International Journal of Economics, Commerce and Management
United Kingdom Vol. IV, Issue 5, May 2016
http://ijecm.co.uk/ ISSN 2348 0386

ROLE OF PROJECT FINANCING APPRAISAL ON THE CREDIT RISK MANAGEMENT IN BANKING SECTOR IN RWANDA: A CASE STUDY OF GUARANTY TRUSTBANK

Kabeja Faustin
Student, Jomo Kenyatta University of Agriculture and technology, Kigali Campus, Rwanda
kabejam79@gmail.com

Kule Julius Warren
Lecturer & Chair of Department of Management and Social Sciences,
Jomo Kenyatta University of Agriculture and technology, Kigali Campus, Rwanda
kulewarren@gmail.com

Mbera Zenon
Lecturer, Department of Management and Social Sciences,
Jomo Kenyatta University of Agriculture and technology, Kigali Campus, Rwanda
rutsiri@gmail.com

Abstract

This study assessed the role of project financing appraisal on the credit risk management in banking sector in Rwanda. The specific objectives were to determine the relationship between technical feasibility of the project and managing credit risk in financial institutions, to establish the effects of assessing financial viability of the project on credit risk mitigation role, to assess the importance of conducting credit rating of the project before providing them with construction loans and to examine the relationship between project financial appraisal and credit risk management. The study used descriptive case study research. The results show that there is a significant relationship indicated by a p-value of .001 which is less than .005. Objective two indicates that financial institutions scrutinize the financial viability as a tool for financial appraisal in a project before issuing loans. Majority of the respondents indicated that indeed they use a business plan to conduct assessment and also majority of them strongly agreed that financial *viability is reflected through profitability of the project. On objective three, results revealed that while conducting financial appraisal in the bank, it is important to assess the credit rating of the client. The study found out that commercial banks in Rwanda still face a high rate of credit risks due to inadequate financial project appraisal tools while financing various projects.*

Keywords: Project Financing Appraisal, Project Credit Risk Management, Technical feasibility, Financial viability, Project Credit Rating

INTRODUCTION

Credit risk is defined as the potential that a borrower or counterparty will fail to meet its obligations in accordance with agreed terms. According to Chijoriga (1997) credit risk is the most expensive risk in financial institutions and its effect is more significant as compared to other risks as it directly threatens the solvency of financial institutions. While financial institutions have faced difficulties over the years for a multitude of reasons, the major cause of banking problems continue 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 lead to deterioration in the credit standing of financial institution's counterparties (Basel, 1999).

The global financial crisis caused the collapse of some financial institutions because they had weak financial appraisal tools to detect the risk having huge non performing loans. Inflation, high and volatile interest rates, recession, spate of banking problems and collapse worldwide has been amongst the pressure that has increased the risk in the banking environment and also, traditional bank management practices have shown to be inadequate by themselves in this demanding, unstable, challengeable, uncertain and hostile operating environment (Garderner, 2007).

Financial institutions in developing countries need to be very conscious about their portfolio in order to avoid credit risks. This is because majority of the clients depend on bank loan to develop their various projects. Portfolio theory is therefore more important in banks because it deals with the selection of portfolios that maximize expected returns consistent with the individual acceptable levels of risk. The theory provides a framework for specifying and measuring investment risk and to develop relationships between risk and expected returns. Its main basic assumption is that investors often want to maximize returns from their investments for a given level of risk. The full spectrum of investments must be considered because the returns from all these investments interact hence the relationship between the returns for assets in the portfolio is important (Reilly & Brown, 2011).

The banking industry has achieved great prominence in the Rwanda economic environment and its influence play a predominant role in granting credit facilities. Credit functions of Banks enhance the ability for investors to exploit desired profitable venture. Credit creation is the main income generating activity of banks. The probability of incurring losses results from non-payment of loans or other forms of credit by debtors. Credit Risk are mostly encountered in the financial sector, particularly banks. Credit risk according to Basel Committee of Banking Supervision Basel Committee on Banking Supervision (2001) and Gostineau (1992) is the possibility of losing the outstanding loan partially or totally, due to credit events (default risk). Athanasoglou, *et al.,*(2005), suggested that bank risk taking has pervasive effects on bank profits and safety.

This study was conducted in GTBank Rwanda which is a Nigerian multinational financial institution. In 2013, Guaranty Trust Bank acquired 70 percent shareholding in the Fina Bank Group for a cash payment of US$100 million (National correspondent, 2013). In January 2014, the bank rebranded to reflect the new ownership structure. As of January 2014, the shareholding in the stock of GT Bank (Rwanda) was distributed among Guarantee Trust Bank which owned 64%, Government of Rwanda which owned 8% and other unspecified stakeholders who owned 28% of total shares.

