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Evaluation of Credit Risk Management Practices in Societe Generale Ghana

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ABSTRACT

The study evaluated the credit risk management strategies of SG-SSB Ghana. The research was an attempt to assess the extent to which the implementation of various credit risk management strategies by the bank has reduced the amount of non-performing loans. In order to answer the research objectives, the case study approach was employed where face-to face interview was conducted to collate the views of a senior credit officer at SG-SSB Ghana Ltd on credit risk management strategies. Besides, information on non-performing loans was obtained from administered questionnaires. The results from the study showed that SG-SSB has a clear, written guideline on credit risk management with the board of directors having an oversight responsibility for implementation. SG-SSB realigns the amount of credit within various sectors grouped into a credit portfolio depending on environmental factors such as political regime, macroeconomic strategy of political regimes, new and existing regulations and legislation, social concerns of operating markets and technological developments within the banking industry in Ghana. The study recommends that SG-SSB should work in collaboration with credit reference bureau in the country to thoroughly investigate the past credit records of loan applicants so as to reduce the high rate of default.

1.1 Background to the Study

Banks and their customers have different perceptions of bank credit or lending. To most bankers, credit is not a capital-market activity, yet to many corporate customers' particularly small and medium-sized companies, bank loans are their most important source of capital. The demand for medium-term or long-term lending comes mainly from commercial and industrial companies and from private individuals. However, amongst all the services provided by banks, credit creation is the main income generating activity for the banks. But this activity involves extremely high risks to both the lender (financial institution) and the borrower (client). The risk of a trading partner not fulfilling his or her obligation as per the contract can greatly hinder the smooth functioning of a bank's operation. On the other hand, a bank with high credit risk faces potential insolvency and this does not give depositors confidence to place deposits with some financial institutions have collapsed or experienced financial problems due to inefficient credit risk management systems typified by high levels of insider loans, speculative lending, and high concentration of credit in certain sectors among other issues. Credit risk management practices and poor credit quality continue to be a dominant cause of bank failures and banking crises worldwide. Again, Financial Institutions have faced difficulties over the years for a multitude of reasons, the major cause of serious banking problems continues to be directly related to lax credit standards for borrowers and counterparties, poor portfolio risk management, or lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of a bank's counterparties (Gil Diaz, 1994).

Some of the underpinning factors that banks claim to have contributed to this situation include high Non Performing Loan (NPL) ratios and high loan loss provisioning. Indeed, the quality of banks' aggregated loan book remains a source of financial sector vulnerability. High levels of Non-Performing Assets in the financial statements of banks have the potential to lower profitability and erode the capital base. Indicators of asset quality measured by the Non-Performing Loans (NPL) ratios hit a peak of 20 per cent in February 2010, declined to 16.5

per cent in September and 16.9 per cent by the end of October 2010 (Amissah-Aurthur, 2010). For this reason, efficient risk management is absolutely required. Carey (2001) indicates that risk management is more important in the financial sector than in other parts of the economy. In the case of banks, the issue of credit risk is even of a greater concern because of the higher levels of perceived risk resulting from the behaviour of clients and the type of business activities they finance. It is thus the purpose of this study to evaluate the credit risk management practices of Ghanaian banks using the SG-SSB Limited as a case study.

1.2 Problem Statement

The aim of every business is to maximize shareholder wealth. Much of the working capital of banks is invested in credits. The giving of credit is very expensive to banks cost, since not all credits are recovered through nepotism, carelessness and negligence on the part of some credit officers. As the volume of credit increase, the risk attached is also increased.

The giving of loans has its own advantages to banks; some of the merits of giving credit are the ability to increase return on equity to most shareholders expectations from time to time. In a way, they will be able to build shareholders' confidence in the bank. The continuous increase in return on equity will attract more people in the share of the bank to increase its working capital. High working capital means more customers will be able to benefit from credit facilities from the bank. The increase in credit facility makes money available for business to expand their operations.

