Innovations

The effect of Credit Management on Financial Performance of Microfinance Institutions in Hawassa, Ethiopia

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Abstract : *The main purpose of this research was to examine the effect of credit management on financial performance of microfinance institutions in Hawassa. To achieve this objective the researcher employed explanatory (ex-post) research design, with quantitative approach, and convenience sampling method. Descriptive statistics, correlation, regression methods and inferential statistics were used to analyze balanced panel data, secondary data obtained from audited financial statements, of three Microfinance institutions (MFIs) in Hawassa for a period of ten years (i.e. 2008 to 2017). The data was analyzed by using STATA software. The Hausman test was also used to determine which of the fixed effect and random effect models was the most appropriate. The result revealed that average collection period (representing credit collection policy) and credit risk had statistically significant and negative relationship with return on Investment. On the other hand, interest rate had positive significant relationship with return on investment of MFIs. Based on this result, the researcher concluded that there was significant relationship between Credit Management and Financial Performance of MFIs in Hawassa, Ethiopia. The researcher also recommended that microfinance institutions can increase financial performance by properly determining an optimal level of interest. Moreover, it should adopt stringent credit collection policy to reduce average collection period and to increase loan repayment rate. Furthermore, management should be able to draw useful lessons from past experience, have a keen awareness to monitor and control credit risk and price loans on the bases of pre-determined risk rate to ensure adequate compensation.*

Key Words: *1. Microfinance 2. Credit Management 3. Financial Performance 4.Interest Rate 5. Return on Investment 6. Credit Collection Policy 7. Credit Risk*

1. Introduction

1.1Background of the study

Access to financial resource plays a crucial role in the process of economic growth and development in all sectors of an emerging economics. The poor and low-income people are provided financial service to start or expand their micro enterprise that will allow them to break out the vicious cycle of poverty and survive in the modern economy. However, they were excluded from conventional banks because receiving loan is almost impossible for rural poor people who are living in the rural areas and working in the informal sectors with riskier environments; and lack assets for collateral, formal wage jobs, and better credit history. This is one of the most significant problems for sustainable development and poverty alleviation Amina Ahimed, et.al (2015).

Micro finance institutions are established with unique opportunity to serve poor people in underdeveloped countries like Ethiopia. It provides a broad range of financial services such as deposits, loan, payment services, money transfers and insurance to poor and low-income households and their micro enterprises (Bob Ssekiziyivu et al. 2017). This is the basic idea on which microfinance has been established. (Lazar D. & P.Palanichamy, 2008).

Financial performance of microfinance institutions can be measured by different tools like financial self sufficiency, return on investment or asset (ROI), Return on equity (ROE) etc to list a few. Business requires resources to sustain all of its activities, even if not all of them are profit-oriented. Good institutions dictate that business resources should be managed efficiently. Money tied up in credit is one area that worth looking management. Credit, for most financial institutions, constitutes a huge amount of their investment resources. Tying up cash in loan is as much as an investment as is tying up cash in plant and equipment. On this note, business leaders cannot overlook credit management and its effect on profitability of the firm as profitability depicts the capacity of financial institutions to work effectively, gainfully to survive, grow and respond to risk (Turyahebwa, A., 2013).

The existence of efficient credit management practices can make a substantial difference between the success and failure of financial institutions since there major revenue was generated from interest income. It is a prerequisite for financial stability and sustainability, while deteriorating credit quality is the most frequent cause of poor financial performance. The proper level of credit is one that allows them to hold it with little or no risk, effectively prepare for uncertainty, and improve their overall financial performance. Therefore, timely identification of potential credit risk is important as high rate lead to decreased cash flows, lower liquidity levels and brings financial distress. In contrast, lower credit exposure means optimal debtors' level with reduced chances of bad debts and therefore financial health (Alice K. and Dr. Jaya S., 2016).

According to Nzotta, S.M (2004), efficient management of credit and its risk is vital for the success and survival of MFIs by enhancing their profitability, creating financial self -sufficiency and thus, contributing for economic growth. This can be done through maintaining cash at a desirable level, settling liabilities on maturity, and using the investment opportunities which is indicative of the flexibility of the economic entity. Moreover; achieving higher loan repayment performance enables MFIs to accomplish their objective of expanding and delivering quality services to the poor without suffering financial shortages. On the other hand, poor loan repayment performance due to poor credit management practice undermines their financial position, which further hinders the revolving funds between institution and borrowers. (S. Abdul Majeeb et.al., 2014). Because, loan is typically the largest asset and the predominant source of revenue, and as such the greatest source of risk for their safety and financial soundness. Therefore, many financial executives are

struggling to identify and implement the best credit collection policy, to determine optimal interest rate, to maintain liquidity and risk management procedures. They also focus on maintaining adequate capital for uncertainties (Biruk Dejene, 2015).

