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The contribution of credit risk management on financial performance: Case study BPR Rwamagana Branch

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ABSTRACT

A number of commercial banks have registered an unsatisfactory financial performance. This crisis has been related to inefficient credit risk management systems. This research assessed "**the contribution of credit risk management to financial performance"**. The guided objectives were the following; to find out the credit risk management applied by BPR Ltd, to determine the level of financial performance of BPR Ltd, and to measure the relationship between credit risk management and financial performance of BPR Ltd. This study is expected to be significant to all Rwandan banking sectors, University of Rwanda, Future researchers, and the general public. The study used BPR Ltd Rwamagana branch, out of 43staff and clients of Rwamagana branch the researcher took a sample of 23 respondents to represent others. The researcher used a descriptive and analytical research based on both qualitative and quantitative data. Primary data was obtained by extracting information from questionnaires designed to get answers from different respondent composed of BPR Ltd staff and clients from different level. Secondary data were collected from books, journals, newspapers and internet materials. In research data is presented in form of tables, graphics while analysis and interpretation were based on frequencies and percentages. The research found that BPR Ltd has a credit risk management that contribute to financial performance though it needs to be reviewed and adopted more to current Rwandan environment. The research found thatthe result shows that majority 52.2% of respondents agree and 30.4% of respondent strongly agree that return on assets have been increased, the result shows that majority 52.2% of respondents agree and 26.1% of respondent strongly agree that they have high ability to meets its financial obligations and majority 43.5% of respondents agree and 30.4% of respondent strongly agree thatliquidity asset of BPR twice great.

bank Rwamagana branch is

Key words: credit risk, credit risk management and financial performance

INTRODUCTION

Globally, the entire human society's history is marked by the exposure to risks of all kinds and the efforts undergone by humans to deal with the risks. From ancient time, at the emergence of species, the human practiced risk management in order to survive, (Zarruk and Madura 1992). The practice of survival instincts lead to the avoidance of risks threatening to extinct the human kind. The very existence of human kind today is the proof of the success of applying risk management strategies by our ancestors. Risks are uncertainties. In the banking universe, there are a large number of risks (Benston, Berger et al. 1983)As the goal of any privately own company, the main goal of bank's management is to maximize the shareholders‶ value. Bankruptcies in the financial sector are costly, not only for the equity and debt holders of banks" but often also for taxpayers. In order to avoid that the banks are constantly under pressure and have to assume high risks and at the same time manage the risks in order to avoid, or at least minimize losses (Benston, Berger et al. 1983).

Competition in the banking sector is typically seen as detrimental to financial stability. The basic idea is that when banks compete intensely for deposits, interest rates fall and their franchise value is eroded. Banks have then less to lose from operational and their incentives to take on risk increase Boyd De(Boyd and De Nicolo 2005) This argument has been very important in shaping banking regulation around the world, for instance in the form of competition and merger policies. A recent influential paper by Boyd De (Boyd and De Nicolo 2005)has challenged this view. Boyd De Nicolo consequently argues that the lending market should be central to future models of bank stability.

(Boyd and De Nicolo 2005)borrowers are implicitly assumed, through their influence on the risk of firms, to have complete control over the riskiness of banks. Wagner argues that, while borrowers may determine the riskiness of their firms, it is banks who decide how much risk they ultimately want to take on. Wagner introduced in a model with a lending channel the possibility for banks to select among different types of borrowers. Thus, they essentially allows for both a risk choice of borrowers as in Boyd De (Boyd and De Nicolo 2005)and a risk choice for banks. They find that this alteration reverses the stability effect of the lending channel. Wagner has shown that when banks have control over their risk-taking, the stability impact of lending market competition may be reversed. This is because banks have an optimal amount of risk they want to hold and thus want to offset the impact of safer borrowers on their balance sheet by taking on more risk. Since competition in the loan market at the same time erodes banks‟‟ franchise values, they even want to overcompensate the impact of safer borrowers because their risk-taking incentives increase. Bank regulators and researchers have long sought to understand the determinants of bank risk taking. Existing theoretical and empirical work developed by (Ali, Hwang et al. 2003) suggest that risk-taking will be affected by a number of factors such as the moral hazard provided by mispriced deposit insurance, agency problems between management and shareholders, leverage, ownership structure, risk preferences, and regulatory actions. (UWIMANA 2017))and Winton (1999) proposed a different methodology based on structural relationship between bank risk-taking and efficiency, using different combinations of credit risk, interest rate risk, and financial leverage in their model. (Kabeer 2009)Jeonk (2001), Almazan (2002) and differential information or screening technologies among intermediaries induce specialization in lending according to Altman, Haldeman and Narayanan (1977).

In Rwanda, the path of financial activity, which concerns banking, insurance, savings and loans associations, etc., had always been paved with numerous contingencies after the genocide of 1994 that destroyed the big part of the national wealth.

