore, the institution is advised to create awareness to the customer, about how to use the money and the management. Based on the collected data possible solution and recommendation were suggested to improve credit management practice of Aggar micro finance institution.

CHAPTER - ONE

INTRODUCTION

1.1 Background of the study

Financial institution is a company engaged in the business of dealing with financial and monetary transactions; such as deposits, loan, investments and currency exchanges. Broadly speaking there are three major types of financial institutions :Depository institutions including banks, building societies, credit unions, trust companies and mortgage loan; contractual institutions include insurance companies and pension funds and third type of financial institution is investment institutions including investment banks, underwriters etc(Prassanna Chandra,1998)

According to Hulme, 1991 microfinance institution was first started in 1988 by professor Mohammed yenus in Bangladesh. Overtime, Microfinance has emerged as a larger movement whose object is a world in which as everyone especially the poor and socially marginality people and household have access to a wide range of affordable, high quality financial products and service including not just credit but also savings, insurance, payment services and fund transfer.

Providers of micro finance play a vital role in the economic development of many developing countries. They offer small loans in business development to low income community in developing countries (Hartugi, 2007). They have a variety of products, transfers, payment services and other pro poor products (Hogue Chisty, 2011)

Credit management practice means the total process of lending starting from inquiring potential borrowers up to recovering the amount granted. In the sense of institution sector, credit management practice is concerned with activities such as accepting application, loan appraisal, loan approval, monitoring, recovery of nonperforming loan (shekhar, 1985)

According to Hettihewa, 1997, Credit management is extremely important as granting credit is considered to be the equivalent of investing in a customer.

Credit is the trust which allows one party to provide money or resources to another party where that second party does not reimburse the first party immediately but instead promises either to repay or return those resources at a later date (Prassanna Chandra, 1998)

Assessment of credit management practice is the assessment of the total process of lending starting from inquiring potential borrowers up to recovering the amount granted in the sense of Aggar micro finance institutions.credit management practice is concerned with activities such as accepting and given out loans (Charles Mensah 1999)

Credit analysis is the first step in the process to trailer-make solution to fit the customer's needs. The assessment starts with an understanding of the customer's needs and capacities to ensure there is a good fit in terms of the financing solution. Credit assessment is most important safeguard to ensure the underling quality of the credit being granted and is considered an essential element of credit risk management (Cade, 1999).

To undertake proper mobilization of funds, financial institution practices credit management activities. Credit management involves many activities ranging from credit investigation to contract with borrowers, appraisal review and follow- up, documentation nursing, recovery and write offs, having two main functions: Those are credit sanction (Provisions) and credit follow up functions which are valuable in managing credit it risks, improves return from credit and making proper credit decision of the institution(MOFED, 2005).

Like other financial institution Agar micro finance institution manage its crediting by using the five Cs criteria such as: Character, Capacity, Capital, Condition, Collateral for selecting proper or creditworthiness of client.

1.2. Statement of the problem

According to Shekhar, 1985, Credit plays an important role in the lives of many people and in almost all industries that involve monetary investment in some form credit is mainly granted by banks and microfinance institution.

Credit management practice is the most important activities in micro finance institutions. An attending credit management policies and procedures makes it sound at the time of managing credit risk and credit decisions.(Mulat,2003) argues that if you not follow the credit management policies and procedures one cannot think of managing credit risk and at the same time credit decision will be come arbitrary subject to individual discrimination and judgment.

As previous studies, made by Mulat, 2007 and Meaza, 2009 on the credit management practice in Aggar micro finance institution in Wolkite town they did not solve the problem of credit risk that there is still credit risk or default risk available because of the inadequate loan sizes, improper monitoring, and improper client selections in Aggar micro finance institutions. And also the previous research studies coverage is different from my study because my study was cover starting from 2011 - 2015 E.C Therefore this study will be conducted and design to fill the gap.

The motivation to study credit management practice in Aggar micro finance institutions is to get answer for the following questions;

1.3, Reserach questions.

1. What are the activities practiced in credit management ofAggar micro finance institution in Wolkite town?
2. What method the institutions use to follow-up the loan?
3. What policies and procedures the institution follows to permit the loan?
4. What are the monitoring mechanisms to collect credit in the institution?

1.4 Objective of the study

1.4.1. General Objective

The main objective of this study was to assess the credit management practice of Aggar micro finance institution.

1.4.2. Specific Objectives

In order to achieve the general objectives, the study considered the following specific objectives.

- To assess the credit management practiced in the institution.
- To assess policies and procedures that the institution follows to permit loans.
- To assess the methods of the institution uses to follow up loan after providing.
- To identify the monitoring mechanisms used by the institutions to collect credits.

1.4, Scope of the study

The researcher was focus on the employee response and the top managers that work on the credit assessment of the customers and financial reporting.

The scope of this study mainly delimited to Wolkite town in Agar micro finance institutions.because of cost constraint and other banks privacy to give full information and it was also focus on the financial report and credit assessment of the institution in the view of their annual report for 5 years starting from 2011 -2015

1.5, Limitation of the study

Some respondents of the company are involuntary to give available information. And also the researcher was facing a problem of time to collect all necessary data from the employers of the company. And also we are not familiar with the experiences on the development of research solution. The other limitation of the study becomes cost expensiveness on the operation of the study because of this the study was restrict on a specific area.

1.6, Significance of the study

The study was have certain significance from the micro finance and clients in finding ways that improve the credit management system of the institution ,such as in reducing delay in repayment of loan that leads to increase the performance level of Agar micro financeni nstitution and leads to strengthen the relationship between client and the institution ,also that leads to reducing the burden of the client high interest payment because of delay in repayment of loan that results from inadequate size, lack of monitoring and improper client selection. In addition it serves as a reference for other researchers. It provide additional knowledge to credit managers in designing credit management and for planning and controlling procedures in credit activities and it helps the clients of the institution by informing necessity of paying credit according to agreements**.**

1.7, Organization of the study

My study is organized in five chapters: The first chapter discusses all about back ground of the study, statement of the problem, objective, scope, limitation, and significance of the study, the second chapter comprises related literature review, the third chapter explained the details of the research methodology, the fourth chapter discussed the results of the study, and finally conclusions and recommendations of the study were presented in the last chapter.

