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INFLUENCE OF CREDIT MANAGEMENT ON FINANCIAL PERFORMANCE OF BANKING INSTITUTIONS IN RWANDA: A CASE STUDY OF ECOBANK

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Abstract: **The effective management of credit is a critical component of comprehensive credit management which is essential for long-term success of a banking institution. Poor credit management continues to be a dominant cause of bank failures and banking crisis worldwide. General objective of this study examined the influence of credit management on financial performance of banking institutions in Rwanda, ECOBANK as case study. This research was adopted descriptive research design where descriptive statistics was applied to analyze data from questionnaires and financial report. In line with this, the target population is 21 employees of ECOBANK working in finance, auditors department and Top management. In this study, data were collected through self administered questionnaires and documentation technique. Credit management influencing the financial performance has an overall correlation with ECOBANKS financial performance. 0.746 is significant at 5%. These indicate good fit of the regression equation used. Analysis of Variance shows that f-calculated is greater that f – critical that is 5.221>0.00. This implies that the regression equation was well specified and therefore the co-efficient of the regression shows that there is a strong relationship between two variables. The analysis of variance of the predictors of the model is significance at 0.000. The results indicate that control the volatile of interest rate is the most significant in explaining the financial performance with a significance at 0.000 which is less that a p-value of 0.05 and beta value is 0.836. This therefore means that control the volatile of interest rate would be at 0.824 when business information and technology held at a zero constants. The results had shown that credit management on financial performance of banking institutions in Rwanda. The study recommends that commercial banks in Rwanda should put stringent measure when conducting loan appraisal process and should adhere to all the lending requirements stipulated in order to enhance financial performance.**

Keywords: **credit management, banking institution, financial performance, ECOBANK.**

1. INTRODUCTION

1.1 BACKGROUND OF THE STUDY:

Banks today are the largest financial institutions around the world, with branches and subsidiaries throughout the world. These banks offer different products and services to public, and because of their high liquidity, these intermediary operations are quite risky. Therefore the banks are faced with diverse risks in the course of carrying out their operations Myers and Brealey (2013).

Banks play a major role in all the economic and financial activities in modern society. One of the core activities of the banking industry worldwide and, in particular Rwanda, is the creation of credit to deserving and deficit units of the economy. Credit creation is the main income generating activity for the banks but this activity involves huge risks to both the lender and the borrower. Banks are subjected to a wide array of risks in the course of their operations and generally banking risks fall into three categories: financial, operational, and environmental risks (Greuning & Bratanovic, 2009).

The banking industry and specifically the commercial banks are sensitized on the need to have formal and documented credit management frameworks. Notably, the more complex a credit type is the more specialized, concentrated and controlled its management must be (Seppala, 2010). Financial institutions are exposed to a variety of credit management among them; interest rate risk, foreign exchange risk, political risk, market risk, liquidity risk, operational risk and credit risk. In some instances, commercial banks and other financial institutions have approved decisions that are not vetted; there have been cases of loan defaults and nonperforming loans, massive extension of credit and directed lending. The risk focused examination process has been adopted to direct the inspection process to the more risk areas of both operations and business. Skills in risk-focused supervision are continually being developed by exposing examiners to relevant training. By adopting this approach, the banking industry, and specifically the commercial banks are sensitized on the need to have formal and documented credit management frameworks. Notably, the more complex a risk type is, the more specialized, concentrated and controlled its management must be (Seppala, & Ramos, 2010).

Credit management is the possibility that the actual return on an investment or loan extended will deviate from that, which was expected (Conford, 2009). The strategies of credit management include, limited institutional capacity, appropriate credit policies, control the volatile interest rates, good management, appropriate laws, control capital and liquidity levels, loan underwriting, credit assessment, lending practices and good supervision by the central bank.

Commercial banks employed different credit management policies majorly determined by; ownership of the banks (privately owned, foreign owned, government influenced and locally owned), credit policies of banks, credit scoring systems, banks regulatory environment and the caliber of management of the banks (Nworji, Olagunju & Adeyanju, 2011). Banks may however have the best credit management policies but might not necessarily record high profits. In addition, although there are industry standards on what is a good credit policy and what is not and further banks have different characteristics. The market may thus be seen to regard an individual banks' poor performance more lenient when the entire banking sector has been hit by an adverse shock such as a financial crisis. Banks may be forced to adjust their credit policy in line with other banks in the market where a herding behavior is practiced by banks (Altman, 2008). Looking at the emphasis that is laid on credit management by commercial banks the level of contribution of this factor to profits has not been analyzed. Petersen & Rajan (2015) notes that expanding lending in the short-term boosts earnings, thus the banks have an incentive to ease their credit standards in times of rapid credit growth, and likewise to tighten standards when credit growth is slowing.