Credit appraisal is normally conducted in the GTBank using the Credit Policy Guide (CPG). This document provides the guidelines for evaluating the project of the loan to find out repayment capacity of the borrower. The primary objective is to ensure safety of the money of the bank and its customers. The process involves appraisal of market, management, technical, and financial. Financial appraisal tries to assess the correctness or reasonability of the estimates of costs and expenses and also the projected revenues. These may include the estimation of selling price, cost of machinery, the overall cost of project and the means of financing. It involves extensive financial modeling in excel. Basically, it takes the financial statements of previous periods and forecasts the future financial position for at least till the loan matures. From that, the cash flows of each year are compared with the installment of loan because ultimately the cash flows are going to honor the payments of bank. Feasibility of the project is evaluated in terms of debt servicing capacity of the firm.

Statement of the Problem

Experiences over the years have shown that inadequate credit analysis and sound judgment of loans application have resulted in Non Performing Loans (NPL). For bank to be successful, their corporate credit appraisal, disbursement, adequate monitoring and repayment must be assured. However, few studies have been done on credit risk management among them includes Owusu (2008) who conducted a study to give insights into the practice on credit practices in rural banks in Ghana found out that the appraisal of credit applications did not adequately assess the inherent credit risk to guide the taking of appropriate decisions. Silikhe (2008) on credit risk management in microfinance institutions in Kenya found out that despite the fact that microfinance institutions have put in place strict measures to credit risk management, loan recovery is still a challenge to majority of the institutions.

Normally, GTBank Rwanda uses use credit policy guide which is designed to be consistent with sound and prudent bank lending practices in use elsewhere in the world. The manual's purpose is to provide all personnel with a comprehensive understanding of how credit of any nature is to be extended by the Bank. Similarly, the biggest problem facing banking in Rwanda is the risk of customers or counter party default. Therefore the researcher intents to assess the effective credit risk management in financing private development projects. The reason for conducting this study is to assess the effects of projects financing appraisal in minimizing risk of NPL in GTBank Rwanda.

General Research Objective

The general objective of this study is to assess the role of projects financing appraisal on the performance credit risk management in baking sector in Rwanda.

Specific Research Objectives

1) To determine the relationship between technical feasibility of the project and managing credit risk in financial institutions
2) To establish the effects of assessing financial viability of the project on credit risk mitigation role
3) To assess the importance of conducting credit rating of the project before providing them with construction loans
4) To examine the relationship between project financial appraisal and credit risk management

Research Questions

The study was guided by the following research questions:

1) What is the relationship between technical feasibility of the project on managing credit risk in financial institutions?

2) What are the effects of assessing financial viability of the project credit risk mitigation?
3) What is the importance of conducting credit rating of the project before providing them with construction loans?
4) What is the relationship between project financial appraisal and credit risk management?

Limitations of the study

The study was limited in accessing some of the detailed information about the strategies used by the bank to manage their credit risks due to the sensitivity and confidentiality of the information sought. Some of the respondents were hesitant to provide some information because they feared that the information might be used to harm the organization. However, the information was obtained from one financial institution (GTBank) and therefore this would be bias. The information obtained in this study is limited because it may not be generalized to represent the situation on other banks. The researcher assured the respondents that the information was to be used purely for academic purpose.

THEORETICAL REVIEW

Value at a Risk (VAR) Theory

This theory was developed by J.P Morgan in 1980 in order to estimate the probability of portfolio losses based on the statistical analysis of historical price trends and volatilities.(Holton, 2002)In the strive for financial stability, a first landmark decision was the 1988 Basle accord by the central banks from the G-10 countries, which defined a minimum standard of capital requirements for commercial banks, using a percentage of risk weighted assets (Basel Committee on Banking Supervision 1988). For financial institutions, risk is about the odds of losing money given out as loans, and VAR is based on that common-sense fact. By assuming financial institutions care about the odds of a really big loss on loans, VAR answers the question, "What is my worst case scenario?"

Factors Responsible for Customer's Default

According to Onwudiegwu (2001), the concept of default is less obvious than it first seems, for it could result from non - or delayed payment of interest and or principal for a given period. One or a combination of the following factors could contribute immensely to default especially in a depressed economy. The more one borrows; the more one would want to borrow consequently. The volume of the loan would increase which decreases the ability to repay as opposed to the willingness to repay. The ability to repay increases with increased net income although that does not say anything about the willingness to repay. One would expect borrowers with high net income to have low debt/equity ratio, the lower the debt/equity ratio, the higher the ability to repay.

EMPIRICAL REVIEW

A study was conducted by Esendi, (2013) to assess the effects of credit risk management on loan portfolio among SACCOs in Kenya. Descriptive research design was used with a target population of 106 licensed Saccos from which a sample of 35 Saccos was identified from Nairobi County. The study used both primary and secondary data; primary data was obtained through questionnaires and secondary data from reports. Data collected was analyzed using descriptive statistics and regression analysis. Results indicate that formulation of the credit policy is largely done by members of the organization and regulation with moderate involvement of employees and the directors. The existing credit policy of the Sacco is the primary document upon which formulation of new credit policy is based, trends of creditors and overhead costs are also taken into account in the process of formulation. Findings further show that CAMEL rating system plays a central role in the assessment of the soundness of Saccos.

