Examining Credit Screening Criteria's: Evidence from Five Selected Microfinance Institutions in South West Ethiopia, Oromiya Region, Jimma Town

Kefiyalew Belachew Bayu[1*] and Dagnachew Abera Hunde[1]

[1]*Department of Accounting and Finance, College of Business and Economics, Wolkite University, Wolkite, Ethiopia.*

Authors' contributions

This work was carried out in collaboration between both authors. Both authors have participated in designing and conducting the study as well as preparing the report. Both authors read and approved the final manuscript.

Article Information

Original Research Article

ABSTRACT

The ability of MFI's to formulate and adhere to policies and a procedure that promotes credit quality and curtails non-performing loans is the means to survive in the stiff competition. Inability to create and build up quality loans and creditworthy customers lead to default risk and bankruptcy as well as hampers economic growth of a country. This study of credit screening– A Case Study on Microfinance Institution in South West Ethiopia, Jimma Town is an attempt to indicate the criteria that MFI's should take in credit screening. Thus, the rationale behind for undertaking this study is to deeply examine and screen the credit criteria and to suggest the possible solutions that enable the MFI's to run its operation most safely as credit is known to be the mainstay of all MFI. For the study, both primary and secondary data were used. Primary data was collected using structured questionnaires and in-depth- interview and Qualitative approach were adopted. Hence, the nature of the study is descriptive and it is related to qualitative analysis method. The census or total universe inquiry method was applied since the study is the easily manageable and the total number of population in the MFI was less than 30. Finally, based on the findings possible recommendations were given. These include the issues impeding loan growth and rising

_____

Corresponding author: E-mail: Kefebelaacct@gmail.com;

loan clients complaint on the MFI regarding the valuing of feature offered for collateral, lengthy of loan processing, amount of loan processed and approved, loan period as well as the amount, and discretionary limits are currently affecting the performance of credit screening and management.

1. INTRODUCTION

Credit screening is the gathering and validation of information that can be used to determine the creditworthiness of a person or a company. Despite their significant importance business enterprises contribution to economic growth they still face with numerous challenges that inhibit entrepreneurial growth. There are different changes and factors have been influenced by the credit profession in recent years. Technological development and regulatory bodies have caused the credit policy to re-examine its purpose intentions and methodology, especially the sub-Saharan suffer from poor management skills which is a result of lack of adequate technological training, this results in the high rate of business failure and he has also indicated in putting together the best possible package to secure a business loan, it's important to know what happens after you leave the MFI and the lending officer evaluates your request.[1]. In evaluating loan application, there are five C's of credit that had to be considered these are: - character, capacity, collateral, Conditions and capital. Character is a check on your financial status and personal credit history, including your previous loan payment record. Collateral is anything of value used as security for repayment of a debt or performance of a contract. Capacity is MFI usually look first to the cash flow of the business as the source of funds for repaying the loan. Conditions are the general economic and social conditions in the customer's line at business. Capital is the customer's financial reserves. [2].

An advantage of preparing an effectively organized loan application, including a well thought out business plan is that it had significantly decreased the time spent waiting for an answer. Much of the time spent in approving a loan can be traced to the MFI's having to ask the potential borrower for more information or for clarification of the information that has already been submitted. [3].The effective and efficient way of evaluating and screening credit criteria is helpful and it is the base that MFI should take

into their consideration to gain profitability and continuous growth. It is a way for either customer for extending credit but if the MFI does not have any idea about the customer credit information and if it simply lend money the MFI would finally end with crisis and it had been gone out of the market because there is the uncertainty of future and the loaned amount may not be returned. So, to reduce the above-listed problems at Microfinance Institution in South West Ethiopia, Jimma Town and to enhance its profitability and continuous growth it is avoidable to conduct a study on this area. [4].