1.2 STATEMENT OF THE PROBLEM:

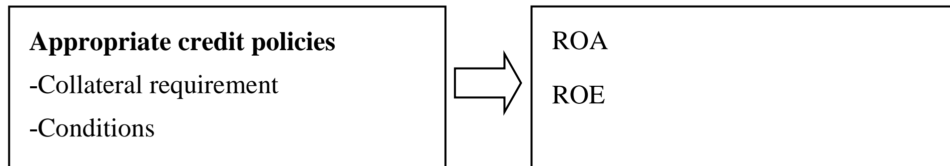
Deposit money banks (DMBs) create loans from deposits from customers and these loans are major income generating source for majority of the banks. However this intermediation function of deposit money banks is associated with enormous risks to both the banks and the deficit units. Banks are now working so hard to attract the massive number of people who are not banking with them. The future of banking will undoubtedly rest on credit management dynamics. Only those banks that have efficient credit management system will survive in the market in the long run (Bessis, 2012).The effective management of credit is a critical component of comprehensive credit management which is essential for long-term success of a banking institution. Poor credit management continue to be a dominant cause of bank failures and banking crisis worldwide (Mwega, 2009). The extents to which banks manage their credit risk have an impact on their entire financial performance or survival. Oretha (2010) studied the relationship between credit management practices and financial performance of commercial banks in Liberia and found out that market fundamentals and institutional factors such as lack of capacity for credit risk managers which results in the use of consultants by banks in formulating credit risk policies influence financial performance. The study concludes that variations in the credit policies are attributable to bank efforts to maintain threatened profit margins.

In Rwanda, commercial banks play an important role in mobilizing financial resources for investment by extending credit to various businesses and investors. Lending represents the heart of the banking industry and loans and advances are the dominant assets as they generate the largest share of operating income. Loans however expose the banks to the greatest level of risk. ECOBANK is still facing the problem of poor credit management to facility the financial performance which was portrayed in the high levels of non-performing loans. Looking at the emphasis that is laid on credit management by commercial banks in the recent time, the level of contribution of this factor to financial performance has not been analyzed which called for this study. Researcher has therefore turned to the study of credit management, which offers natural experiments for the betterment performance assessment of commercial banks in Rwanda. The broad objective of this paper is to examine the relationship between credit management and financial performance of banking institutions in Rwanda.

1.3 SPECIFIC OBJECTIVES:

To determine the influence of appropriate credit policies on financial performance of ECOBANK.

2. CONCEPTUAL FRAMEWORK



2.1 RESEARCH DESIGN:

This research was adopted descriptive research design where descriptive statistics was applied to analyze data from questionnaires and financial report.

2.2 TARGET POPULATION, SAMPLE SIZE AND SAMPLING TECHNIQUES:

In line with this study, the target population is 21 employees of ECOBANK working in finance, auditors department and Top management.

Robert and Groves (2007) stated that in a case where a study total population is 100 or less, the researcher can as well go ahead to use the whole study population size as the study sample size. Therefore, this study was used the total population of 21 as the sample size. The researcher was used both universal and purposive sampling.

3. RESEARCH FINDINGS AND DISCUSSIONS

Table 1: The influence of appropriate credit policies to the financial performance

Statements	SA	A	UN	D	SD
1. The bank has appropriate credit policies that can influence the financial performance.	(89.6%)	(10.4%)	-	-	-
2. The bank policies related to credit management is clear.	(59.3%)	(40.7%)	-	-	-
3. The credit policies are applicable for all bank branches.	(53.0%)	(47.0%)	-	-	-
4 Most of time Ecobank renew its credit policies which can influence the bank financial performance.	(93.5%)	(6.5%)	-	-	-

Source: Primary data, 2018

A credit policy is to maximize the value of a firm. An optimum credit policy is achieved through proper adjustment of credit standards, credit terms and collection efforts. These are the controllable decision variables that should be considered in the extension of credit to optimize investment in accounts receivable. Credit policy is a guide to successful credit administration and benefits must be weighed against the cost to ensure the benefits are worth the effort of administering the credit. Benefits like increase in market share, retention of existing customers, acquisition of new ones, must be weighed against costs like selling and production costs, administration costs incurred during assessment, supervision and collection of credit and bad debts losses.

The above Table shows the perception of the respondents on how an appropriate credit policy influences the financial performance of ECOBANK. 89.6% of the respondents are strong appreciated the bank has appropriate credit policies that can influence the financial performance. The respondents said that the bank policies related to credit management is management is clear for every customer of ECOBANK, 59.3% of respondents are strongly appreciated while 40.7 are appreciated too. Most of time ECOBANK renew its credit policies which can influence the bank financial performance.