According to Kamara,*et al.,* (1997), a classic case of financial crises precipitated by bad debts is the financial turmoil that befell East Asia in late 1990's, affecting mainly Thailand, Indonesia, Malaysia and South Korea. At that time, more than 15% of bank loans in the four countries were non-performing compared to only 1% in the United States of America.

Credit Risk Management Strategies

According to Lindergren (1987), the key principles in credit risk management process are sequenced as follows; establishment of a clear structure, allocation of responsibility, processes have to be prioritized and disciplined, responsibilities should be clearly communicated and accountability assigned. The strategies for hedging credit risk include but not limited to these;

Credit Securitization

It is the transfer of credit risk to a factor or insurance firm and this relieves the bank from monitoring the borrower and fear of the hazardous effect of classified assets. This approach insures the lending activity of banks. The growing popularity of credit risk securitization can be put down to the fact that banks typically use the instrument of securitization to diversify concentrated credit risk exposures and to explore an alternative source of funding by realizing regulatory arbitrage and liquidity improvements when selling securitization transactions (Michalak & Uhde, 2009).

Adoption of a sound Internal Lending Policy

The lending policy guides banks in disbursing loans to customers. Strict adherence to the lending policy is by far the cheapest and easiest method of credit risk management. The lending policy should be in line with the overall bank strategy and the factors considered in designing a lending policy should include; the existing credit policy, industry norms, general economic conditions of the country and the prevailing economic climate (Kithinji,2010).

Credit Bureau

This is an institution which compiles information and sells this information to banks as regards the lending profile of a borrower. The bureau awards credit score called statistical odd to the borrower which makes it easy for banks to make instantaneous lending decision. Example of a credit bureau is the Credit Risk Management System (CRMS) of the Central Bank of Nigeria (CBN).

Credit appraisal in Financial Institutions

Credit appraisal of a term loan denotes evaluating the proposal of the loan to find out repayment capacity of the borrower. The process involves appraisal of market, management, technical, and financial. The bank follows an extensive process of credit appraisal before sanctioning any loan. It analyses the loan proposal from all angles. The primary objective of credit appraisal is to ensure that the money is given in right hands and the capital and interest income of the bank is relatively secured. A financial institution conduct financial appraisal by focusing on evaluating of credit worthiness of the company and future expected stream of cash flow with the amount of risk attached to them. Credit worthiness is assessed with parameters such as willingness of promoters to pay the money back and repayment capacity of the borrower. There are four broad areas of appraisal by banks are market, management, technical and management (Akalu& Turner, 2002:33).

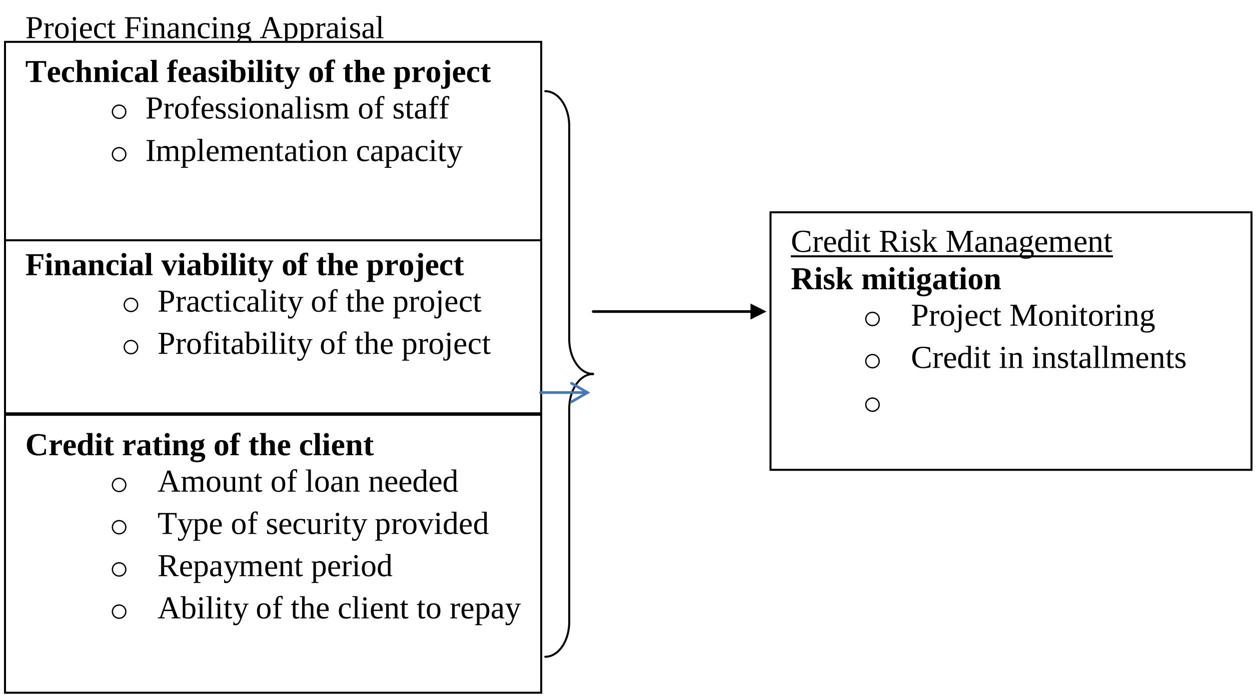
Management Appraisal: Management of the company needs to be appraised for their intentions, knowledge, and dedication towards the project. By intention, it is meant to evaluate the willingness of the promoters of the company to pay the money back. It needs to evaluate the real objective of borrowing. Only good intentions would not generate cash flows to honor the installments of the loan. The management needs to be strong in terms of their knowledge about business, commitment towards achieving the set goals etc (Akalu& Turner, 2002:45).