CHAPTER TWO

RELATED LITRATURE REVIEW

2.1 INTRODUCTOIN

2.1.1 DEFNITION OF CREDIT

The term credit comes from Latin word credo meaning; I believe and usually defined as the ability to buy with a promise to pay. Credit is contractual agreement in which borrowers receives something of value now and agree to pay the lender of some later date. When a customer purchase something using a credit card, they are buying on credit (receiving the item at that time and paying back the credit card company month by month) any time when individual finance something with a loan (such as an automobile or a house they are using credit in that situation as well and it is the borrowing capacity of individuals or companies. (Prassanna Chandra, 1998)

In other words, credit is sale goods, service and money claims in the present in exchange for a promise to in a money in the future. The debtor and creditor can agree, of course to settle their transaction in something else of value. (Prassanna Chandra, 1998)

2.1.2 Types of credit

Two basic type of consumer credit exist; closed – end credit and open- end credit closed – end credit, poll pay bank one time loans in a specified period of time and in payment of equal amounts. With open- end credit, loans are made on a continuous basis and you are billed periodical for at least peril payment.

2.1.3 Closed – End Credit

Closed end credit is used for a specific purpose and involves a specified amount mortgage loans, automobile loans, and installment loans for purchasing furniture or appliances are examples of closed end credit. An agreement or contract lists the repayment terms; the number of payment, the payment amount, and how which the credit will cost eloped end credit payment plans usually involve a written, agreement for each credit porches. A down payment or trade in may be required, with the balance to be repaid in equal weekly or monthly payments of closed end over a period of time generally, the sale holds title to the merchandise until the payment have been completed. .

The three most common types of closed end credit are instrument sales credit, installment cash credit, and single wimp-sum credit, installment sales credit is a loan that allows you to received merchandise usually high priced items such as large appliance, or further you make a down payment and usually signed contract to repay the balance plus interest & serves charges, in equal installment over specific period. (Prassanna Chandra, 1998)

2.1.4 Open- end credit

Using a credit card issued by a department store, using bank credit card (visa, master card to wake purchased at deferment stores, changing a meal at a restaurant, and using overdraft protection are examples of open- end credit. As you will see you don't apply for open-end credit to wake a single purchase, as you do with closed end credit. Rather, you can use open credit to make any purchase you wish if you do not exceed your line of credit; the maximum dollar amount of credit the lender has made a viable to you. You may have to pay interest, a periodic charge for the use of credit, or other finance charge. Some creditors a low you agree period of 20 to 25 days to pay a bill full before you incur any interest charge. (Prassanna Chandra, 1998

2.1.5 Features of credit

The following are the essential Features of credit:

Trust and confidence- Trust is the fundamental element of credit the lender will lend his money or good on the at least and confidence that the borrower or buyer will pay back the money or price in time.

Time clement- All credit transaction involves time element. Money is borrowed or goods are brought with a promise to repay the money or pay the price on some future data.

Transfer of goods and services- credit involves transfer of goods and service by the seller to the buyer on the pay- back promise of the buyer on some future date.

Willingness and ability- credit depends in a person willingness and ability to pay the borrowed money. In fact, credit of a person depends on his character, capacity and capital. It is these three C's on which a man credit depend, A person who is honest and fair in his dealings possesses the capacity of making his business and success such a person can get credit easily.

Purpose of credit- Bank and financial institutions gives large amount of credit for productive purpose rather than for con gumption purposes. (Prassanna Chandra, 1998)

2.2 Historical background of micro finance institution

Micro finance is the propulsion of broad range of financial services such as deposits, loans, payment service, money transfer and insurance products to the poor and low income households, for their micro enterprises and small businesses, to enable them to raise their income and improve their living standards. Micro finance is a form of financial development that has primarily focused on alleviating poverty through providing if at all as being about micro credit i.e. lending small amounts of money to the poor. (Mengstu bediye, 1998)

Micro finance is the process of lending money without collateral to help poor people to become entrepreneurs. It is about the provision of the usual of range of the banking services including credit and loan facilities to segment of the society with un meet demand for accessible affordable appropriately structure that offer financial service to very active poor. Micro finance institution is an organization that offers financial service to the very active poor.(Mengstu bediye, 1998)

2.3 Development of Micro Finance Institution in Ethiopia

The culture of credit and saving in semi-formal way emerged in Ethiopia during 1960s with credit and saving cooperatives though people in the country have had long history of torturing money and asset to carry out economic activities, build asset and mange unfortunate events. In the real work, many NGOs have also including saving and credit aimed at creating employment and generating income with the view to improving the lives of people affected by recurrent droughts in the country during the past two deceases. Governmental intuition like commercial and development banks have also been providing credit rural house hold for porches of agricultural inputs and tools more formal micro financing step, avoiding to the (Annual Report on the Ethiopian Economy, 1999/2000). In 1990 when an urban micro financing scheme was initiated at not national level with credit agreement signed between Ethiopian government and international Development Association (IDA). The credit scheme implemented since 1994 in 59 towns of Amhara, Tigray, Oromia, and SNNPR has dispersed up to the end of 1997, a total of 17.3 million birr, no percent contributed by the Ethiopian government and 8% covered by IDA, among more than 34,000 beneficiaries of which percent were women determined by respective boards of the Agar And metemamen micro finance institution (AMmfI, 2011p3-8)

2.4 Factors influencing the Volume of Credit

Sometimes credit expends when borrowing and lending go on briskly. At other times, credit contracts when borrowing and lending take place slowly. We discuss bellow the factor on which the volume of credit depend on country.

Boom and Recession – under boom condition when industry and trade are expanding, the demand for credit increases the creditor land more because the interest rate is rising, they also know that the money will be returned due to high rate of profit in the industry. But when there is recession the quantity of credit contracts, Business are not prepared to borrow even through interest rate is low.

Political condition – credit expands when there is political stability in the country. It encages investment which increases the demand for credit. On the other hand, political instability and in security of life and property, business and investment are discharged.

Currency conditions- The volume of credit expands or contracts depending up on the currency Condition of the country.