(Harelimana 2017) These risks cannot be predicted accurately and this therefore gives rise to the involvement of a careful management. The Rwandan financial framework, as any other financial system in the world, deals highly with risks in its every day management. As a reason for this, we can mention the fact that there are factors that are not under the control of managers such as globalization, world changes or market variables like price changes or stock exchange trends.

Historically the banking and finance management in Rwanda has always been subject to some major risks, the careful management of which has always led to survival in the financial sector. Many Rwandan financial houses handle these risks on a daily basis in order to grow and encounter rapid changes. Therefore, risks must be understood and carefully managed for a proper decision making in the Rwanda financial system.

Problem

The failure of BPR atlas Mara has resulted from the rising of credit risk management, however it has affected their financial performance. This bank increases their credit risk management across all their market segments is yet another indicator of poor credit risk management defaulted affecting their performance. The research was therefore set out to establish the contribution of credit risk management to financial performance. It has well shown how the problem of credit risk management affected the financial performance of BPR of Rwamagana.

Objective of the study

General objectives

The general objective of this study is to assess the role of credit risk management on financial performance banking in Rwanda referring to BPR atlas Mara Rwamagana branch.

Specific objective

To find out the credit risk management applied by BPR.

To determine the level of financial performance of BPR from 2016 to 2018

To measure the relationship between credit risk management applied and the level of financial performance in BPR.

Methods

Sample size: A sample of 23 respondents including senior, middle and operational workers involved in Credit Risk Management of BPR Ltd. But in order to conduct this research well, this formula of Yamane taro have used to calculate the sample size.

By Yamane taro: $n=N/1+N(e)^2$

After getting the sample size the questionnaire has distributed into twenty three respondents to get information needed.

Sampling techniques: A sampling techniques refers to the procedure the researcher would adopt in selecting items for the sample (Shukla, Vatsa et al. 2013)). In carrying out this study, the researcher used purposive sampling whereby credit and finance departments were considered to ensure relevant people with the required skills in the study, and the researcher used simple Random sampling among the Selected departments to avoid bias.

Data Correction Procedures

Data collection for this study collected through documentary sources, observation, questionnaires and structure and unstructured interviews.

Documentary sources: According to (Gaertner, Mann et al. 1989)documents are materials, which contain the information about a phenomenon that researchers wish to study.

Observations: According to Bailey (2014), as cited by Rwigamba (2014), an observation is the primary techniques for collecting data on non-verbal behavior. Although observation commonly involves sight or visual data collection via other sense such as hearing, touching and smelling. Observation was used especially to categories of those respondents who do not want to reveal their personal status with regard to what they own.

Summary of major findings

This part presents the summary of the research findings in line with the objectives of the research. The findings are in relation to credit risk management and profitability of commercial BPR Ltd in Rwanda specifically the Rwamagana branch.

Major findings of the study are summarized in the following subsections which are organized according to the objectives of the study.

Objective one: To find out the credit risk management applied by BPR Ltd

This objective was set to assess whether BPR Ltd has a credit risk management applied. Different questions were put in the questionnaire to seek an answer and the following were its summaries.

As confirmed by 100 % of the respondents BPR Ltd has a credit risk management which was set to apply and mitigate credit risk while increasing the profitability of the bank, so it is certain that the bank has a credit risk management.

To analyze the level of financial performance in BPR Ltd

In achieving the objective" To analyze the level of financial performance in BPR Ltd – Rwamagana Branch. This means from2016 up to 2018, the results shows that profitability ratio of BPR Ltd is 2.8%, 4.3% and 15.9%, solvency ratios during the covered period is 0.3%, 0.4% and 1.4%. And this has continued to the liquidity ratio of this BPR Ltd where it shows that From2016 up to 2018, the ratio on liquidity are the following, 14.1% in 2016, 18.6% in 2017 and 25.8% in 2018. This means that the BPR Ltd-Rwamagana branch is able to pay off its liability compare with the asset they have

Table

Relationship between credit risk management and financial performance of BPR bank Ltd.

			Credit risk identification	profitability
Spearman's rho	Credit risk Identification	Correlation coefficient	1.000	.619**
		Sig. (2-tailed)	.	.000
		N	23	23
	Profitability	Correlation coefficient	. 619**	1.000
		Sig. (2-tailed)	. 000	.
		N	23	23

Source: researcher computation

The significant Spearman`s correlation coefficient value of 0.619 confirms that there is a strong positive correlation between the two variables (credit risk management and financial performance of BPR bank). Thus the increase of credit risk management associated with financial performance of BPR bank values.

This could be formally reported as follows: "A Spearman`s correlation was run to determine the relationship between 23 respondents and the financial performance of BPR bank. There was a strong correlation between credit risk management and financial performance of BPR bank (r_S= .619, n=82, p<.001)"

Conclusion

This research compounds five chapters preceded by a general introduction and ended by conclusion which presents the summary of research, suggestions and recommendations from different stakeholders. This study have somehow complicated because I have known that every information you need about your topic from your case study must be obtained but it is not that, it is a right of respondent to give information. And am very surprisingly to found a company with insolvency problem and not able to pay off continue to provide services to their client without closing the doors as I thought it.

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