Technical Appraisal: Technical appraisal is subject to the kind of business and industry of the borrower. If it's a manufacturing concern, all those parameters like project site, availability of raw material and labor, capacity utilization, vicinity to selling market, transportation etc., would be examined. A project needs to be technically very sound to be able to sustain all business cycles.

Financial Appraisal: Financial appraisal involves extensive financial modeling in excel. Basically, it takes the financial statements of previous periods and forecasts the future financial position for at least till the loan matures. From that, the cash flows of each year are compared with the installment of loan because ultimately the cash flows are going to honor the payments of bank. Feasibility of the project is evaluated in terms of debt servicing capacity of the firm. Debt service coverage ratio is a key ratio which is calculated for each future financial period and if that ratio is satisfying the norms accepted by the bank, the loan would get another green signal (Akalu&Turner, 2002:38).

Conceptual Framework

Figure 1. Conceptual Framework



The conceptual framework above explains the relationship between credit risk management and loan performance. In this framework, the study shows that projects financial appraisal is the independent variable which affects credit management of the bank. In most cases, the bank will require collateral as security for the loan. Simply put, if the borrower defaults on the loan, the secured lender can be repaid by seizing the collateral and selling it. If the company is seeking a loan for the purpose of buying equipment for the business, it might be able to pledge title to the equipment as collateral for the loan.

Critique of Existing Literature

The study conducted by various authors cited in this study such as (Muasya, 2009; Muthee, 2010 & Abdifatah, 2010) they reflects that in as much as a lot of researches have been done on the impact of credit risk management and financial performance of commercial banks, most of the local studies have leaned heavily towards the various tools and techniques of credit risk management, practices and strategies used by various institutions. However, the above mention studies did not establish a clear relationship between credit risk management and financial performance.

All studies that tempted to analyze Credit Risk Management and Financial Performance from the empirical review are biased towards various methods and techniques of Credit Risk Management used by various Institutions. The studies described that Credit Risk management can contribute to the financial performance of Banks but did not establish a clear effect between Credit Risk Management and the Financial Performance it only stated credit as a factor influencing Financial Performance.

RESEARCH METHODOLOGY

Research Design

The research design used in this study was a descriptive case study research design. Descriptive research sought to establish factors associated with certain occurrences, outcomes, conditions or types of behavior.

Target Population

The study was conducted in GTBank Rwanda. Fifty two (52) employees of the business department, credit department and recovery department formed a target population.

Table 1. Statistical Population

Departments	Number of employees	Target Population
Business department	37	
Credit department	8	
Recovery department	7	
Total	**52**	**52**

The following table shows the sample frame which was used to conduct the data collection exercise. The researcher considered using Morgans' formula in case N is ≥ than 100 people as sampling method whereby N is the target population. Since the number of the targeted population is not exceeding 100 the researcher decided to use a census whereby all the targeted population was considered for data collection. The researcher used census technique by grouping the respondents into departments in the bank.

Research Instruments/ sources of data

Primary data was collected using questionnaires and secondary data was collected using annual reports for the purpose of this study and this data was derived from the financial statements of the banks and questionnaire which was distributed to the respondents. A closed ended questionnaire drafted in a Likert scale of 1 to 5 were used where by respondents were required to rate the variables based on their degree of acceptance or rejection of associated variables. The difference between primary and secondary data is that a secondary data is the information obtained from the documented evidence conducted by other scholars whereas the primary data is the first hand information collected from various individuals during the data collection exercise. Secondary data was obtained from annual reports of the bank.

Data Gathering Procedures

The researcher developed a request letter which stated the purpose of the study and describe the procedures to be followed and describe any potential benefits of the study. The researcher made appointment with members particularly the custodians of relevant reports basing on their availability and convenience that is time and space.