Credit policy of the central bank- when the central bank follows cheap credit policy, it lowers the interest rate and the demand for credit increase. On the country, a dear credit policy by rising interest rate contracts the quantity of credit in the country.

Economic development credit expands in a developing country in which new banks and financial institution are being set up such institution provide credit to tiny, smell medium and large industry, to agriculture, etc. (Jhingan, 2006, p170).

2.4.1 Significance of Credit

Modern economy is said to be a credit economy. Credit is the vital for the working of any economy. It is the oil of the wheel of trade and industry and helps in the economy prosperity of a country in the following wakes.

Economic- credit instrument economies the use of national currency. They are cheaper than coinage the metal used for other productive purpose.

Increase productivity of capital- credit increases the productivity of capital people having idle money deposit it in banks and with non – bank financial institution which is went to trade and industry for productive uses.

Convenient credit instruments are a convenient mode of national and international payments. They help intern suffering payments with little cost and without they use of actual money from one place to another quickly.

Encouraging investment- According to Keynes, credit is the payment along which production travels and that bankers provide facilities to man facture to produce to full capacity.

Increase Demand- Availability of cheap and easy credit increase the demand for goods and service in the country, this leads to increase in the production of such durable consumer goods as a motor vehicles, refrigerators, TV etc(Jhingan, 2006, p.170).

2.5 THE FIVE Cs OF CREDIT

It is most common question business owner asks their banker what are you looking for from me and my business it need to borrow".

While each lending situation a bank reviews a unique, most banks utilize some valuation of the five Cs credit when making a credit decision:

- Character
- Capacity
- Capital
- Conditions &
- Collateral

Character: banks want to put their money with clients who have the best creditable and references. The way you treat your employees and customers and the way take responsibility, your time lines in fulfilling obligation that is called character.

Capacity: what is your company's borrowing history and track recorded of repayment. How much debt you can company handle? Will you able honor the obligation and repay the debt? There are numerous financial bench marks such bas debt and liquidity ratios that banks use before advancing loan.

1. **Capital:** How well capitalized is your company? How much money has invested in the business? Banks wants to see that you have a financial commitment: that have put yourself at risk in the company.
2. **Conditions:** What are the current economic conditions and how does your company fit in? If your business is sensitive to economic down turns, the bank wants to know that you are good at managing productivity and expenses.

3. **Collateral:** While cash flow will nearly always the primary source of repayment of loan, baker look at what they call secondary source of repayment. Collateral represent assets that the company pledges as an alternative repayment source for loan. Most collateral is in the form of real estate and office or manufacturing equipment's. Your accounts receivable and inventory can also be pledge as collateral. Unless you are a business a proven repayments track record, you will at most always be required to pledge collateral (Jhingan, 2006, p. 270)

2.6 Advantage of credit

The credit system benefits both society and individuals for:

Idle goods and services are transferred from creditor to debtor and put to work increasing business and national income.

Specialization and division of labor stimulated by already flow of goods and services from creditor to debtor.

Consumptive credit broadens in industry market, increase production and so help reduce and raise the general living standard.(Prassanna Chandra, 1998, p.20)

2.7 Disadvantages of credit

Perhaps the greatest disadvantage using credit is the temptation to overspend, especially during periods of inflation it seems easy to buy today and pay tomorrow using cheaper dollars. But continual over suspending con lead to serious treble whether or not credit involves security (sum thing of value to back the loan), Failure to repay a loan may result in loss of income, valuable property, and your good recitation. It even lead to court action and bankrupts, misuse of credit can create serious long term financial problems damage to family relationship, and slowing of progress towards financial goals, (Prassannachandrapp20.4)

2.7 CREDIT TERM

Credit term involves both length of credit period and discount given. Credit period is a means by naturally expected to have their loan approved more readily than application and continued relation with a customer which a firm may be able to affect product demand hopping to increase demand by extending the credit period. Discount given involves an attempt to spend up the payment of receivable to be sure, the discount is not regarded as a means of cutting price and by previous loan and other services gives that bank information about the borrower that is not easily available to others. The cost of obtaining and verifying such information makes it impractical for little known firms to public security offering and make it economical to maintain ongoing relation with banks, (I am Pandey, 2010).

2.8 CREDIT INFORMATION

In affirm does want credit information on customers, there are a number of sources. Information sources commonly used to assess credit worthiness includes the following:

1) Financial statement: A firm can ask a customer to supply financial statements such as balance sheet and income statements, minimum standards and rules of thumb based on financial ratios.

2) Credit reports on the customer's payment history with other firms: Duties a few organizations sell information on the credit strength and credit history of business firms. The best known and largest firm of this type is Dun and Bradstreet, which provides subscribes with a credit reference book and credit reports on individual firms.

3) Banks generally provide some assistance to their business customers requiring information on the credit worthiness of other firms.

4) The customer's payment history with firm. The most obvious way to obtain information about the livelihood of a customer's not paying is to examine whether they have settle past obligations and how quickly met these obligations (Ross, Westfield, Jordan, 2011, pp64).

2.8.1 CREDIT INSTURMENTS

The credit instrument is the basic evidence in datedness most trade credit is offered account. This means that the only formal instrument of credit is invoice, which is sent with the shipment of goods and which the customer signs as evidence that the goods have been received. After wards, the firm and its customers record the exchange on their book of account.

At times the firm may require that the customer sign a promissory note, this is the basic IOV and might be used when the order is large, when there is not cash discount involved, or when the firm anticipate a problem in collections promissory note are not common, but they can eliminate possible controversies later about the existence of debt. (Ross, Westfield, Jordan, 2011, pp. 606-607)

2.8.2 CREDIT LIMIT

A credit limit is maximum amount of credit which firm will extend at a point of time. It indicates the extent of risk taken by the firm by supplying goods on credit to customer. Once the firm has taken a decision to extend credit to applicant, the amount and duration of the credit have to be decided. The decision on the magnitude of credit will, depend up on the amount of contemplated sole are the customers financial strength.