The banking industry has experienced tremendous changes in terms of product packages for its customers. Credit facilities have been of much concern to the banking institutions. It has been suggested by some literatures that without effective banking practices, efficient appraisal and monitoring of credit the banks are faced with high tare of credit defaults and the economy cannot really experience growth. For this reason, it has become necessary to look for the causes of the high rate credit defaults and how it can be reduced if not total elimination, in order to promote banking for the sustenance of the economy as a whole. The 2014 annual banking survey report by KPMG showed deteriorating levels in the asset quality of certain financial institutions in the country and Societe Generale Ghana was not an exception. The principal concern of this work is to evaluate credit risk practice, the techniques used and the extent to which their performance can be augmented by proper credit risk management policies and strategies by Societe Generale Ghana, Tema.

1.3 Research Objectives

The main objective of this study is to evaluate the credit risk management practices of SG-SSB Ltd Community one branch. The specific objectives of the study are:

- To find out how credit risk is managed in the bank.
- To find out the extent at which credit risk management will affect the profit maximization of banks.
- To find out how the credit risk management has affected the credit facilities given to customers.

1.4 Research Questions

The research questions for the study are:

The study also intends to answer the following research questions:

- The extent to which credit risk has been managed in the bank.
- The principle, policies and practices that govern the credit risk department in exercising its duties.
- How successful the bank has been in retrieving its loans from borrowers

❖ How profitable the credit risk management has been to the bank.

2.0 METHODOLOGY

2.1 Population Description:
SG-SSB Ghana Limited, Community one branch which constitute about 200 staff was chosen as the case study for this work. The population for this study was compiled from the staff of community one branch, which consisted of personnel from the management department, account department and other sub managers.

2.2 Sampling Method
In order to ensure that accurate and reliable information on credit risk management is obtained, the study adopted the purposive sampling technique in deciding on whom to interview. The choice of the purposive sampling technique was motivated by the fact that the information on credit risk management strategies is specific and therefore an expert with the requisite experience is required in order to achieve data that is reliable

2.3 Sample Size
However, since the study is interested in credit related matters, credit officers of the bank are the sample of interest. SG-SSB Ltd has a common credit risk management strategy. Therefore, the study interviewed a senior credit officer at the Bank and questionnaires were administered to other staff at the credit risk department which constituted a sample size of 30 respondents.

3.0 DATA PRESENTATION, INTERPRETATION AND DISCUSSIONS

3.1 Data Presentation and Analysis
Forty (40) questionnaires were administered to the employees of SG-SSB Ghana Limited Tema main branch. Thirty (30) valid questionnaires were ultimately analyzed forming the basis on which the research was conducted. The data collected was analyzed below

Table 1: Loan facilities available to customers at the bank

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Personal Loans	10	33.3	33.3	33.3
	Business Loans	15	50.0	50.0	83.3
	Trade Finance Lease	5	16.7	16.7	100.0
	Total	30	100.0	100.0	

Source: Field Survey July 2015

The researcher wanted to know the number of loan facilities that the bank offers to clients and customers. From the data collected it showed Business loan is the most loan facility available for customers and the represent 50% of the total population. 10 respondents representing 33.3% of the population said personal loans, trade finance and lease are the least of loan facilities available for customers. Table 1 above shows the distribution.

Table 2: How successful has the bank been in retrieving loan from customer?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Good	5	16.7	16.7	16.7
	Very Good	21	70.0	70.0	86.7
	Excellent	4	13.3	13.3	100.0
	Total	30	100.0	100.0	

Data Source: Field Survey July, 2015

In soliciting information from respondents with regard the success in retrieving loans form customer, (5) respondents representing 16.7% expressed that it is good, (21) respondents representing 70% said very good. However, only (4) respondents representing 13.3% said the bank has been excellent in the collection of loans of the total population said average. This means that the bank is not doing much in terms of retrieving loans from customers as shown in table 2.

Table 3: what is the impact of a high default of loan on bank profit?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Erodes bank asset	9	30.0	30.0	30.0
	Makes lending difficult	9	30.0	30.0	60.0
	Reduce Profit	12	40.0	40.0	100.0
	Total	30	100.0	100.0	

Data Source: Field Survey July, 2015

On the question- impact of high default of loan payment on banks profit, it can infer from the analysis that it really poses a great challenge to the bank. A large portion of the population said default of loan payment reduces profit of the bank and represents 40% which represents six (12) respondents said it makes lending difficult and 30 % representing (9) respondents each said such practice erodes bank's asset and makes lending difficult. This is quite obvious and true that non- payment of loans by customers cripples the bank in so many ways as shown in table 3