Data Processing and Analysis

Data was analyzed using descriptive statistics. Descriptive statistics provides simple summaries about the sample and about the observations that were made. Such summaries were quantitative, i.e. summary statistics and visual, i.e. simple-to-understand graphs. However, quantitative data was analyzed based on Pearson correlation analysis and multiple regression models which took the form of:

$$Y = \beta 0+ \beta 1X1 + \beta 2X2 + \beta 3X3 + Є$$

Where: Y = Probability of bank to either accept or reject to give loan to a client

X1, X2, and X3 = Independent Variables

X1= Technical feasibility of the project

X2= Financial viability of the project

X3= Credit rating of the client

β0 = Constant, β1, β2, β3 = Regression coefficients or Change included in Y by each X value

є = error term

ANALYSIS AND FINDINGS

Analysis of specific objectives

Table 2: ANOVA test showing the relationship between technical feasibility of the project and credit risk management in GTBank Rwanda

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.040	1	.040	.072	.001a
Within Groups	24.811	45	.551		
Total	24.851	46			

Table 2 represents the statistics obtained for objective one in assessing the importance of conducting financial appraisal of the project through the assessment of the technical feasibility of the project. The study used two sets of variables whereby one variable elaborates the response on the use of business plan to assess the risk on whether the client has technical capacity to undertake the project before GTBank decides to fund them. The response of the variable showing the use of a business plan is binary and the other variable is a scale. The results show that there is a significant relationship indicated by a p-value of .001.

Figure 2: ANOVA test on technical feasibility of the project

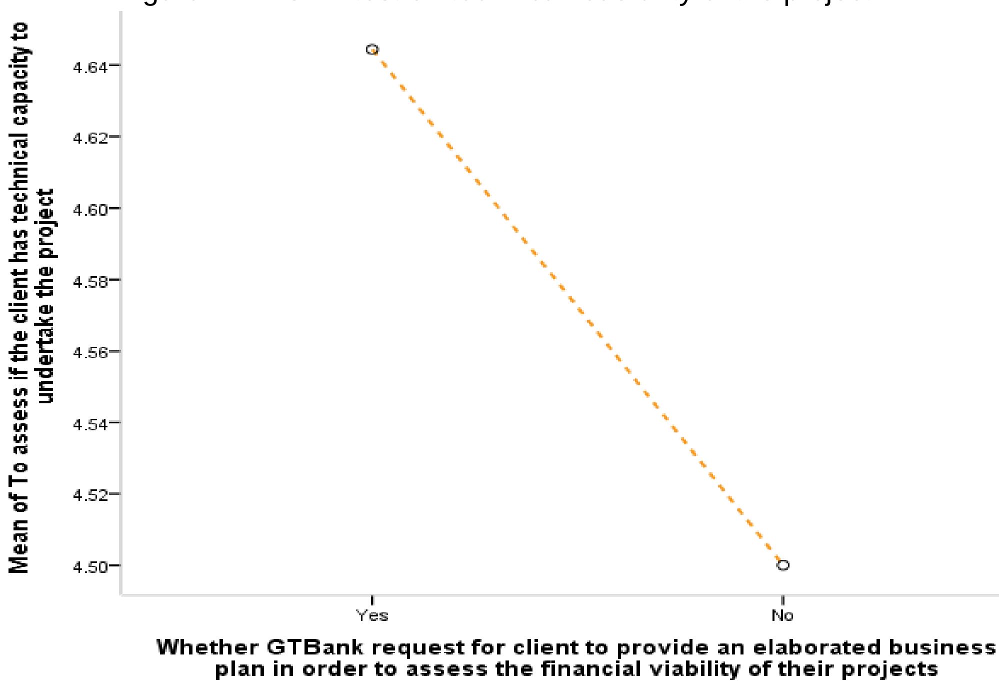


Figure 2 shows that indeed majority of the respondents indicated that the bank uses elaborate business plan to assess the technical viability of the project indicated by the mean value of 4.62 respondents strongly agreeing that indeed business plan provides information which reflects the technical viability of the client to undertake a successful projects. This shows that there is a strong correlation between the use of business plan to assess risks related to technical capacity of the client before lending them with money. This prevents the bank from plunging in to credit risk.

Table 3: ANOVA showing the relationship between financial viability of the project and credit risk management in GTBank

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	8.445	1	8.445	28.572	.000
Within Groups	13.300	45	.296		
Total	21.745	46			

Table 3 shows the ANOVA test of objective two which indicates that financial institutions scrutinizes the financial viability as a tool for financial appraisal in a project before issuing loans. The study reveals that there is a statistical significance between these two variables indicated by a p-value of .000 which is less than .005.

