EFFECT OF LOAN MANAGEMENT ON THE FINANCIAL PERFORMANCE OF COMMERCIAL BANK: THE CASE OF BANK OF KIGALI (B.K)

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ABSTRACT

This paper explores the effect of loan management on the financial performance of commercial bank with reference to Bank of Kigali (BK). Loan management play a major role in the banking institution to maintain the financial performance.

Bank are expected to be socially responsible, support local communities and ensure adequate supply of credit to all legitimate businesses and consumers to price those loan reasonable in line with market determined rates without jeopardizing the viability of the institution. The objective of this study was to find out how far loan management affects financial performance of a banking institution.

Data collection techniques adopted were questionnaires and documentation, where qualitative and quantitative data about loan management and financial performance of BK were gathered and analyzed. The study findings revealed that there is an effect or a close relationship between loan management and financial performance of Bank of Kigali, where it was noted that well management of loan was the main source of the positive financial performance achieved by B.K.

Finally, this study ends up with some recommendations where the Bank of Kigali should improve the training of employees of credit department to enhance the suitable effective performance of loan management.

Key words: Loan, management, loan management, and financial performance

Introduction

Banks are firms that efficiently provide a wide range of financial services for profit.

Not surprising, banks have an important role in the economy and the society as a whole. Their central role is to make the community's surplus of deposits and investments useful by lending it to people for various investment purposes: company growth, education, houses (Bart Baesens and Tony Van Gestel, 2009).

According to Brick, J. R. (2006), banks perform a very important service to all sectors of the economy by providing facilities for the pooling of savings and making them available for economically and socially desirable purposes. This is beneficial to their customers since they are rewarded by the payment of the interest on their savings, which are safe and in a highly liquid form.

The main function of banks is to receive deposits from individuals who have savings these deposits are kept in various types of accounts opened in the bank. Then loan fund from those deposits to those in needs and charges interest.

John A. Hslem (1985) specifies that the functions of commercial banks are: creation of money, payment mechanism, pooling of saving, extension of credits, financing of foreign trade, trust service, safekeeping of variables and brokerage services.

In addition, banks act as brokers between supply and demand of securities, and they transform short-term deposits into medium- and long-term credits. Specialized information on financial products is gathered by banks to improve investment decisions and to manage the risk (Bart Baesens and Tony Van Gestel, 2009).

Therefore, from its main function the bank is the pillar of the financial sector of the economy, they provide financing to different groups, different sectors in the economy namely, the contractors, builder's real estates, traders, households, and manufacturers. These credits will be used to reinvest in businesses and for which the owners expect to earn a return. At the same time, lenders or financial intermediaries supply credit to earn a return when these companies borrow. This process for extending credit has a multiplier effect on the global money supply, so this is why credit is a powerful driver of our economy.

This transformation from supply to demand side is not without risk. Banks are exposed to credit, market, operational, interest rate and liquidity risk. The appropriate management of these risks is a key issue to reduce the earnings risk of the bank, and to reduce the risk that the bank becomes insolvent and that depositors cannot be refunded (Bart Baesens and Tony Van Gestel, 2009).

According to JoEtta Colquitt (2007), credit risk arises whenever a lender is exposed to loss from a borrower, or counterparty who fails to honor their contracted debt obligation, as agreed, in a timely manner. For lenders who extend credit in the form of loans, credit risk is inherent in all their business activities and is an element in virtually every product and service that is provided.

This task is not easy as it is involves detailed and elaborate analysis of the documentation provided by the applicants and their collaterals mismanagement of bank resources will result in huge non performing asset lending policies will determine the future of a country's economy as they channel funds to productive investment alternative. Therefore, there is a need of an effective loan management where loans should be very well managed to minimize potential risks that may affect the bank's performance.

Examiners therefore find it necessary to devote a large portion of their time and attention of bank loan portfolios. The examiner 's evaluation of the loan portfolio involves much more than merely oppressing the individual loan therein. Prudent management and administration of the overall loan account, including establishment of sound lending policies and guidelines are of vital importance if the bank is to be continuously operated in an acceptable manner.