The quality of credit screening and standard of the practice in an organization is mainly determined by the essence of its policies, procedures, and the process of its implementation [5,2]. The relevancy and validity of criteria's used in credit screening also determined by the degree it meets the organizational objective, in this regard understanding the needs and interest of the organization help to determine that should be put in the credit screening practice of the organization. [6,5,2]. In today's world, financial institutions especially MFI's have many functions. From all the functions, lending or extending credit is the most important one. Credit or a loan comprises a very large portion of total assets, and it is the backbone of every MFI. The strength of the MFI's is thus primarily judged by the soundness of its credit policy and management credit to customers requires the backing of more capital than other types of MFI's assets. [7,4,8]. There are some research and project which had done on credit-related topics i.e. [9], focused on the effects of credit management on the profitability of commercial bank of Ethiopia but he does not show which criteria the MFI's should follow to screen the customer credit capacity. The other study was by [1] and it focuses on the quality of credit evaluation at MFI's in Ethiopia but he does not cover and focused on the cause, effect and remedies to be taken by the MFI's to screen and evaluate the customer credit capacity and the procedures that the MFI should follow to evaluate credit in case of Microfinance Institution

in South West Ethiopia, Jimma Town. Currently, there are about more than 105 MFI's in our countries. Among them, some of them are located in the Southwest part of Ethiopia, Jimma Town. For success and continuous growth purposes, following of rules and procedures is not enough but evaluating and screening customer credit capacity is preferable because, in credit mechanism, there is un-collectability of the amount. MFI's may run out the market, if it does not device and evaluate effective credit screening criteria. So, evaluation and screening of customer information is very critical concepts before extending the credit and continuously evaluating the customer attitude and capacity is the best way for organization success. The main reason that initiated the study to conduct this research is that to examine the problems that Microfinance Institution in South West Ethiopia, Jimma Town in time of screening credit as well as to fill the gap and to show the way to screen the credit criteria before lending the finance. In this regard or from the above-stated statement of the problem, this study had observed and investigates the criteria's of credit screening of Microfinance Institution in South West Ethiopia, Jimma Town and tries to address the following questions such as:-

1. What are the credit screening criteria's used by Microfinance Institution in South West Ethiopia, Jimma Town?
2. What effects does credit screening criteria's of the MFI's have on the credit provision at Microfinance Institution in South West Ethiopia, Jimma Town?
3. Is credit policy of the firm periodically revised and followed effectively Microfinance Institution in South West Ethiopia, Jimma Town?
4. What do the credit provision of the firm look like in Microfinance Institution in South West Ethiopia, Jimma Town.?

The primary and general objective of the study is to examine the criteria's used in credit screening at Microfinance Institution in South West Ethiopia, Jimma Town.

The specific objective of the study had intended:

- To examine the overall credit screening criteria's of Microfinance Institution in South West Ethiopia, Jimma Town.
- To analyze the effects of credit screening criteria on MFI's credit provision and achieving their primary objective at Microfinance Institution in South West Ethiopia, Jimma Town.
- To explore whether the credit policy of the firm is periodically revised effectively Microfinance Institution in South West Ethiopia, Jimma Town.
- To examine credit provisions information at Microfinance Institution in South West Ethiopia, Jimma Town.

2. LITERATURE REVIEW

2.1 Theoretical Literature Review

2.1.1 Definition and concepts underlining credit

Credit is a mechanism of extending the loan to get interested back with its principal and as a result, it is essential for individual consumers, retailer, service business operations, wholesales, manufactures, financial executive, and government officials to have a clear understanding of what credit is what it does, what it can do and what it cannot do. [9,10]. More formally credit is defined as an immediate acquisition of fund or something in return for promise makes an appropriate payment in the future. These days credit becomes "the business of financial institution and the primary basis on which lenders quality and performance judged" credit enables people to obtain goods, or services even if they do not have enough money to pay for them right away. [3,11].

Credit is borrowed funds with specified terms of repayment when there are insufficient accumulated savings to finance a business and when the return on borrowed funds exceeds to interest rate changed on the loan it moves sense to borrow rather them postpone the business activity until sufficient savings can be accumulated, assuming the capacity to service the debt exists. In business the word credit means the act making loan either by ways of direct lending or by post-payment for transactions carried at present with the transfer at good or money. Credit act as a medium of exchange by facilitating. The passage of goods, services from the seller to buyer just like money it is also medium of exchange that is created a t the time of the transaction and that arise to facilitate that transaction. [12].