A credit policy is the blue print used by microfinance or rather a lending institution in making its decision to extend credit to a customer. A credit policy helps to avoid extending credit to customers who are unable to pay their accounts. Credit policy for some larger businesses can be quite formal; involving specific documented guide lines, credit checks and

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customer credit applications, the policy for small businesses tends to be quite informal and lacks the items found in the formal credit policy of larger businesses. Many small business owners rely on their business instinct as their credit policy (Blair, 2002). Credit policy has direct effects on the cash flow of any business. Hence, a credit policy that is too strict will turn away potential customers, reduce sales and finally lead to a decrease in the amount of cash inflows to the business. On the other hand, a credit policy that is too liberal will attract slow paying (even non-paying) customers, increase in the business average collection period for accounts receivables, and eventually lead to cash inflow problems. A good credit policy should help management to attract and retain customers, without having negative impact on cash flow.

3.1 Regression Analysis:

Table 2: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.437[a]	.746	.626	251
Predictors: (Constant), Appropriate credit policies.				

Table 2 presents the coefficients of model fitness on how credit management influencing the financial performance of ECOBANKS explained by Appropriate credit policies. Appropriate credit policies have an overall correlation with ECOBANKS financial performance. 0.746 is significant at 5%. These indicate good fit of the regression equation used.

The rule of Thumb said that, usually an R square of more than 50% is considered as better. This study proves the rule of Thumb the R^2 is (0.762). In this study the rule of thumb is that, usually an R square of more than 50% is considered as better.

Table 3: ANOVA[b]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	24.612	3	6.401	5.221	.000[a]
	Residual	.742	8	.010		
	Total	32.355	11			
a.	Predictors: (Constant), Appropriate credit policies					
b.	Dependent Variable: Financial performance.					

Table 3 shows the overall significance of the regression estimation model. It indicates that the model is significant in explaining the relationship between credit management and financial performance at 5% level of significance. Analysis of Variance shows that f-calculated is greater that f – critical that is 5.221>0.00. This implies that the regression equation was well specified and therefore the co-efficient of the regression shows that there is a strong relationship between two variables**.** The analysis of variance of the predictors of the model is significance at 0.000.

Table 4: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.114	.081		1.728	.000
	Appropriate credit policies	**.**612	.031	.833	22.050	.000
a. Dependent Variable: Financial performance						

From Table 4, the regression model therefore becomes:

$Y=0.114+0.612+ \varepsilon$

On Table 4, the regression coefficients of the predictors (credit management) are presented. Results indicate that control the volatile of interest rate is the most significant in explaining the financial performance with a significance at 0.000 which is less that a p-value of 0.05 and beta value is 0.612. This therefore means that appropriate credit policies would be at 0.612 when other sub variables held at a zero constants.

Appropriate credit policies is positively related to the financial performance of ECOBANK and therefore a unit increase of appropriate credit policies would lead to an increase in the financial performance of ECOBANK. However, this is significant at 5% level of confidence.

4. CONCLUSIONS

The main purpose of this research is to investigate the influence of credit management on financial performance of banking institutions in Rwanda. The results had shown that credit management on financial performance of banking institutions in Rwanda. Through identifying the credit management and financial performance indicators, and to find an empirical evidence of the degree to which credit management affects banks' financial performance and how the banks can enhance their financial performance ratios. There is a continuing debate about the nature and degree of the effective credit risk management effect on ECOBANK profitability.

The study concludes that majority of the respondents agreed that credit management contribute to financial performance of ECOBANK through the appropriate credit policies, credit assessment and control the volatile of interest rate. The study concludes that the commercial banks credit management contributed greatly to financial performance in ECOBANK. According to the findings, majority respondents indicated that credit management contributed to financial performance in the commercial banks at a great extent.

This study shows that there is a significant relationship between bank financial performance and credit management. Better credit management in terms of appropriate credit policies, Credit assessment and Control the volatile interest rates contributed to the ECOBANK performance.

5. RECOMMENDATIONS

The study recommends that commercial banks in Rwanda should put stringent measure when conducting loan appraisal process and should adhere to all the lending requirements stipulated in order to enhance financial performance. Further the study recommends that ECOBANK need to come with credit policies and devise strategies that will not only limit the banks exposition to credit management but will establish a proper credit risk management strategies by conducting sound credit evaluation before granting loans to customers. This study therefore recommends that the ECOBANK have to monitor credit advances and adopt other appropriate steps necessary to control or mitigate the risk. There is a need for commercial banks to adopt non-performing loans management practices. Such practices include ensuring sufficient collaterals, limiting lending to various kinds of businesses, loan securitization, ensuring clear assessment framework of lending facilities and use of procedures in solving on problematic loans among others.

The study also recommends ECOBANK to conduct credit management analysis on businesses and individuals before lending. From the study, it was found out that loan appraisal and subsequent approvals should be based on borrower's capacity, character, condition, credit history and collateral. The study recommends commercial banks to use credit scoring model in credit risk assessment.

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