According to Augusto, G, (2003), lending policies should be clearly defined and set forth in such a manner as to provide effective supervision by the directors and senior officers. In as much as board of director of every bank has the legal responsibility to formulate lending policies and to supervise their implementation.

To stay profitable, examiners of banks credits should encourage establishment of and maintenance of written, up-to-date lending policies, which have been approved by the board of directors. A bank's lending policy should not be a static document, but must be reviewed periodically and revised in light of changing circumstances surrounding the borrowing needs of the bank's customers as well as changes that may occur within the bank itself. These lending policies are designed to serve only as guidelines for areas needing consideration in overall policy evaluation.

In addition, According to Gibson (2006), management should maintain a written loan review policy that is reviewed and approved at least annually by the board of directors policy guideline should include a written description of the overall credit grading process and establish responsibilities for the various loan review function.

The sources and causes of problem loans cover a multitude of mistakes a bank may permit a borrower to make, as well as mistakes directly attributable to weaknesses in the bank's credit administration and management. Some well constructed loans may develop problems due to unforeseen circumstances on the part of the borrower; however, bank management must endeavor to protect a loan by every means possible in order to preserve it performance.

The major concern of this study was to find out if loan management is effective in Bank of Kigali through some indicators, to evaluate the financial performance achieved by this bank in highlighting the role played by loan management on that performance.

Method

This study applied both descriptive and analytical research design to find out the effect of loan management on the financial performance of Bank of Kigali. This helped the researcher to describe and analyze the views of respondents on subject under study.

Population and sampling techniques

According to Kenneth D. Bailey (1978), a population is a universe or a sum total of all units of analysis. Sommer et al (1992) defines a population as the total number of items in a specified field of inquiry and he added that population is an asset of cases about which one wishes to draw some conclusions. Therefore, the targeted population for this study was the employees of Bank of Kigali working in Credit department whose number was 25.

The study used universal sampling techniques, where all the employees of Credit department were selected as sample size, because it was easy for the researcher to reach every one and given the size of the population there was no need to find out a sample size from the population, the sample size equal to the population.

Research Instruments

This study used some research instruments like questionnaire. A questionnaire is defined as a survey instrument intended to self administered questions (Mannheim and Richard, 1995). They further emphasis that a questionnaire is a set of related questions designed to collect information from respondents. It is an information gathering technique that gathers information, attitudes, beliefs, behaviors and characteristics from selected respondents, organizations who may be affected by a given phenomenon. The questionnaires were distributed to respondents in order to provide the necessary information related to loan management and financial performance of Bank of Kigali.

The questionnaire of this study was designed in a search manner it would give information about respondents, among others the respondents' profile, assessment of loan management in Bank of Kigali, appreciation of the financial performance achieved by this bank from year 2010 to 2013. Within this process both qualitative and quantities data about this study were gathered.

In addition to questionnaire, the researcher used documentation as a source of information for this study. Documentation is the careful reading; understanding and analysis of written documentation for some purpose other social research (Bridget and Cathy, 2005). The researcher visited Bank of Kigali website for additional information on it performance and some achievements necessary for this study.

Statistical treatment of Data

Data gathered were recorded into Statistical Package for Social Sciences (SPSS) software after being coded. Encoded Data were then examined to ensure there were no encoding errors-missing data and outliers.

Method of Data analysis

To organize and tabulate the data collected from respondents, the researcher used the statistical Package for Social Sciences (SPSS) software. Thereafter, statistical procedures were used to analyze and interpret data, where descriptive statistics were used to describe the respondents profile and their views on loan management and financial performance using percentages.

Results and discussions

Questionnaires targeted 25 respondents, who are employees of Bank of Kigali who works in credit department in Kigali city. The findings were analyzed and interpreted using the information given by the selected respondents in accordance with the objectives of this study. The analysis was based on the findings from the field in which the respondents expressed their views on the subject matter. Data from questionnaires were analyzed using SPSS and interpreted to arrive at meaningful and reliable findings. The data collected include respondents profile, loan management and performance of B.K

The respondents profile presents gender, age, marital status, education level, field of study and working experience of the respondents as shown in tables 1, 2, 3, 4 and 5 here after.