The credit limit must be reviewed periodically. If tendencies of slow paying are found, the credit con is revised downward. At times a customer may ask for the amount of credit in the excess of his limit. The firm at such times agrees to his request if the product has agrees to his request if the product a right margin or if additional sales help to the un utilized capacity of the firm , and the cost of expected deluged payment or bad debt loss than the expected incremental profit.(I am Pandey , 2010,pp613-614).

2.8.3 CREDIT POLICY

Credit policy after referred to as a standing decision made in advance to cover a prescribed set of condition.

It provides guidelines for deterging whether the extent to customers and how much credit to extend. A bank may adept either liberal or sight credit policy. Liberal credit policy involves extending credit to more risky class whose credit worthiness is not known exactly.

This policy increase profit by increasing the level of loans extended to customers but in curs high risks of bad debt losses and faces the problem liquidity. Tight credit policy involves extending credit to those who have proven credit worthiness this policy is very selective in extending credit and results a low profit but it has maximum cost and chance of bad debt losses. Thus managers should develop credit policies which make tradeoff between risks and return (Begley and Brigham, 2008).

2.8.4 CREDIT POLICY EFFECTS

In evaluating credit policy, there are five factors to consider:

Revenue effect: If the firm grants credit than there will a delay in revenue collections as some customers take advantage of the credit offered and pay later. However, the firm may be able to charge a higher price if edit grant credit and it may be able to increase the quantity sold. Total revenue may then increase.

Cost effects: Although the firm experience delayed revenue if it grants credit, it will still have to incur the cost of sales immediately. Whether the firm sales for cash or credit, it will still have to acquire or to produce the merchant descend pay frit.

The cost of debt: When firm credit, it must arrange to finance the resulting receivables. As a result of firms cost of short term borrowing is a factor in decision grant credit.

The profitability of nonpayment: If the firm grants credit some percentage of the credit buyers will not pay. This cannot happen of course, if the firm sells for cash.

The cash discount: When the firm offers a cash discount as a part of its credit terms, some customers will choose to pay early to take advantage of the discount. (Ross et.al 2010)

2.8.5 OPTIMAL CREDIT POLICY

So far we discussed how to compute net present values for as which in the credit policy. We have not discussed the optimal amount of credit or the optimal credit policy. In principle, the optimal amount of credit determined by the point of which the incremental cash flow from increased sales is exactly equal to the incremental costs of the increase in investment in accounts receivable(Ross et.at,2011) .

2.9 CREDIT ANALYSIS

Thus for we have focused on establishing credit farms once a firm decides to grant credit to its customers, it must then establish guidelines for determining who will and who will not allowed buying on credit. Credit analysis refers to the process of deciding whether to extend credit to a particular customer, it usually involve two steps; gathering relevant information and deforming credit worthiness. Credit analysis is important simply because potential losses on recordable can be substantial (Ross et al, 2011).

2.9.1 CREDIT INVESTIGATION AND ANAALYSIS

After having observed the credit information the firm will get an idea regarding the matters which should be further investigated. The factors that affect the extent of credit investigation of individual customers are**:**

- The type of customer whether new or existing

- The customers’ business line back ground and related trade risks
- The nature of the product perishable or seasonal
- Size of the customer’s order and expected future volume of business with him
- Company’s credit policies and practices (I am Pandey, 2010).

2.9.2 ANALYSIS OF CREDIT FILE

The firm should maintain a credit file for each customer. It should update with the information about the customer collected from the report of sales man, bankers and directly from the customers. The firm’s trade experience with the customer and his performance report based on financial statement submitted by him should also record in his credit file. A regular examination of credit file will reveal to the firm credit standing of the customer .Whenever the firm experience’s a change in the customers paying habit or receive a request for extended credit terms or large order on credit, his credit file should thoroughly scrutinized .(A swath Demos, 2000).

2.9.3 CREDIT EVALUATION AND SCORING

If a firm decides to grant credit to its customer than it must establish procedures for extending credit and collecting.In particular, the firm will have to deal with the following components of credit policy:

1. Terms of sale: the terms of sale establish how the firm proposes to sale its goods and services. A basic decision is whether the firm will require cash or will extend credit.

2 .Credit analysis; in granting credit a firm determines how much efforts to expend trying to distinguish between customers who will pay and customers who will not pay.

3 .Collection policies: after credit has been granted the firm has the potential problem of collecting the cash when it becomes do for which it must establish a collection policy. (Ross, Westfield Jordan 1998, pp615

2.9.4 CREDIT PERIOD

The credit period refers to the length of time customers are allowed to pay for their purchases. I t generally varies forms 15 days to 60days.When affirm does not extend any credit, the credit period would obviously be zero. If a firm allows 30 days, say, of credit , with no discount to induce early payments, its credit terms are stated as net 30 : lengthening of the credit period pushes sales up by inducing existing customers to purchase more and attractive additional customers. This is how ever: accompanied by a larger investment debtor and high incidence of bad debt loss shortening of credit period would have opposite influences: it tends to lower sales decrease investment in debtors and reduce the incidence of bad debt loss, (Prassannachandrapp20.4).

2.9.5 CREDIT RISK

Credit risk also arise from contingent liabilities and balance sheet exposure banks assume such as derivative securities services to assist customers in copying with the greater volatility that exists in today's financial markets.

Credit risk is managed by operational limits on credit lines, loan provisioning in portfolios diversification and collateralization, loan securitization, separately, capitalized derivatives vehicles and credit derivatives.

The use of these methods should lead to greater efficiency in portfolios management, more refined pricing and to better allocations of capital. J.P Morgan's credit matrix model for evaluating credit risk enable a bank to consolidate credit risk across its entire organization and provides statement of value at risk (VAR) due to credit caused by upgrades down grades and default... Internal data on loan defaults and recovery aren't shared by banks (H.R Maharaja, p168-169).

1.10 SCREENING AND MONITERING

As Walter Winston stated systematic information is a common problem in the loan market because leaders have less information about the investment opportunities and activities of borrowers do.