2.1.2 Access to finance: Some definitions

2.1.2.1 Equity versus debt financing

There are two primary sources of external finance for new SMEs, equity and debt. External

equity in the form of venture capital or the stock exchange is usually not available for new SMEs, primarily due to the relatively small levels of financing desired by a new SME. The lack of external equity makes many new SMEs dependent on MFI's loans and overdrafts and suppliers credit for early-stage financing. Despite the dependence of SMEs on debt finance, access is very limited for new SMEs, especially in developing countries). [13,14,8]

2.1.2.2 Indicators of access

Objective indicators of access used by the World Bank Enterprise Survey of 2008 include whether the firm has any credit products (e.g. Overdrafts, loans or line of credit), loan applications and rejections, percent of finance for working capital and investment, and interest rate. Subjective indicators of access include whether the firm claims to access is one of the top three obstacles and whether the firm states no need for a loan as a reason for not applying for a loan.

2.1.2.3 Measures of quality access

External finance is used by firms to finance working capital requirements and investment in productive assets. Thus, two commonly used measures of the quality of access are [15] percent of bank finance used by firms to pay for their working capital and [13] the percent used to pay for investments.

2.1.3 Credit policy

The term credit policy refers to those which influence the amount of credit. According to, [7,16] If affirm decides to grant credit to its customer, them it customer, it must establish procedures for extending credit and collecting. In particular, the firm will have to deal with the following complaints of credit policy. That is of sale credit analysis and collection policy. Optimum credit policy is one which maximizes the firm's value. Value of firm is maximized when the incremental rate of return of investments equal to the incremental cost of fund used to finance the investment incremental rate of return can be calculated as incremental operating profit divided by incremental investment in receivable the incremental cost of fund is the rate of return required by the supplies of funds. [17,18,12].

2.1.3.1 Terms of sales

The terms of sale establish how the firm proposes to sell its good and services. A basic decision whether the firm will require cash or will extend credit if the firm does grant credit to a customer, the terms of sales will specify the credit period, the cash discount and discount period the type of credit instrument.

2.1.3.2 Credit analysis

In griming credit a firm determines to show much effort to expend trying to distinguish between customers who will pay and customers who will not pay. The firm uses several device and procedures to determine the probability that customers will not pay, and put together these are called credit analysis.

2.1.3.3 Collection policy

Often credit has been granted, the firm has the potential problem at collecting the cash for which it must establish a collection policy. [6,4,8].

2.1.3.4 Credit Policy effects

In evaluating credit policy, there are five basic factors to be considered:-

2.1.3.5 Revenue effects

It the firm grant credit then there will be a delay in revenue collection as some customers take advantage of the credit offered and pay later. However, the form may be able to change higher price it is grant credit and it may be able to increase the quantity sold. Total revenues may thus increase.

2.1.3.6 Cost effects

Although the firm may experience delayed revenues if it grants credit, it will still incur the costs of sales immediately. Whether the sells for cash or credit, it will still have to acquire or produce the merchandise (and pay for it).

2.1.3.7 The cost of debt

When the firm grants credit, it must arrange to finance the resulting receivable. As a result, the firm's cost of short term borrowing is a factor in the decision to grant credit.

2.1.3.8 The probability of non-payment

If the firms grant credit some percentage of the credit buyers will not pay. This can't happen if the firm sells for cash.

2.1.3.9 The cash discount

When the firm offers a cash discount at part of its credit term, some customer will choose to pay early to take advantage of the discount.

2.1.4 Credit evaluation and Credit Scoring

Credit evaluation: there are no magical formulas for assessing the probability that a customer will not pay in very general terms, the classic five C's of credit are the basic factors to be evaluated by [18,11,1]. They are explained briefly as follows:-

Character: Character is a check on your financial status and personal credit history, including your previous loan payment record. The theory is that people are creatures of habit - if you have repaid a loan on time before, you will repay this one as well. Conversely, if you have defaulted on a previous loan, the danger is that you'll tend to default again.

Another facet of character is experienced in the type of business you are trying to finance, including the level of responsibility, education, and business management training. Lenders are particularly concerned that potential borrowers have a solid understanding of financial record keeping, business credit, the importance of collecting accounts receivable, inventory control and turnover, and marketing their product or service.

Capacity: MFI's usually look first to the cash flow of the business as the source of funds for repaying the loan. Consequently, preparing a cash flow statement with future cash flow projections to present with your loan request is important. Doing so indicates to the lender that you are aware of the cash coming into your business, and are therefore better able to avoid a cash shortage that would jeopardize making monthly payments.

Collateral: While cash flow is the primary source of loan repayment, lenders will want a backup or secondary source as an exit or last resort, should your business not prove profitable. Collateral - anything of value used as security for repayment of a debt or performance of a contract - can be real estate, stocks and bonds, savings accounts, equipment, accounts receivable, or the cash value of life insurance policies.