In response to the question of type of collateral required for loan, the researcher found that Land constitute more and this represents 46.7% of the total population. Four (4) respondents (13.3%) said the bank requires certain investment as collateral. Nine (9) respondents representing 30% said the bank requires building as collateral to grant loan. Three (3) respondents making 10% of the population said the bank only require a guarantee to grant loan to customers. Table 4 shows the detail

Table 4: What type of collateral is required for a loan to be granted

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Building	9	30.0	30.0	30.0
	Land	14	46.7	46.7	76.7
	Guarantee	3	10.0	10.0	86.7
	Investment	4	13.3	13.3	100.0
	Total	30	100.0	100.0	

Data Source: Field Survey July, 2015

Figure 1: Are customers able to meet repayment requirement?

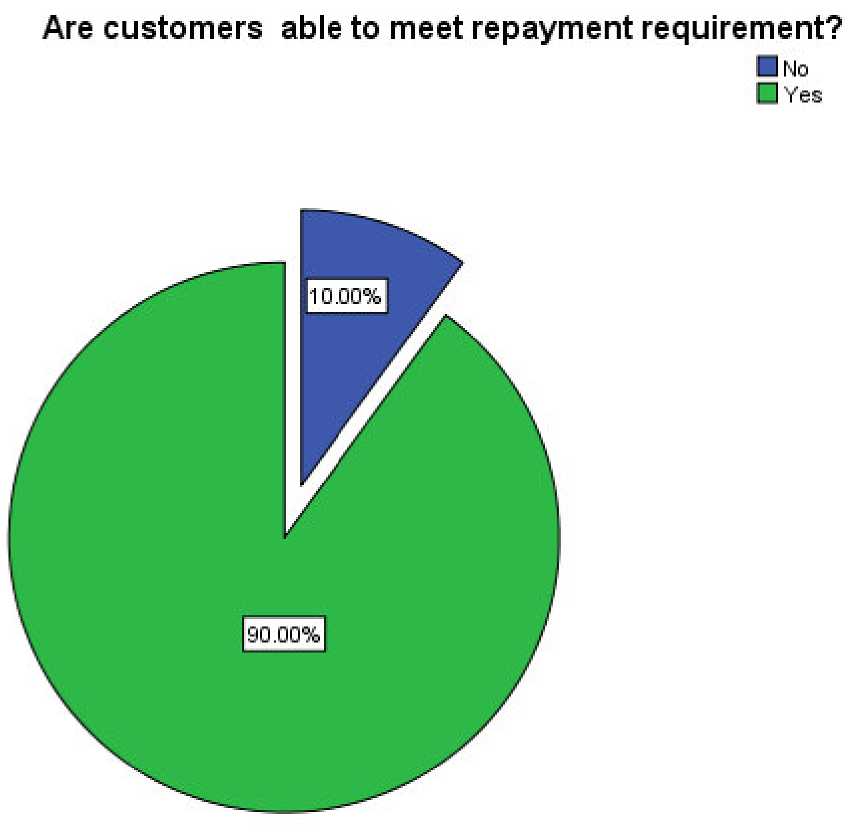

Figure 1: Data Source: Field Survey July, 2015

On the issue of whether customer meet repayment requirement by the bank, the data collected shows that customers do meet the requirement. Twenty- seven (27) respondents 90% of the population said yes. Three (3) respondents said no and this represents 10% of the population. This is evident in figure 1.