The business of banking is the production of information banks engaged in to the information – producing activity, screening and monitoring. Credit risk form the good ones, so that loans are profitable to perspective borrowers the principle of credit risk management requires effective screaming and information collection. Monitoring and enforcement of restrictive, covenant once a love has been made the borrower has an intensive to engage in risky activities that make it less likely that the will be repaid off. To avoid this moral hazard banks should try restrict borrowers to engaging in risky activities to see wither they are complying with the restrictive covenants and by enforcing the covenants if they are not, leader con make sure that borrows are not taking on risks at their expense. The accedes of banks to engage in screeching and monitoring explains why they are seed too much money on auditing and information collection activities (Fredric misk kin pp. 246, 1997)

2.11 COLLECTION POLICY AND PROCEDURES

A collection policy needed because not all customers pay the firms bills in time; some customers are slow payers while some are non-payers. The collection effort should, therefore, aim at accelerating collections from slow payers deducting bad debt losses. A collection policy should ensure and promoted collection needed for fast over working capital, keeping collection costs and bad debts with in limit and maintaining collection efficiency. Regulatory in collections keeps debtors alert and they tend to pay dues promptly.

The collection policy should lay down clear-cut collection procedures for past dues or delinquent accounts should also establish in unambiguous terms the slow paying customers are needed to be handle very tact fully, some than may be permanent customers . The collection procedures against them should initiated only after have overcome their financial difficulties and do not intend to pay promptly the firm should decide about offering cash discount for prompt payment . In practice companies may take certain per caution vies-a-vise collections, some companies require their customer to give per signed chigoes' billing discounting is another practice in India. Unfortunately, it is not very popular with a number of companies some companies provide for peal rate of interests for debtors who fails to in time (I am Pandey, 2010)

2.11.1 Methods used to follow-up the loan

Follow- up starts after the loan disbursement has been effective. There should no relaxation in the follow-up of loans. Credit follow-up is one of the main tasks of manager and loan officers as well as the credit and risk management department. Nevertheless, it is also the most especial source of potentials. In many ways the most difficult function of lending is the collection of disbursed loans. If any loan falls arrears of is overdue (loans and advances which are not repaid in full at the agreed period as per contract) in spite of regular follow up the lending branch shall contact borrowers by telephone and visit them.

CHAPTER-THREE

RESEARCH METHODOLOGY AND DESIGN

This refers to the variables over which the data for the study was collected and the method that uses in the data collection, analysis and interpretations.

3.1. Research design

Research design deals with a logical problem and not a logistical problem ,before a builder or architect can develop a work plan or order materials they must first establish the type of building required, it uses and the heads of the occupant(Yin,1989)

Research design refers to the overall strategy or blueprint that a researcher adopts to conduct a study. A well-structured research design helps to minimize bias, enhance the reliability and validity of results, and provide a clear framework for interpreting findings.

Descriptive research design is a study designed to depict the participants in an accurate way. And also descriptive research design tries to discover answers to the questions who, what, when, where and sometimes how.

The research desigln was use or applies descriptive analysis method on the assessment of credit management practice on microfinance institution in case of Agar micro finance institution in Wolkite town.

3.2. Type and Source of data collection

Qualitative type of data is a data that emphasizes on how theories were generated and it allows the researcher to get the facts and not abstract about the aim of dissertation (Bryman and Bell, 2007). Quantitative type of data is an inquiry in to a social problem; explain phenomena by gathering numerical data that are analyzed using mathematically based methods (Aliaga and Gunderson, 2002).

The researcher used both qualitative and quantitative type of data with the aim of collecting sufficient data and accurate information.

Primary source are original sources from which the researcher directly collects data that have not been previously collected (prassanna Chandra, 1988). In my case of study we used observation which will give us the knowledge and awareness of the institution. The other method is interview which was constructed with structured and unstructured questioning. And questionnaire was formulated to get the relevant information. In this case we used open-end and close-end questionnaire.

Secondary source are sources containing data which have been collected and that are already available (prassanna Chandra, 1988).The secondary data was collected from credit manual of the institution.

The researcher used source of data primary source of data to collect sufficient data and information.

3.3, Method of data collection

For the purpose of my research and in order to achieve the objectives ,the researchers used both primary and secondary data .The primary data was collected from observation ,structured and unstructured interview and open and close ended questionnaires and the secondary data was being collected from the credit manual and operating report of the institution.

3.4 Target population

The target group of this study was mainly the beneficiaries of the Aggar micro finance institution in Wolkite town and the employees and clients who are directly involved in providing the service.

3.5, Sample size

Those who have sufficient knowledge familiarity with the subject matter of 12 respondents was selected for sampl And the sampling techniques that were implemented for the study is non probability judgmental sampling. This technique of sampling is selected because it enables to get relevant, accurate and sufficient information.

3.6, Data Processing and Analyzing

Data processing is generally activities which involve editing, coding and classifying data to make it suitable for future analysis. Which will help us analysis and transform the relevant data that has been collected and processed, it change the information in any manner deductible by an observer (Data processing and information technology 10th edition)

The collected data was analyzed by using descriptive analysis method. Descriptive analysis is used to describe the basic future of the data in the study to provide simple summaries about the sample and the measure.

CHAPTER-4

DATA ANALYSIS AND INTERPRETATION

This chapter deals with the presentation, analysis and interpretation of data by using primary source which is collected in the form of questionnaire and secondary data from the office documents. Therefore, the data discussed in the subsequent sections of this report is a summarized response of 12 respondents and secondary data from the institution documents.

12 questionnaires were prepared and distributed to Aggar micro finance institution share company staffs. All the 12 questionnaires were filled out by the staffs members who were directly involved in the process of related tasks.