Table 1: Gender of respondents

Sex	Frequency	Percentage
Male	15	60%
Female	10	40%
Total	25	100%

Table 2: Age of respondents

Age's range	Frequency	Percentage
21-30 years	4	16%
31-40 years	10	40%
41-50 years	6	24%
51-60 years	3	12%
Above 61 years	2	8%
Total	25	100%

Table 3: Marital status of respondents

Marital status	Frequency	Percentage
Married	18	72.0
Single	7	28.0
Total	25	100.0

The table 1 indicates that the number of male is high than female which represents 60% of respondents while the female represents 40% respondents. This implies that this research benefited views from male and female at a considerable level.

Table 2 shows the age of respondents where 16% of respondents are in the range of 21-30 years, 40% were aged in the range of 31-40 years, 24% of respondents in the range between 41-50 years, 12% of respondents were between 51-60 years, while 8% of the respondents in the range of 61 years and above. This shows that the respondents were mature enough to provide reliable information for this study.

From table 3 we have respondents profile by marital status where it indicates that the number of respondents who married represents 72% of all respondents and 28% of the respondents were single. This shows that there was a big number of married respondents compared the number of single, which seems to be an advantage for this study.

Table 4: Education level of respondents

Educational level	Frequency	Percentage
Masters	8	32%
Bachelor Degree	11	44%
Diploma	6	24%
Total	25	100%

Table 5: Field study of respondents

Field of study	Frequency	Percentage
Management	7	28%
Finance	2	8%
Accounting	8	32%
Other qualification	8	32%
Total	25	100%

Table 6: Experience of respondents

Working years	Frequency	Percentage
2 years-3years	12	48%
4years-5years	9	36%
Above 6years	4	16%
Total	25	100%

Table 4 shows that all respondents were educated at different levels as it corresponds to their qualifications. The highest number of respondents was bachelor's degree holders with 44% of all respondents. This is followed by master's degree holders with 32% of the respondents and finally Diploma with 24% of all respondents. Therefore, the qualification of the respondents is usually considered as important because is a determinant of the working quality of the workers which can enhance the organizational loan management which can lead to its performance. In addition, this qualification of the respondents shows that data collected were provided by people understanding the subject under study.

Table 5 illustrates the field or area of study of respondents, with 28% of all the respondents who did management, 8% of the respondents are qualified in finance, 32% of the respondents in accounting and 32% of respondents are qualified in different domain like Law, banking, project management. The qualifications of respondents give confidence to this study as they are much informed about the subject under study.

Table 6 indicates the working experience of respondents, where 48% of all the respondents range between 2 and 3 years, 36% of the respondents range between 4 and 5 years and to16% of the respondents have working experience above 6 years. This implies that all the respondents have enough experience to accomplish their duties in order to improve the effectiveness of loan management. Therefore, when the institution has many employees experienced, there is upholding the positive effect of loan management on performance. For this study, this shows that we can rely on their views because they know what is happening in credit management.

During this research study, the evaluation of loan management was examined. The loan management if is applied well in the organization, can improve the loan management and when loan are well management, the institution may recover its fund invested in times of credit and this can have a positive effect on the performance of banking institution. The tables 7, 8, 9 and 10 give details on the assessment made on loan management in BK, where experience in credit management, professional training, independence, existence of lending procedures were examined.