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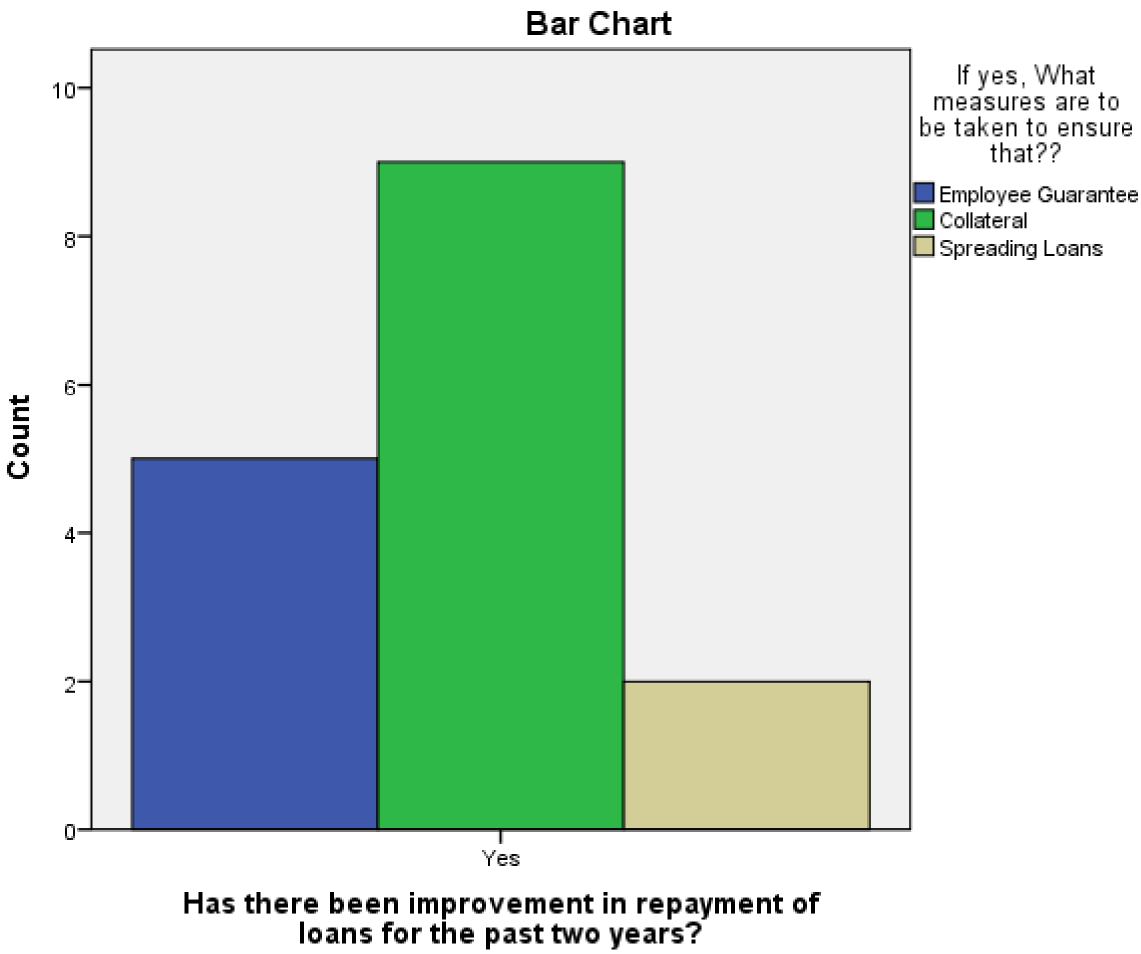
Table 5: Has there been improvement in repayment of loans for the past two years?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	14	46.7	46.7	46.7
	Yes	16	53.3	53.3	100.0
	Total	30	100.0	100.0	

Data Source: Field Survey July, 2015

On the question of whether there has been improvement in repayment of loan from 2013 to 2014, majority of the population said yes and this represent 16 respondents making 53.3% of the total population. Fourteen (14) respondents 46.7% said No. According to them there has not been any improvement in the payment of loan, it could also be evident from the difference of respondents that loan repayment was encouraging for the past two years as shown in table 5.

Figure 2: Has there been improvement in the repayment of loans for the past two years?



Data Source: Field Survey July, 2015

In soliciting the information with regards to measures taken to ensure repayment of loan by customers, the analysis shows that collateral is one of the best ways of doing so. This represents 56.3% of population, thus nine (9) respondents say so. Five (5) representing 31.3% said one best ways is through employee guarantee and two (2) respondents said by spreading the loan. To them it reduces the amount to be paid per month and hence reduces the pain of paying so much per month which sometimes they find it difficult to pay as shown in figure 2.

Table 6: Does the bank demand for insurance cover loan?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Sometimes	17	56.7	56.7	56.7
	Always	13	43.3	43.3	100.0
	Total	30	100.0	100.0	

Data Source: Field Survey July, 2015

The researcher wanted to know whether the bank demands for some kind of insurance cover on loan. From the data collected it proved that the bank does not. From the analysis seventeen (17) respondents representing 56.7% of the population said sometimes. Fourteen (14) respondents said the bank always demand some sort of insurance. This represents 43.3% of the total population.