Psychologically, lenders feel that borrowers have more interest in repaying the loan if they know that failure to do so will result in the lender taking possession of whatever has been put up for collateral. A lender will also try to obtain personal guarantees so that if you default on the loan, the institution has access to your assets

Conditions: General economic conditions in the customer's line at the business

Capital: The customer's financial reserves.

2.1.5 Credit scoring

Refers to the process of calculating a numerical rating for a customer based on information collected and turn granting or refusing credit based on the result.

2 2 Empirical Review

[19,20] have tried to analyze and evaluate customer credit management on MFI's performance which was reflected their financial statements and to provide some comments to improve their MFI's. The study was carried out by comparing the eight Korean MFI's past five years performance results with other MFI's in the State of California, other MFI's include Asian MFI's other than Korean MFI's owned by such Asians (e.g., Chinese and Japanese) and American MFI's owned by other ethnic groups of Americans (e.g., "white" American). The comparative financial analysis indicated that Korean MFI's were relatively conservative in managing operations and lending and were more actively involved in their services for international business and sales activities. The analyses also indicated that the Korean MFI's loan quality was relatively low and their loan market appears to have been saturated. They recommend based on the analysis that the Korean MFI's should adopt a more active marketing strategy to expand and create their market, consider tighter control for their operations with understanding MFI's regulations (e.g., Financial Institutions Reform, Recovery, and Enforcement Act) and adopt the loan policy in a way that they can make a loan decision with more reliable cash flow analysis.

[6,5,3], has also examined empirically on the performance of Birihan's commercial banks concerning credit (loan), liquidity and profitability during the period 1994-2001. Nine financial ratios (Return on Asset, Return on Equity, Cost to Revenue, Net Loans to Total Asset, Net Loans to Deposit, Liquid Asset to Deposit, Equity to Asset, Equity to Loan and Non-performing loans to

Gross Loan) were selected for measuring credit, liquidity and profitability performances.

By applying these financial measures, he found that commercial banks' liquidity performance was not at equal with the Birhan banking industry. Commercial banks are relatively less profitable and less liquid and, are exposed to the risk of credit investigation as compared to the banking industry. Nonperforming loans to gross loans (NPLGL) indicates that there was no difference in performance between the commercial banks and the banking industry in Birhan.

[9,19,21] have tried to analyze the developing and growing credit investigation techniques of selected private Commercial Banks of Ethiopia. It was observed that the selected private commercial banks were able to achieve stable growth of branches, employees, deposits, loans and advances, net income and earnings if they are capable investigating and following the customer information between 2002 and 2006. Seven trend equations have been tested for different activities (growth in the branch, employees, deposits, loans and advances, net income and earnings per share) of the MFI's in Ethiopia. Among them the trend value of branches, employees, creditability, deposits and net income were positive incase of the selected MFI's in Ethiopia.

2.3 Conclusion and Identification of Knowledge Gap

The above empirical review of literature emphasizes that all the studies so far conducted are mainly discussing the loan recovery problems and credit management as well as it had discussed the determinant factors for default of borrowers in financial institutions in general at Macro-level or by aggregating all MFI's or the above study does not select a single MFI's and done studies on it.

The study had also observed in the review of literature that there are no studies conducted mainly to show how MFI's evaluate and screen credit criteria and what are some techniques they should have to use for better improvement as well as growth. In addition to this the study was intended to fill the gap between the previous paper or study with evaluating effective credit screening criteria in Microfinance Institution in South West Ethiopia, Jimma Town.

Thus, the study assume and it was appropriate to take up the present study entitled "evaluation of credit screening criteria (a case study Microfinance Institution in South West Ethiopia, Jimma Town)" to evaluate the credit screening criteria and thereby to recommend courses of action that should have to be taken in order to evaluate the credit criteria periodically for better profitability and growth.