4.1 Analysis and presentation of primary data

This data on the characteristics of the respondents collected to have clear picture about persons involved in the study. The following table deals with these issues

Table 4.1 Respondents personal information

No	Item	Alternatives	Frequency	Percentage
1		Male	8	66.67%
	Sex	Female	4	33.33%
		Total	12	100%
2	Age	20-25	0	
		26-30	1	8.33%
		31-35	7	58.33%
		>35	4	33.33%
		Total	12	100%
3	Education	12th completed	_	_
		Deploma	0	_
		BA Degree	7	58.33%
		Others	5	41.67%
		Total	12	100%
4	Position	Manager	1	8.33%
		Vice manger	1	8.33%
		Accountants	5	41.67%
		Others	5	41.67
		Total	12	100%

Source: Researcher's Survey result from Questionnaire 2025

According to the above table the personal data regarding sex of the employee 8(66.67%) of the respondents are males and 4(33.33%) of them are females. Concerning their age item of the above table show that 0(0%) of employee were between the range of 20-25years, 1(8.33%) were found between 26-30 years, 4(33.33%) of them above 35, 7(58.33%) were found between 31-35 years From this the researcher can concluded the total respondents 8 found to be male and the rest 4 were female. The number of male is greater than the number of female. This shows that the participation of female employee is low. And the educational level of employees is an important factor with regard to making business decisions. Education improves the skill, capacity, communication and access to development endeavors.

As it can be reviewed from table above, that 7(58.33%) of the respondents are BA degree holders and 41.67 percent of the respondents are other holders. This denotes that the majority of the institution employees working in the loan are well skilled. This enables the institution to perform most and become competitive in the industry.manager (8.33%) controling a company and vice manager (8.33), accountants (41.67%) others (41.67%) perform the activities

No	Item	**Frequency**	Ppercentage
1	Lower level communities	5	41.32%
2.	Medium level communities	4	32.21%
3.	Small level communities	3	26.21%
		12	**100**

What is the objective of credit?

All 100% (12) of the respondent replied that the objective of credit is to maximizing the economic value of the social economy, supporting lower level, medium and small business communities in order to get income, decreasing unemployment rate and increasing job creativity, improving living standard of the people and ensuring fair distribution of income among the society. From this the researcher can analyzed that granting of loan or credit is important to the society in maximizing of social economy, decreasing unemployment and ensuring fair distribution of wealth among the people.

Table 4.2 mechanism of the institution to grant credit

No	Item	Alternative	Frequency	Percentage
	How do you express the credit mechanism of the institution to grant credit?	Excellent	1	8.33%
		very good	2	16.67%
		Good	4	33.33%
		Poor	5	41.67%
		Total	12	100 %

Source: Researcher's Survey result from Questionnaire 2025

From the above information 1(8.33%) of the respondents replied that the institutions mechanism of granting credit was excellent, 2(16.67%) of them believed that the mechanism of granting credit was very good. 4(33.33%) of the respondents said that it was good. 5(41.67%) of the respondents said that it was poor. From this the researcher can understand that credit mechanism in granting credit was poor.

Table 4.3 problem of the institution in granting credit

No	Item	Alternative	Frequency	Percentage
	Is there any problem in granting credit in the institution?	Yes	7	58.33%
		No	5	41.67%
	Total		12	100%

Source: Researcher's Survey result from Questionnaire 2025

As indicated in the above table, 7(58.33 %) of the sample respondents replied that there was a problem in granting of credit in the institution and 5(41.67%) of the sample respondents replied that there is no a problem in granting of credit in the institution. According this data the researcher can sum up the institution has a problem in granting the credit

No	Item	Frequency of response	
		No	%
1. 2.	Manual system uses Computerized uses	7 5	84% 16%
	Total	12	**100%**

If your answer for question number 3 is yes what are the problems?

All 12(100%) of the sample respondents replied that the main problem in the institution is still now the institution is using manual system even though currently it introduces computerized system in little manner. Because of this financial services takes or consume much times. The researcher can concluded the institution is still now useing manual system.

Table 4.4 credit collection

No	Item	Alternative	Frequency	Percentage
	Does the institution collect the credit within the credit time?	Yes	3	25%
		No	9	75%
	Total		12	100 %

Source: Researcher's Survey result from Questionnaire 2025

From the table above 3(25%) of the respondent replied that the institution does collect the credit within the credit time and 9(75%) of the respondent replied that the institution does not collect the credit within the credit time. From this the researcher concluded that the institution does not collect the credit within credit time.

Table 4.5 credit collection effort of the institution

No	Item	Alternative	Frequency	Percentage
	How do you describe the collection effort after granting loan?	High	3	25%
		Medium	4	33.33%
		Poor	5	41.67
		None	-	-
			12	100 %

Source: Researcher's Survey result from Questionnaire 2025

From the above table, information 3(25%) of the respondents replied that the collection efforts after granting loan was high, 4(33.33%) of them were said that the collection effort after granting loan was medium and 5(41.67%) of the respondents expressed that the collection after granting loan was poor. The researcher concluded from majority's point of view the institution is poor in collection of loan after granting and this creates problem for the institution.

No	Item	Frequency of response	
		No	**%**
1.	Lower level community - high level Youth cmmunity - high level Farmers community- medium level	7 5	53.67% 46.33%
		12	**100%**
2.	Small enterprise community -medium level all other society low level	8 4	40% 60%
	Total	12	**100**

To whom you provide credit service?

As all 12(100%) of the sample respondent said that this organization gives financial services to females, to lower level community, youth, farmers, small enterprise and to all society who fulfill the criteria.

Why your organization selects this group?

As the total sample respondent stated that there were several reasons for selecting of these selected groups. As their explanation this organization select these groups because it's goal is reducing poverty of females and the whole society. And also select these groups to help them increase their income.

Table 4.6 attitude of the society towards the institution

No	Item	Alternative	Frequency	Percentage
	What is the attitude of the society towards the institution?	Positive	7	58.33%
		Negative	2	16.67%
		Both	3	25%
		No effect	-	-
	Total		12	100%

Source: Researcher's Survey result from Questionnaire 2025

As the table indicates that 7(58.33%) of the respondents describe that the society have a positive attitude towards the institution, 2(16.67%) of the respondents describe that the society have a negative attitude towards the institution and the remaining 3(25%) of the respondents replied that the society have both positive and negative attitude towards the institution. The researcher can analyze that the society have a positive attitude towards the institution.

Table 4.7 supervision and follow up of the institution

No	Item	Alternative	Frequency	Percentage
	Does the institution conducted supervision and follow up to review the operation of its customers periodically?	Yes	4	66.67%
		No	8	33.33%
	Total		12	100%

Source: Researcher's Survey result from Questionnaire 2025

From the above table indicate that 4(33.33%) of the sample respondents justified that the institution was conducted supervision and follow up periodically and 8(66.67%) of them replied that the institution does not conducted the supervision and follow up periodically after granting loan to review of its customers operation and the interview made with the manager indicate that the institution does not conduct supervision and follow up the operation of the clients on a regular base. From this the researcher can analyzed that from the majority point of view the institution does not conduct supervision and follow up to review its customers operation periodically.