Table 7: Experience in credit management for respondents

Working experience	Frequency	Percentage
2 to 3 years	10	40%
4 to 5 years	11	44%
6 to 8 years	4	16%
Total	25	100%

Table 8: Professional training in loan management for staffs of credit department of BK

	Frequency	Percentage
Yes	22	88%
Non	3	12%
Total	25	100%

Table 9: Independence in loan review process in credit department

Alternative	Frequency	Percentage
Agree	19	76%
Tend to agree	3	12%
Tend to disagree	3	12%
Total	25	100%

Table 10: Existence of specific lending procedures and guidelines for loan view process in credit department

	Frequency	Percentage
Agree	25	100
Tend to agree	0	0
Tend to disagree	0	0
Total	25	100%

Table 7 shows the working experience in credit management of respondents, where 40% of respondents have experience in credit management between 2 and 3years, 44% of respondents have working experience in credit management of 4 to 5 years, and 16% of the respondents have spend at least 6 years in credit management. Therefore the respondents have enough experience in credit management which can help to accomplish their duties in order to improve the loan management which can lead to better performance.

Table 8 indicates that 88% the respondents confirmed that they have benefited from professional training in credit management. This shows that a big number of employees have benefited from professional training in credit management and has strong skills and knowledge in loan management. Professional training seems to be a very important obligation for the management, because it keeps employees up to date in times of credit analysis, risk assessment and other connected responsibilities; this can help in facilitating effective management of loan in BK.

Table 9 shows the independency of loan review process in credit department. As it was observed 76% of the respondents acknowledge that they feel independent when they are reviewing the different loan requests from clients, 24% of the respondents do not have sufficient information on this independence because their responsibilities or duties the first stage of loan management, where they have to receive from clients all required documents for loan request then submit these request to next stage for assessment. Therefore, based the information above we can recognize the level of independence as shown in table 9. This implies that the independency in loan review process in credit department is followed at BK, and this can lead to allow only credits or loans which fulfill specific requirements as requested by guide lines.

Table 10 indicates that 100% of the respondents confirmed that BK have specific lending procedures and guidelines for loan view process in credit department which can help them to know how to assess loans without being confused and avoid misunderstand within credit management. The lending procedures and guidelines are the foundation of loan management, without them there is a higher risk that credit would be mismanaged. So far, we can assume that these guidelines may have a positive effect on loan management within BK.

Table 11: Factors considered in loan review process

Factors Considered	Frequency	Percentage
Credit quality	2	8%
Sufficiency of credit and collateral documentation	3	12%
Compliance with internal policies and procedures and applicable laws and regulations	7	28%
All above	13	52%
Total	25	100%

Table 12: Categorization of credit approval in credit analysis

	Frequency	Percentage
Agree	18	72%
Tend to agree	5	20%
Tend to disagree	2	8%
Total	25	100%

Table 11 shows the factors considered in loan review process at BK, factors are so important in loan management because they references on which credit managers have to refer themselves to make that the credits granted respect the minimum requirements. From the table above all respondents recognize the existence of some factors to be considered before allowing a loan to a client, where 52% of the respondents agree that before granting a loan they have to consider at the first level the quality of credit or the consistency of the loan request, then they have to make sure that there is Sufficiency of credit and collateral documentation and finally compliance with internal policies and procedures and applicable laws and regulations. In addition, 28% of the respondents have chosen compliance with internal policies and procedures and applicable laws and regulations as the factor considered, 12%

of the respondents agreed that sufficiency of credit and collateral documentation is the factor and 8% of the respondents have selected Credit quality as factor. All these factors help credit managers to not use their own understanding and judgment to approve loan but to use specific factors, which may have positive effect on loan management at BK.

Referring to the results from table 12 there is categorization of credit approval in credit analysis at different level in B.K, 72% of the respondents agree that there is categorization of credit approval at B.K, 20% of the respondents seems also to agree with this categorization. This implies that there is more than one level for analyzing and approving credits to clients of B.K. This categorization help all parts involved in credit management to make sure that all factors are considered at the highest level in order to avoid errors and mismanagement which may occur at any stage of credit approval, and this is a very important aspect in credit management which leads to the effectiveness of loan management.

The information shown in tables 7 to 13 indicates how loans are managed in B.K and it reveals at significant level that credits are well managed. Therefore, we would like to present the views of the respondents on the financial performance achieved by B.K and how far they do consider loan management' contribution on that performance. The tables 13 to 15 below give details on the achievements of B.K.