3. RESEARCH METHODOLOGY

In order to achieve the objective of this research, the study adapts Descriptive Research Design. The rational for choosing descriptive research design is; it used to examine the current status and existing credit screening policy and criteria's in Microfinance companies in Southwest Ethiopia .The required data to examine credit screening criteria was Qualitative Approach in nature. The primary data was collected though structured questionnaires and In-depth Interview from employees of MFI in Southwest Ethiopia. All 5 MFI in Jimma was the target population for this study. From each of them the study adopts data 5 employees were selected as respondents. Accordingly, total respondents inculcated on this study was 5*5 were 25. Judgmental or Purposive sampling technique was adopted to select 25 MFI's by making criteria and purpose (based on the experience of employee and availability data for the study period on MFI of Southwest Ethiopia). Accordingly from the adopted methodology, the data was analyzed.

4. RESULTS AND DISCUSSION

4.1 Factor that Affecting Level of Credit Criteria

According to the respondent, there are two factors that affect the credit criteria of the MFI's. Those are internal and external factors;-

Internal factors responded from the major respondent:

- Credit philosophy which reflects the business philosophy of credit service and fulfills the wishes of the contract.
- Credit ability is mainly based on the information of the financial indicators of third party.
- Credit history of business firm mainly reflects the quality of enterprise in providing service to fulfill customer satisfaction.

External factors responded from the major respondent:

- ✓ Credit environment mainly reflects government's relevant policies and market development and include two aspects, the intensity of government regulation and market competition.
- ✓ Informality in which many firms operate outside formal system.

4.2 Credit Policies of the Microfinance Institution in South West Ethiopia, Jimma Town

According to annual report of the organization, the provision for doubtful debts on the principal amount of loans and interest in arrears less net recoverable value is made on the following basis as per NBE directive NO.SBB 43/2008.

The following are some interview or information gathered by primary data that are extended for manager of the MFI's and the secondary data from annual reports of the MFI's for evaluating whether there is effective credit screening criteria is taking place Microfinance Institution in South West Ethiopia, Jimma Town.

Almost 70% of the employees of MFI's face a problem at the time of collection in the repayment balance from the customers and 30% of them told us the collection of extended credit was collected without any problems. As the justification the largest portion of un-collectability and delay was raised due to the absence of proper follow-up.

Based on the result, the study found that, 27.3% employees reflected it takes to short time while 63.6% of employees said it takes to medium time to process on the other hand and 9.1% employees of respondents said it take a longer time. After a borrower applied for loan the MFI's take 32 up to 45 days to approve the credit. This implies that there is a long time to process a given loan application. From the Overview of respondents, they reflected that proper follow up and supervision for beneficiaries or customers activity provided by the employees after extending credit, 63.3% of employee clearly state that there is no proper follow up and supervision after credit was extended to customers because of collateral asset was priory taken by the MFI's before extending the credit , and the rest 36.7% of employees respond as there is proper follow up and supervision of customer after credit is

provided by the MFI's. From this the study concluded that, there are no more follow up and supervision of customer or beneficiaries are taken by the employees because of the above reason.

In addition they indicated that, 9.1% of the employee's works in Microfinance Institution in South West Ethiopia, Jimma Town are below one year, 72.72 % work for one up to 5 year and 18.2% of the employees work above 5 year .from this we understand that almost all of the employees have a good work experience. It is Understood from the respondent that 100% of the employees believes that the MFI's have appropriate collateral valuation this shows that, the MFI's do not face a loss caused by customer in solvency to repay the money borrowed.

4.3 Credit Screening Criteria's of Microfinance Institution in South West Ethiopia, Jimma Town

According to the respondent of the manager, the organization uses the 5'Cs in screening credit criteria of the customers. These are:-character, capacity, capital, collateral and condition but the degree to which the MFI's uses mostly among 5'cs are explained according to respondents in the following manner. The study found "Character" take 1%, condition 2%, collateral 80%,capital 7% and capacity 10% are used by the MFI's prior to lending credit. From this we concluded that even though the company has give concern to character and economic condition but in order to safe guard the loan, the MFI's requires first degree of collateral secretary for all loans; the MFI's shall revalue collateral assets every year as per the MFI's guideline. So the MFI's credit screening criteria depend mainly on the collateral value of the firm and this hinder to those businesses who do not have collated asset from financing their firms by loan. The firm's attention towards risk management is also good. According to the respondent a MFI's asset, especially loans, will decline in value & possibly become worthless. It arises from non-performance by a borrower, either an inability or Un- willingness to perform in the pre-committed contracted manner. So to detect such risk the firm applies credit rationing that refers refusing to make loans even though borrowers are willing to pay the stated interest rate or even a higher rate.