Table 4.8 credit management policy of the institution

No	Item	Alternative	Frequency	Percentage
	How do you describe the credit management policy in your organization	Good	4	33.33%
		Medium	8	66.67%
		Low	-	-
		None	-	-
	Total		12	100%

Source: Researcher's Survey result from Questionnaire 2025

From the above table 8(66.67%) of the respondents said that there is a medium credit management policy in the organization, 4(33.33%) of them replied that there is a good credit management policy in their organization. From this point of view the researcher have understand that there is a medium credit management policy in the organization. And it needs higher priority from the management to improve the credit management policy.

Table 4.9 Evaluation of client's borrowing history

No	Item	Alternative	Frequency	Percentage
	Does the institution evaluate clients borrowing history before granting credit?	Yes	9	75%
		No	3	25%
	Total		12	100%

Source: Researcher's Survey result from Questionnaires 2025

As indicated in table above respondents were asked whether the bank checks the borrower's history before granting loans or not. With this regard, 9(75%) of the respondents replied yes on the issue while 3(25%) of employees replied No that the institution does not checks the history of a borrower and the interview made with the manager indicate that the institution evaluate clients borrowing history. This denotes the institution checks borrowers' history before granting loan.

Table 4.10 credit management procedure

No	Item	Alternative	Frequency	Percentage
	Does your organization uses procedures for granting credit ?	Yes	12	100%
		No	-	-
	Total		12	100%

Source: Researcher's Survey result from Questionnaire 2025

From the above table all 12(100%) of the respondent justified that the institution uses procedures for credit management system, this denote that the institution uses a procedure for granting credit in order to make the institution profitable and stable.

What are the selection criteria for credit client?

All 12(100%) of the respondents stated that the selection criteria for the client are: Character, Capacity, Capital, Conditions ,and Collateral and also age greater than 18 and identity card, those are the selection criteria the institution uses in selecting credit client.

Table 4.11 the maximum and minimum limit of cash allowed

No	Item	Minimum cash	Frequency	Percentage
	How much cash given for one client?	500	12	100%
		Total	12	100%
		Maximum cash	Frequency	Percentage
		20,000(this may differ based on the nature of business)	12	100%
		Total	12	100%

Source: Researcher's Survey result from Questionnaire 2025

As the above table indicates that 12(100%) of the respondents justified that the minimum cash given for the client was birr 500 and the maximum cash given for one client was 2000,000 but the maximum cash balance that allowed for client is differ based on the nature of business but it also reach to 1% of capital. The researcher can concluded that the cash given for the client is differ based on the nature of business.

Why customers delay in retuning their loan?

All 12(100%) of the sample respondent stated that there are some reason for delay in returning of their loan those are: fluctuation of market or market seasons, drought, death, faller of selection of right credit client, political and economic crises, and business loss(this most of time the debtors are used for their personal or self consumption).

Table 4.12 procedures to permit loan

No	Item	Alternative	Frequency	Percentage
	Do all the customers fulfill the institutions procedures to permit loan?	Highly fulfill	7	58.33%
		Fulfill	3	25%
		Partial fulfill	2	16.67%
		Not fulfill	-	-
	Total		12	100%

Source: Researcher's Survey result from Questionnaire 2025

As the table indicates that 7(58.33%) of the respondents show that the customer highly fulfill all the procedure while as 3(25%) of respondent said customers fulfill the procedures and 2(16.67%) of respondents said customers partial fulfill the procedures. and the interviews made with the manager indicate that the institution customers highly fulfill all the procedures to permit loan. The researcher analyzed that the customers of the institution highly fulfill the institutions procedure to permit loan.

What are the methods to follow-up the loan?

According to the sample respondents the methods to follow-up in the loan are If any loan falls arrears of is overdue (loans and advances which are not repaid in full at the agreed period as per contract) in spite of regular follow up the lending branch shall contact borrowers by telephone and visit them.

Table 4.13 monitoring mechanism

No	Item	Alternative	Frequency	Percentage
	Are the institutions monitoring mechanism effective?	Yes	-	-
		No	12	100%
	Total		12	100%

Source: Researcher's Survey result from Questionnaire 2025

As the table indicates that the entire respondent replied the institution monitoring mechanism are not effective. But as the interview made with the manager indicate that the monitoring mechanism of the institution is effective.

4.2 Analysis and presentation of secondary data

Table 4.14 Non performing loan (%)

Year	2012	2013E.C	2014E.C	2015E.C
Nonperforming loan (%)	10.14%	8.95%	9.3%	9%

Source: secondary data

A non-performing loan is a loan granted by the institution on which interest and principal repayments are not paid timely. From the table above, 2012followed by 2014 reported the highest non-performing loans. Non-performing loans for 2013 was the least and followed by 2015 reported the least non performing loan. The year 2013 had the best performance in terms of non-performing loans but in 2012 nonperforming loans shows increase by 1.19 percent from 2013.

Table 4.15 default rate (%)

Year	2012 E.C	2013 E. C	2014 E.C	2015 E.C
Default rate (%)	0.5%	0.3%	0.4%	0.2%

Source: secondary data

From the table above, the default rate was increased from 2015 to 2014 and then decreased in 2013 and then again increased in 2012 The year 2015 had the best performance in terms of default rate followed by 2013 but default rate shows increase by 0.2 percent in 2012 from the point of 2013. The average default rate of the four years (2012 E C. -2015E.C is 0.35% this shows Dedebit credit and saving institution default rate increases above average rate in 2012 E.C.

CHAPTER FIVE

MAJOR FINDINGS CONCLUSIONS AND RECOMMEDATIONS

In this chapter, conclusion of the research findings that has been discussed and analyzed in detail in the previous chapters is briefly presented. In addition, general conclusions that are highly related with the research objective of this paper are offered. Furthermore, possible recommendations based on the findings are made.