Figure 3: ANOVA test for assessing financial viability of the project

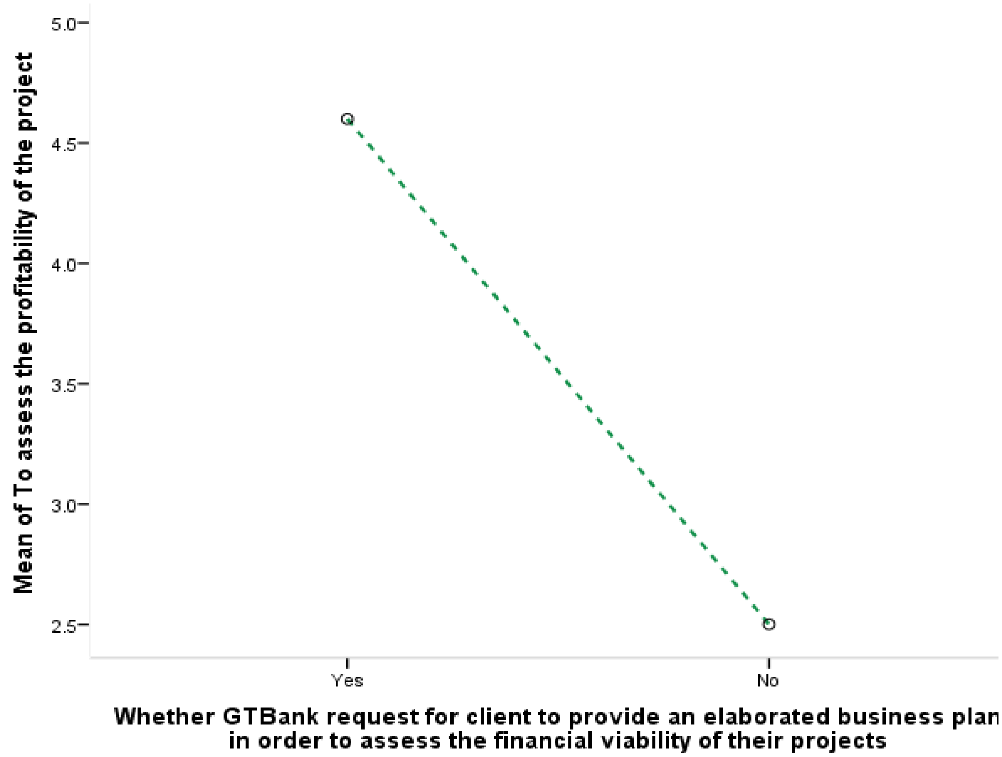


Figure 3 indicates that for financial viability a business plan is used to assess the profitability of project. Majority of the respondents indicated that indeed they use a business plan to conduct assessment and also majority of them strongly agreed that financial viability is reflected through profitability of the project.

Table 4: ANOVA showing the relationship between credit rating of the client and credit risk management in GTBank Rwanda

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.689	1	.689	2.096	.002
Within Groups	14.800	45	.329		
Total	15.489	46			

Table 4 shows the results of objective two which indicates that while doing financial appraisal in the bank; it is important to assess the credit rating of the client. It is observed that credit rating is significantly related to financial appraisal of the project as indicated by a p-value of .002 which is less than .005.

Figure 4: ANOVA test on credit rating of the project/client

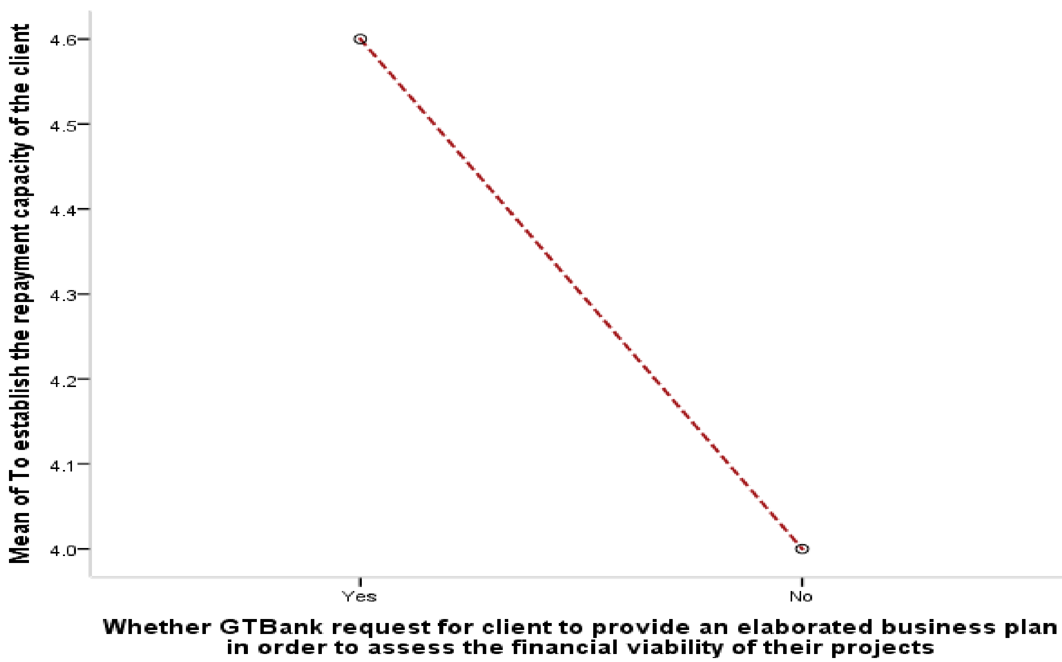


Figure 4 reveals that majority of the respondents agreed that they use business plan to establish the repayment capacity of the client or the project before granting loans. The above ANOVA statistics indicates that the appraisal processes enhance risk management in GTBank because the graphs slops down from left to right showing that majority of the respondents strongly believe that a detailed business plan assist the banker to establish the technical capacity of the client, financial viability of the project and credit rating before giving them loans. This information is crucial while seeking to assess the credit risk subjected to the bank while issuing loan for the development of projects.