Table 7: Does the bank do any form of credit approval in all credit

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	7	23.3	23.3	23.3
	Yes	23	76.7	76.7	100.0
	Total	30	100.0	100.0	

Data Source: Field Survey July, 2015

On the issue of whether the bank performs any form credit appraisal, it was evident that the bank does so. Twenty- three (23) the respondents said yes to the question and this represents 76.7% of the population and 23.3% constituting seven (7) respondents objected to that fact. This means that the bank takes into consideration all risk associated with credit. It also means that with such policy, the bank has a clear understanding when it comes to giving out credit to customers.

Table 8: Does the bank review its lending policies?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not at all	1	3.3	3.3	3.3
	At times	15	50.0	50.0	53.3
	Very Often	14	46.7	46.7	100.0
	Total	30	100.0	100.0	

Data Source: Field Survey July, 2015

In soliciting for the information with regards to the bank's review of lending policies, the researcher found out that the bank does but not steadily. From the analysis, fourteen (14) respondents representing 46.7% said very often the bank does review it lending policies. This they said when the need arises. Fifteen (15) respondents representing 50% of the total population said at times, the bank does review its lending policies. To them once a while the bank changes it policies governing lending. Only one (1) respondent said that the bank does not review it lending policies. This represents 3.3% of the population.

4.0 SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

4.1 Summary of Findings

Looking at the way credit risk is being managed or assessed, there has been remarkable progress in the area of credit risk prevention over the years. The bank has put in place prevention techniques and tools to measure and evaluate credit risk.

The research objectives were to determine the various policies guiding lending. It also set out to know if policies are reviewed periodically to adjust to current change. In addition, it also aimed at examining the various survival strategies developed by bank managers to manage credit risk and formulate possible new strategies to address the problem.

This study was carried out to find out how successful banks have been in credit risk management. To examine these, SG-SSB Ghana Ltd, Tema branch was selected.

The study identified the importance of managing credit risk in banking. To do this successfully, both primary and secondary data source were used for the analysis. The research encountered some problems in the course of the study. Among them were limited time and unwillingness on the part of the correspondents to offer information concerning banking operations, the considered the possibility of such information being liked to other competitors, although they were assured the research was meant for academic purposes.

From the research conducted, it was discovered that there are principles, practices and policies guiding lending which are;

- Advances should be given to customers of the banks who may need and are qualify for such loans. Qualification here refers to whether the customers have regular income and other securities as required by the bank in order to serve as the basis on which a loan can be granted.
- Loans should be spread to all sectors of the economy (such as personal, agricultural, mining etc) to minimize risk default, should a sector fail.
- Also, loans should be approved within ones or a group committee stated limited.

In addition, it was also revealed that the bank has improved in recovering the loan from borrowers. The recovering rate has improved compared with the previous years'. The rate is currently about 83%. Notwithstanding this, the banks' credit risk management activities have succeeded in minimizing the credit risk from appraisal to disbursement of loan facilities.

Information gathered also indicated that collateral or securities required for loans to be granted should be marketable, realizable, adequate, risk free and must possess value, which has been registered. An example is land and building. This way, more people will be in the position to meet the requirements of the bank and more people would be able to assess loan.

The banking industry has become very vibrant and competitive, and if the terms and conditions of assessing and granting loans are not attractive enough, the customers of the bank will resort to taking loans from other banks who's terms and conditions are more favorable.

It was also found out that the banks' customers most at times are able to meet their repayment requirement; however, this situation is not always so some customers in isolated cases are able to completely outwit the bank and default in the repayment of the loan. In effect, the impact of high default rate has a negative impact on the banks' profits.

It was also discovered that the banks sometimes demand insurance cover on loans. This is done especially when huge sums of money are involved or loans are meant for big business projects, the higher the amount of money, the higher the risks involved, hence insurance covers are demanded to hedge against the risk or reduce the effect on the profits of the bank in case of default or non-payment.