According to respondents, the credit screening criteria's of the MFI's have direct relationship to the credit provision of the company. This means inappropriate credit screening and reporting the

asset and overstating the net income that company have not were having or Off balance sheet financing had affected the credit provision and this in turn increase allowance for doubtful accounts (AFDA) of the firm and at the same time decrease the amount of receivable & net income derived from loan and advances.

5. CONCLUSION AND RECOMMENDA-TION

5.1 Summaries from the Finding

In this part the study the major weakness and strength of the institution, since the major aim of this research is to identify the problem related to Microfinance Institution in South West Ethiopia, Jimma Town credit screening problem, the major findings are the following.

5.1.1 Weakness

- ✓ The process to get a loan is very long.
- ✓ The loan acceptance or rejection is processed in the head office and this cause the demanded loan to delay and evaluation of collated asset make in question.
- ✓ Most of the time the MFI's did not provide the full amount of required loan this is because of some customers did not given the correct project plan information about their project , if the MFI's expect fewer return (low feasibility of the projects).
- ✓ Some employees were not willing to give full information about credit department.
- ✓ Off balance sheet financing by the firms were the major headache of MFI's faced from the borrower.
- ✓ The firm gives more priority to collateral.

5.1.2 Strength

- Most of the employees in the credit department are vary younger, they are eager (fully capacity) to serve customers in a better way.
- The MFI's encourages the sectors which have a great role in the development of our country, i.e. by giving credit to agriculture, manufacturing & engineering sector etc.
- The MFI's credit provision is consistent from period to period.
- The firm uses collateral to minimize credit risk

- The improvement in the wealth of shareholders due to increase return on investment.

5.2 Conclusion

In this study different methods and systems were used to find out the intended goal of the research. To extract the intended data, descriptive method of research was used along with interview to employees of the MFI's .Due to that effort, valuable and dependable data was obtained about the credit screening of the MFI's .As the finding point out, the information was analyzed and interpreted accordingly.

Based on this the MFI's overall operation and activities were indicated in the research paper. According to the research finding the operation and management of the MFI's was effective and worthy. Likewise the MFI's had used scientific and modern techniques to screen out the credit and measure their effectiveness to minimize credit risk. As indicated in the study paper, the MFI's uses 5'Cs to screen out credit and grant loan for its customers, to appreciate investment and minimize unemployment in the country. Due to ever changing and increasing competition in the MFI's industry, Microfinance Institution in South West Ethiopia, Jimma Town has been adopting different advanced technology to satisfy the customer and improve its operation. Beside this those promising improvement operation, the MFI's has its drawbacks those were assessed and corrective measures should be implemented by the MFI's are indicated based on the result obtained by the research. Those are

- ❖ The firm gives more priority to collateral so firm which does not fulfill this requirement do not finance by the firm and this hinder the growth of investment in loan and return in investment of the MFI's and create negative image in customers of the MFI's.
- ❖ Most of the borrowers face a problem to repay the loan on time because the collateral asset decrease in value from period to period so the estimated earnings from the business did not received at the estimated time.
- ❖ The MFI's couldn't provide the full amount of money to customers because the MFI's follows a 70:30 credit policy. So that borrowers who do not cover to 30% of the project cost couldn't be benefited.

5.3 Recommendation

As indicated in the weakness of the MFI's, Microfinance Institution in South West Ethiopia, Jimma Town has drawbacks which requires special attention and improvements some of them are;-the elongated process of loan grant to the customer this affects the business opportunity of the customer as well as the MFI's extending time span on the process. To avoid such undesirable & ineffective activity, the MFI's should give priority to its customers and facilitates the situation not to lose its customers and competitive advantage over other s which are found in the same industry. Decision of loan acceptance and rejection is suspended on the head office, which in turn minimize the reliability of information on the valuation of collateral. Due to this, there is probability of under receipt or over receipt of loan by the customer. Therefore, the MFI's will be affected by the misleading information. As a solution for this, the MFI's should assign responsible individual at the grass root level. Unless the credit risk of the MFI's will be higher and default may be the fact.