SUMMARY OF FINDINGS

Relationship between technical feasibility of the project and managing credit risk in financial institutions

Objective one was to assess the importance of conducting financial appraisal of the project through the assessment of the technical feasibility of the project.

The results show that there is a significant relationship indicated by a p-value of .001 which is less than .005. Majority of the respondents indicated that the bank uses elaborate business plan to assess the technical viability of the project and also majority of them strongly agreed that a business plan provides information which reflects the technical viability of the client to undertake a successful projects.

Effects of assessing financial viability of the project on credit risk mitigation role

Objective two indicates that financial institutions scrutinize the financial viability as a tool for financial appraisal in a project before issuing loans.

The study reveals that there is a statistical significance between these two variables indicated by a p-value of .000 which is less than .005. Majority of the respondents stated that for financial viability a business plan is used to assess the profitability of project. Majority of the respondents indicated that indeed they use a business plan to conduct assessment and also majority of them strongly agreed that financial viability is reflected through profitability of the project.

Importance of conducting credit rating of the project before providing them with construction loans

The results of objective three which indicates that while doing financial appraisal in the bank; it is important to assess the credit rating of the client. It is observed that credit rating is significantly related to financial appraisal of the project as indicated by a p-value of .002 which is less than .005. Majority of the respondents agreed that they use business plan to establish the repayment capacity of the client or the project before granting loans.

Also while seeking to establish how the employees of GTBank perceive their financial appraisal capacity the researcher got a mixed perception regarding the project financial appraisal in the bank. It was concluded that this was due to fact that the bank can encounter challenges in following up and recovering some money which were channeled through unsuccessful projects.

The study also wanted to find out the risks subjected to GTBank while financing various projects. The study found out that majority of the respondents still consider that there is a high rate of risks subjected to the GTBank while financing various projects in Rwanda. According to the respondents, more than 85% said that the risk is high. This implies that in average the bank needs to come up with stringent measure to handle bad debts and non performing loans in the bank.

Relationship between project financial appraisal and credit risk management

Objective four sought to find out the relationship between project financial appraisal and credit risk management in GTBank Rwanda. The results shown in ANOVA statistics indicates that the appraisal processes enhance risk management in GTBank because the p-value of .001 the two variables reflects a significant relationship indicated by a response of the variable showing the use of a business plan is binary and the other variable is a scale. Similarly, the ANOVA test indicates that financial institutions scrutinize the financial viability as a tool for financial appraisal in a project before issuing loans. Third, it was observed that while doing financial appraisal in the bank; it is important to assess the credit rating of the client in order to mitigate risk through credit rating. The results show that there is a significant relationship between financial appraisal of the project and risk mitigation as indicated by a p-value of .002 which is less than .005.

CONCLUSION

Relationship between technical feasibility of the project and managing credit risk in financial institutions

Majority of the respondents stated that it is being done for the purpose of assessing the viability of the project and the rating is indicated, to provide management with enough information to know to assess whether the project can be done was rated, to see whether the final product will benefit its intended users was rated, to assess how much technical risk is subjected and to assess if the client has technical capacity to undertake the project. This implies that in average majority of the respondents chose either the value 4 or 5 in a Likert scale which indicates that they either agreed strongly or normally with the above stated variable. The study also reveals that GTBank request for client to provide an elaborated business plan in order to assess the financial viability of their projects. A business plan serves as a blueprint for how a client intends to conduct his/her business. This document informs the banker whether the business is viable or not. A client needs to have a business plan to seek investors or get a loan for his/her company; the plan is actually for both the client's benefit as well as the bank's benefit.

Effects of assessing financial viability of the project on credit risk mitigation role

Some of the effects highlighted by the majority of the respondents stated that project financial appraisal enables the bank to avoid credit risks, to assess the profitability of the project, to establish the amount of loans to be given to the client and to establish the repayment capacity of the client rated. In regards to debt recovery strategy used in GTBank, the most common one is disposing the collateral security through auctioning at any prevailing cost so long as the having. The second one is approaching the guarantor today the remaining dues being and least is taking the matter to the court and waiting the court verdict.

Importance of conducting credit rating of the project before providing them with construction loans

To start with the study reveals that the bank has to conduct adequate credit appraisal to see whether the project is worth financing or not. Secondly, the bank requires a client to provide a mandatory security. This is in form of a collateral security which covers the loans in case of default in payment. Thirdly, is to bank or rather to open an account in GTBank so that the project revenue can be deposited. This will enable the bank to monitor the account as well as assess the progress of the client. The fourth one is through the process of financing the project. If the project is huge and requires a lot of money and time, the bank can organize to finance the project in installments. The fifth is by conducting adequate feasibility study. Lastly is by conducting regular visits at an interval to assess the progress of the project.