Presently, the banking industry has become very competitive with the influx of new banks and each bank trying to win over customers to their side. To maintain its market share and build upon its customer base, the banks' lending policies are reviewed very often to meet the dynamic and the competitive nature of the banking sector and its part of the standards and requirements defined by the Central Bank. From these findings the objectives of the research have been addressed and thus, can be referred to as been fulfilled.

4.2 Conclusion

It is difficult to draw a general conclusion from the study of credit risk management in banks, because credit risk management varies from one bank to another due to various internal conditions. Nevertheless, since banks are regulated and operate within the same economic, political and social environment, there is the likelihood of banks sharing some common features regarding credit risk management. Therefore, SG-SSB Ghana Limited always operates within the definitions of the regulatory body which is the Central Bank and also operate in fulfillment the missions and purpose of its establishment.

To conclude, it must be noted that the long-term survival of banks depends largely on the profit derived from its lending activities, which in turn depend on how effective credit risk activities and practice have been managed. Taking a look at the advancements made in the banking sector, it is obvious that there have not been effective and efficient strategies to combat the problems completely. From a verbal conversation between the researcher and the head credit risk management at the bank and also analysis from the questionnaires, it is clear that provision for bad and doubtful debts kept rising from early 2000.

However, through effective credit management policies and loan recovering policies, the bank saw a reduction in the provision for bad and doubtful debts to the extent that 6.6% was recorded in 2014 as compared to 13.9% in 2013.

The financial sector is currently undergoing rapid changes. In responses to these changes, it is appropriate to review the strategies of the bank. The banks should concentrate on their core business of good and sound banking for all sectors of the economy, exploring its distinctive capabilities and keeping force.

In a nutshell, managing credit risk is a fundamental component in the safe and sound management of companies. Credit risk management involves establishing a credit risk philosophy, policies and procedures for prudently managing such risks.

4.3 Recommendations

One success factor for successful management of business is having the act of effective management risk to improve their profits, reduce cost and make good appraisal of loans. However, for effective management of credit, the respondent recommended that there should be constant review of credit policies, procedures to include modern concepts and practices, training of credit staff and proper mechanism put in place to minimize the effect of credit risk. In addition, in order to reduce default rate on loans, early identification of credit risk at all level of credit delivery, constant monitoring of loans and regular customer visit should be enforced.

In effect, credit risk management standard should be maintained, notwithstanding pressure for increased profitability, marketing considerations and vastly more complex financial environment.

When a bank is concerned about the credit risk of a borrower, it can

- Refuse to lend
- Agree to lend, but at a high rate of interest to compensate for the risk, and perhaps on terms that differ from the customer’s original proposition, example, for shorter lending term.
- Agree to lend, but with some protections in the form of security, a guarantee, or a loan covenants.

For companies granting trade credit, the options are different. They can refuse credit, and so risk losing the customer’s business by insisting on cash advance. Alternatively, they can arrange a more secure method of payment.

The bank can also adopt insuring loans as means of hedging its risk. Credit insurance protects the holder from non-payment by customers for goods supplied or services rendered. Debts can be ensured subject to the approval by the insurance company. Credit insurance will help to minimize the bank’s exposure to credit risk for the debts covered by the insurance policy. The bank must ensure that all assets offered as security to the Bank must be adequately insured.

When providing a facility to purchase specified items (motor cars, residential properties, etc), the Bank must insist on comprehensive insurance cover to provide certainty that in the event of a valid claim, the customer and the Bank will be reimbursed in respect of the losses. To ensure that the cover is in place the Bank may arrange the cover and debit the premium to the customer’s account. Only policies from insurance companies which the bank considers to be reliable should be accepted.

As with all insurance policies, terms of cover are agreed with the insurance company in return for the payment of a premium. The purpose and the attraction of credit insurance is the removal of credit risk and, often, the provision of bank facilities. Where a property (land and buildings) is to be used as security, assessment thereof will take into account its location, construction, proposed use, tenure, covenants, restrictions, valuation and marketability. The Bank should require a mortgage with good title, with leases having a minimum unexpired period as stipulated in the rules and regulations as required by law.

The researcher also suggests that the bank should also identify whether there are any detrimental environmental issues that may result. Such issues will be assessed so as to identify the impact on the marketability and credit risk.

With these, the researcher believes that credit risks will be effectively managed and the adverse effect of losses incurred by the bank as a result of non-payment of loans will be drastically reduced.

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