5.1 Major Finding

- The number of males is greater than the number of females. This shows that the participation of female employees is low.
- Since the loan amount is small, Aggar micro finance instituting lending amount doesn't invite business persons who want to engage themselves in better business activities than retailing, tailoring and so on.
- Aggar institution default rate is increasing.
- The institution doesn't mostly collect its credits on the specified time period; rather it mostly collects after the due date this is because of market fluctuations, improper client selection, inadequate loan taken, economic crisis, political issue, and business loss (specially using the money for self consumption).
- According to employee loans is not timely repaid.
- According to employee most of the customers fulfill the criterion required to take loan.
- The objective of the institution in granting credit is maximizing the economic value of the social economy, supporting lower level, medium and small business communities in order to get income, decreasing unemployment rate, increasing job creativity, improving living standard of the people and ensuring fair distribution of income among the society.
- Still now the institution is using manual system of recording transactions even though it has many customers and economic events. This headed the institution not to provide flexible and quick services to its customers.
- As it can be seen from the analysis, the loan collection effort of loans after granting credit back at maturity by the institution has been poor.
- As the researcher has seen from the study, the institution does not conduct the supervision and follow up periodically after granting loan to review its customers operation.

- ❖ The institution checks the borrower history. The institution assesses customer ability to meet obligations. The credit granting process creates accountability. The institution is not in a position to monitor or visit the clients business on regular basis after disbursement that creates a huge amount of non-performing loan and According to respondents Credit management policy in the institution is good

5.2. Conclusion

As it has been pointed out in the findings, the institution has different problems. These problems undoubtedly will have negative impact on its performance.

- ❖ The overall credit management practice of the Aggar needs the attention of the management. The main problem in Aggar institution is not lack of clear policy and procedure rather a problem in the implementation of the existing policy in proper manner. The finding of the study also assures existence of poor credit management including improper follow-up.
- ❖ Since the loan amount is small, the lending amount of the institution doesn't invite business persons who want to engage themselves in better business activities than retailing, tailoring and soon.
- ❖ Generally microfinance activities have significant importance in the economy of developing countries. The sector contributes a lot by minimizing un employment by providing jobs opportunities for those who are actively seeking jobs. Therefore, even though the institution has problems unless otherwise it strengthens its follow up and supervision on the activities of the customers rather than relying on court procedures.

5.3 Recommendations

Based on the in-depth examination and subsequent findings from the study, the following recommendations are forwarded; in the hope that they would help in order to curb the major problems identified in the study and facilitate the overall credit related activities.

- ❖ The institution should formulate an appraisal process or procedures for loan granting that would encompass matters with basic identification of credit worthy customers, comprehensive credit analysis and authentic sanctioning process. The appraisal process should also capture consideration of basic 5cs, including capital adequacy, capacity of the applicant, value of the collateral (fair estimation), repayment history (character) and the overall business conditions.

The institution should also make use of approved and certified feasibility report of the proposed project which was suggested by appropriate technical professionals before financing. Frequent contact or business visit shall be conducted to minimize loan loss since it helps the bank to advise the customers besides reduces diversion of the loan

- Even if the credit is not collected with the specified period, the institution must be ready to make change like; Appreciating customer, which pay on time, by giving them a discount and having strict follow up for those customers, which do not pay on time at the same time the institution should train and create awareness on its customers about how to use and manage the money they take.
- If the institution starts lending above 2,000,000 birr for those whose business activities are attractive and profitable, it can increase its customer as well as its profit.
- The number of females was less than the number of males, relating to this the researcher wants to recommend the company to encourage female participation.

The company have large numbers of customers, but the institution still used manual system, so the company cannot provide flexible service to its customer, the institution should have introduce computerized system

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APPENDIX A: QUESTIONNAIRE

WOLKITE UNVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING AND FINANCE

Dear respondents

The purpose of this questionnaire is to collect relevant data on the title of assessment of credit management practice in Aggar micro finance institution Wolkite Town for the requirement to fulfill BA degree in accounting and finance. All information gathered from this questionnaire used only for academic purpose. Please feel free to provide your valuable response that will make this research successfully.

Thank you for your willingness to response!!

Instruction

There is no need to write your name

Please put a tick on appropriate blank

Personal data

Sex : Male ☐ Female ☐

Age: 20-25 ☐ 26-30 ☐ 31-35 ☐ above 35 ☐

Education level 12th completed ☐ Diploma ☐ BA degree ☐ others ☐

Position manager ☐ vice manager ☐ accountants ☐ others ☐

Topic related to educated respondents

1, What is the objective of credit?

2, How do you express the credit mechanism of the institution to grant credit?

Excellent ☐ Very good ☐ Good ☐ Poor ☐

3. Is there any problem in granting credit in the institution?

Yes ☐ No ☐

4, If your answer for question no 3 is yes what are the problems?

____

____

____

5, Does the institution collect the credit within the credit time?

Yes ☐ No ☐

6, How do you describe the collection effort after granting loan?

High ☐ Medium ☐ poor ☐ none ☐

7, To whom you provide credit service?

8, Why your organization selected this group?

____

9, What is the attitude of the customers towards the institution?

Positive ☐ Negative ☐

10, Does the institution conducted supervision and follow up to review the operation of its customers?

Yes ☐ No ☐

11, How do you describe the credit management policy in your organization

A High B,Medium C,Low D, None

12, Does the institution evaluate client before grant credit?

Yes ☐ No ☐

13,Does your organization uses procedure for granting credit ?

Yes ☐ No ☐

14, What are the selection criteria for credit client?

15, How much cash given for one client?

Minimum ---------------- maximum-----------------------

16, What is your institutions credit interest rate?

17, Why customers delay in returning their loan?

18,Do all the customers fulfill the institutions procedures to get loan?

A, Highly fulfill B,fulfill C,partial fulfill D,not fulfill

19, What are the methods to follow up in the credit management?

20, are the institutions monitoring mechanism effective?

Yes ☐ NO ☐

21, If your answer for number 20 is yes, what are the monitoring mechanisms used by the institution?

22, Additional information that you can provide