Table 13: Trend of financial performance been realized by B.K from 2010 -2013

	2010		2011		2012		2013	
Levels	**Frequency**	**Percentage**	**Frequency**	**Percentage**	**Frequency**	**Percentage**	**Frequency**	**Percentage**
Excellent	18	72%	19	76%	20	80%	23	92%
Very good	5	20%	4	16%	4	16%	2	8%
Good	2	8%	2	8%	1	4%	0	0%
Poor	0	0%	0	0%	0	0%	0	0%
Total	25	100%	25	100%	25	100%	25	100%

Table 14: Role played by loan management on the performance achieved by B.K

	Frequency	Percentage
Agree	20	80%
Tend to agree	4	16%
Tend to disagree	1	4%
Total	25	100%

Table 15: Loan management and better performance of B.K

	Frequency	Percentage
Agree	21	84%
Tend to agree	3	12%
Tend to disagree	1	4%
Total	25	100%

Table 13 shows that in 2010, 72% of the respondents consider the financial performance of BK as Excellent, while in 2011, 76% of the respondents consider that the financial performance was Excellent. In 2012, we observe that the perceptions of respondents regarding financial performance achieved shifted from 76% in 2011 to 80% in 2012. Finally in 2013 that financial performance is regarded as Excellent by 92% of the respondents.

These appreciations from respondents on the excellent financial performance achieved by B.K are based on different awards received in 2011 up to 2013. Specifically, In 2011 Bank of Kigali was awarded to be the Bank of the year where it has shown resilience and provided good shareholder returns; in 2012 Bank of Kigali was awarded two awards, the first one for being the *Best Financial Reporting Company in Rwanda* and the second one for being *Best African Listing* where it was recognized to generate significant interest from international, regional and local investors; in 2013 Bank of Kigali was recognized to be the best bank in Rwanda, where *Euromoney 2013 Awards for Excellence* goes to this Bank.

Table 14 indicates that 80% of the respondents confirmed that loan management plays a vital role in the financial performance achieved by B.K. This shows that the respondents know that the loan management has a direct effect on financial performance of B.K. There is a close relationship between loan management and financial performance, since the loan granted are the major source of income for Bank of Kigali, so when the loans are refunded automatically it would affect the financial performance.

Table 15 shows that 84% of the respondents agree that loan management output contribute to the better financial performance of B.K as it was observed. This implies that loan management output has a significant effect on the financial performance of this commercial. When there is an effective loan management in an organization the profitability is also good, but when is contrary the profitability also is low. This means that the profitability in this case is dependent upon loan management. The well managed loan return the equity and assets of the organization which can generate the financial performance.

Conclusions

This study intended at finding out the effect of loan management on financial performance of Bank of Kigali. 25 respondents from credit department from this Bank were selected using purposive sampling techniques and they have received and responded to the self administered questionnaires.

The study findings reveal that there is a close relationship between loan management and financial performance achieved by BK from 2010 to 2013. Through the assessment of respondent's views on this relationship, the researcher found out that the loans were well managed, because all indicators considered at this level shown that the employees working in credit department have experience in credit management, there was professional training organized in order to keep them up to date, they have recognize being independent in loan review and the researcher found that there are lending procedures and guidelines designed and implement in order to improve loan management.

Findings revealed also that there are factors considered in loan management like credit quality, Sufficiency of credit and collateral documentation and Compliance with internal policies and procedures and applicable laws and regulations. These factors help credit managers to a common understanding of what is required and what should be done in order to avoid errors and other mismanagement which may occur with loan analysis and approval. In addition, to strengthen the loan management Bank of Kigali has introduced categorization in credit analysis and approval, so that any credit may be reviewed at different levels and by different people.

Finally, the researcher assessed the respondent's views on financial performance achieved by Bank of Kigali, where they confirmed that performance to be at higher level from 2010 to 2013. This was supported by different awards received bay Bank of Kigali for the performance achieved, among others for being the best bank in Rwanda For several times. Furthermore, the respondents have shown that the financial performance achieved by Bank of Kigali depends on an effective loan management. It was shown that it is absolutely impossible to have a good performance with a poor loan management.

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