Relationship between project financial appraisal and credit risk management

The study found that some of credit risks faced by GTBank include fund deviation, lack of tenants of commercial buildings and inflation rate. However, to avoid huge losses the bank usually conducts financial project appraisal of the client before lending them loans in the bank. The objective of credit analysis is to look at both the borrower and the lending facility being proposed and to assign a risk rating. The risk rating is derived by estimating the probability of default by the borrower at a given confidence level over the life of the facility, and by estimating the amount of loss that the lender would suffer in the event of default.

RECOMMENDATIONS

1. The bank should develop more stringent measures to which are effective in monitoring risks subjected to the bank while financing various projects
2. Improve their assessment on lending security values. The bank should select competent property valuers with experience and capacity to evaluate the property being provided by a borrower as collateral security in the banks in order to avoid overvaluation of the property which will affect the ability of the bank to recover their money.
3. Target small projects or clients. In Rwanda, nearly 70% of traders operate small business but the rate at which they turn around the first capital is impressive. They are ambitious and would want to succeed as well and therefore an additional value to what they already have.

REFERENCES

Abdifatah, I. O. (2010) A comparative analysis of credit risk management practices of Islamic and conventional banks in Kenya, unpublished MBA project, University of Nairobi

Akalu M.M & Turner J.R. (2002) Investment Appraisal Process in the Banking & Finance Industry http://papers.ssrn.com/

Athanasoglou, P., Brissimis, S N., and Delis, M D. (2005), Bank-specific, industry specific and macroeconomic determinants of bank profitability, MPRA Paper No.153.

Basel Committee on Banking Supervision (1988) International Convergence of Capital Measurement and Capital Standards (www.bis.org/publ/bcbs04A.pdf)

Basel Committee on Banking Supervision, (2001). Risk management practices and regulatory capital: Cross-sectional comparison. Basel Committee on Banking Supervision. Available from www.bis.org

Chijoriga I.V.,(1997). Raising the profitability of commercial banks, BIATEC, Retrieved on April, 2005, 11. Available from http/www/nbs.SK/BIATEC/.

Kamara T., Chen, K. and Pan, C. (1997). An Empirical Study of Credit Risk Efficiency of Banking Industry in Taiwan, Journal of Chinese Management Review, 15(1), 1-16.

Esendi T.J (2013) The effects of credit risk management on loan portfolio among SACCOs in Kenya.

Gardener E.P.M., (2007) Risk Management :A New Risk management Tool For Banks p. 10

Gostineau, G.L., (1992). Dictionary of financial risk management, Swiss Bank Corporation, Chicago. (same font size)

Holton G.A. (2002) History of Value-at-Risk: Working Paper July 25. Accessed on http://stat.wharton.upenn.edu/

Jorion P., (2001) Value at Risk, 2nd edition, McGraw-Hill.

Kithinji, A.M. (2010). Credit Risk Management and Profitability of Commercial Banks in Kenya.Business management Journal, University of Nairobi.

Lindgren, H. (1987). Banks, Investment Company, Banking Firms, Stockholm Enskilda Bank (1924-1945), Institute for Research in Economic History, Stockholm School of Economics, Stockholm.

Lintner, J. (1965). The valuation of risk assets and the selection of risky investments in stock portfolios and capital budgets, Review of Economics and Statistics, 47 (1), 13–37.

Manganelli S., & Engle F. R, (2001) Value at risk models in finance, Margrabe W. (2007) Credit risk management of commercial loan portfolio

Marsh, I.W. (2008). The Effect of Lenders' Credit Risk Transfer Activities on Borrowing Firms' Equity Returns, Cass Business School, London and Bank of Finland.

Michalak, T. and Uhde, A. (2009).Credit Risk Securitization and Banking Stability: Evidence from the Micro-Level for Europe", Draft, University of Bochum, Bochum.

Muasya, B. W. (2009) The impact of non-performing loans on the performance of the banking sector in Kenya, unpublished MBA project, University of Nairobi.

Mugenda, O.M and Mugenda A.G. (1999) Research methods: Qualitative and Quantitative approaches, Nairobi; Acts Press.

Muthee, J. G. (2010) The relationship between credit risk management and profitability: A study of commercial banks in Kenya, unpublished MBA project, University of Nairobi

Nation Correspondent, (29 December 2013). "Regulator Approves Plan By Nigerian Bank To Buy 70 Percent Fina Stake". Daily Nation Mobile (Nairobi).Retrieved 7 June 2015.

Onwudiegwu L.M. (2001) Excess Liquidity and Unplanned Inventory.Business Times Wed. 4 April 2001

Owusu J., (2008). "Central bank and the macroeconomic environment in Nigeria".Quarterly Review, 3(3): 25-34.

Reilly O.K & Brown, T.J (2011). The Effects of Credit Derivatives on U.S. Bank Risk and Return, Capital and Lending Structure, Draft, Sam M. Walton College of Business, Arkansas. Working Paper Series 075, European Central Bank.

Sharpe, W.F. (1964). Capital asset prices: A theory of market equilibrium under conditions of risk, Journal of Finance, 19 (3), 425–442

Silikhe, N.J. (2008). The profitability of banking sector in Hong Kong.In Hong Kong Monetary Authority Quarterly Bulletin.pp. 5- 14