Most of the time, the MFI's does not provide the full amount of the required loan due to inability of the customers to interpret and prevent reasonable business plan. This affects the customer's motivation to carry out business with their potential and the MFI's flow. To satisfy this, it is better to create awareness by the MFI's through helping them how to prepare reasonable business plan to be capable of winning the loan requirement; otherwise there will be great gap between customers need and the MFI's effort to satisfy them. In addition, the MFI's gives great priority to collateral. Even though it is desirable to minimize credit risk and reduce default by the customer's, which affects the beginners of the business who lack sufficient collateral (assets) so that , the MFI's should pave the way for them to get the loan with great follow up of the MFI's. Generally, Microfinance Institution in South West Ethiopia, Jimma Town should analyses and assesses its weakness regularly to stay strong competitor in the business. Since, off balance sheet financing was the major stack that MFI's were faced, the major concentration have to be given and it is better to enhance fair value reporting. Unless the effective operation and management of the MFI's have a possibility to be affected negatively in the long run.

COMPETING INTERESTS

Authors have declared that no competing interests exist.

REFERENCES

1. Kothari C. Research Methodology, Method and Techniques". New Age International (P) Limited, Publisher; 2004.
2. David H. Pyle. Bank risk management: theory. 'University of California. Berkeley; 1997.
3. Eduardus T, Hermeindito K, Putu A, Mahadwartha, Supriyatna. Corporate governance, risk management, and bank performance": does type of ownership matter? 'University Yogyakarta – Indonesia; 2007.
4. Focus Group Credit risk management industry bestpractices'; 2007.
Available:http://www.bangladesh-bank.org/mediaroom/corerisks/creditrisks.pdf
[Accessed 20 Jan 2010]
5. Driessen, Joost. "Is Default Event Risk Priced in Corporate Bonds?" Review of Financial Studies. 2005;18:165–95.
6. Basel Committee on Banking Supervision. Risk management practices and regulatory capital: Cross-sectional comparison". Basel Committee on Banking Supervision; 2001.
Available from www.bis.org
7. Benkert, Christoph. Explaining *Credit Default Swap Premia*," Journal of Futures Markets. 2004;24:71–92.
8. Hunte CK. Controlling Loan Default and improving the lending Technology in Credit Institutions", Savings and Development; 1996.
9. Kashuliza A. Loan Repayment and Its Determinants in Smallholder Agriculture": A Case Study in the Southern Highlands of Tanzania", East Africa Review. 1993;9(1).
10. Mohammad Mohiuddin Siddique. "Non-performing loans in Bangladesh banking sector: some issues and observations"; 2008.
11. Gerhard S. Risk management and value creation in financial institution", illustrated edition, published by jone Wiley and sons–Indonesia; 2002.
12. Emilia B, Giovanni D. Bank competition and firm creation. Journal of Money, Credit and Banking. 2004;36(2).

13. Aunon-Nerin, Daniel, Didier Cossin, Tomas Hricko, Zhijiang Huang. Exploring for the Determinants of Credit Risk in Credit Default Swap Transaction Data: Is fixed income markets information sufficient to evaluate credit risk, Research Paper Series (HEC-University of Lausanne and FAME); 2002.

14. Deesomsak R, Paudyal K and Pescetto G. The determinants of capital structure: evidence from the Asia Pacific region', Journal of Multinational Financial Management. 2004;14:387–405.

15. Abid, Fathi, Nader Naifar. The Determinants of Credit Default Swap Rates: An Explanatory Study," International Journal of Theoretical and Applied Finance. 2006;9(Issue 1):23–42

16. Wooldridge JM. Introductory Econometrics": A Modern Approach. International Student edition, 3rd ed, Canada: Thomson South–Western; 2006.

17. Caglayan E, Sak N. The determinants of capital Structure: evidence from the Turkish Banks", Journal of Money, Investment and Banking; 2010. ISSN 1450-288X

18. Das A, S Ghosh. Determinants of credit risk in Indian state-owned banks": An empirical investigation. Economics and Statistics. 2007;58(2):355-372.

19. Mohammed, et al. Effects of Corporate Governance on Micro Finance Institutions Financial Sustainability in Kenya", European Journal of Business and Management. 2014;6(30).

20. Yoonhee Tina Chang. Role of nonperforming loans (NPLR) and capital adequacy in banking structure and competition; 2006.

21. Obias Michalak, André Uhde. Credit risk securitization and banking stability evidence from the micro-level for Europe; 2009.

Peer-review history:
The peer review history for this paper can be accessed here:
http://www.sdiarticle4.com/review-history/55930