Credit managers can improve profitability by organizing and managing the lending function in a highly professional manner. This can be achieved by implementing appropriate credit collection policy, doing so pro-actively through minimizing the degree of credit risk & assumed losses, shortening the cash conversion cycle through reduction in the outstanding number of day's receivables. Any decision made by managers in this context can significantly affect return of the MFIs which shall transform their value and ultimately increase shareholders wealth. Therefore, they need efficient credit management strategy. It is against this background that this study seeks to examine the effect of credit management on the financial performance of micro finance institutions in Hawassa city Administration.

1.2. Statement of the problem

The effect of a business organization is measured in monetary bases and the greater extent of its success depends on the efficient management of its financial resources. Management strategy aimed at maintaining a balance among Credit risk and profitability of the business has far reaching consequences on the growth and survival of the firm. Although managers of financial institutions spend most of their time and effort on day-to-day operations of credit management, they are unable in proper planning and implementation of credit policy, controlling loan provision and its related risks, collecting credit and pricing interest rate of the institutions. These failures can be attributed to the inefficient Credit management. Ogunlade and Oseni (2018), stated that poor credit management practice leads financial institutions in to inefficient resource utilization, self-sufficiency problem, and finally to bankruptcy. Because, too much receivables result in wasting cash, increasing non- performing loans, limiting re-investment access, reducing liquidity, and ultimately decreases profitability. Thus, management of finance in credit area is a very sensitive and complex issue in the operation of financial institutions where one should be aware of setting loan price that covers financial and operating expenses, earning income and minimizing risk while administering loans (Gebru Meshesha, 2015). Moreover, most of the empirical studies on MFIs focused on assessing credit management practices, determining its effect on loan performance, examining the impact of credit risk management on profitability and suggesting possible solution to the problems. No study has been conducted in microfinance institutions regarding the effect of credit management on financial performance in Hawassa city Administration. Hence, the researcher was interested to examine it as the modest contribution to bridge the research gap the area of credit management and financial performance.

1.3. Objective of the Study

The general objective of this study was to determine the effect of credit Management practices on the Financial Performance of Micro finance institutions in Hawassa, Ethiopia.

Specific objectives

The specific objectives of the study were:-

- To evaluate the effect of Credit collection Policy on return on Investment of MFIs
- To identify the effect of lending interest return on Investment of MFIs
- To examine the effects of credit risk control on return on investment of MFIs
- To determine the effect of firm age (experience) on the profitability of MFIs

1.4. Research Hypotheses

To achieve the above stated objectives, the following null hypotheses were formulated and tested during the study:-

H01: There is positive and significant relationship between credit collection policy and return on investment of MFIs in Hawassa.
H02: There is positive and significant relationship between lending interest rate and return on investment of MFIs.
H03: There is negative and significant relationship between Credit risk and return on investment of MFIs.
H04: There is positive and significant relationship between firm age and return on investment of MFIs.

2. Literature Review

2.1 Microfinance Institution

Various authors and organizations have seen microfinance institutions in a number of ways. It is defined as the provision of financial services to low income poor and very poor self employed people. It offers a variety of credit options in addition to savings, money transfers, and insurance. As a provider of financial services to the poor, it helps to reduce risk, grow assets, generate and enhance income, and contribute to the development of local communities Mohammed Arif S.and Pagadala Suganda D. (p.3, 2017).

2.2 Credit Management

Deposits are mobilized by financial institutions and used for lending. Lending is generally promoted since it causes funds to flow from the system to productive uses, resulting in economic growth. The borrower acquires cash in the form of a loan from Microfinance Institutions (MFIs), and then repays the principal plus interest according to the terms of the credit agreement. Credit is a contract in which a borrower obtains something of value now and agrees to repay the lender at a later date after a set length of time has passed. Microfinance institutions provide some money to the debtor with the intention that they will receive return after some future time. Sometimes in the non – performance of the loan assets, the fund of the MFIs gets blocked and the profit margin goes down. To avoid this situation, microfinance institutions should manage its overall credit process. Alice Kagoyire and Dr. Jaya Shukla (2016).

Elizabeth M. & Dr. Gladys (2016) define credit management as a service that promotes good portfolio management and administration in order to ensure equitable resource allocation and encourage liquidity planning. It is the process of maintaining and putting in place a set of policies and procedures in order to limit the amount of capital held in debtors and the company's risk of bad debts. It has methods and strategies that are adopted by a financial institution to ensure that they have maintained an optimal level of credit and its effective management. It is also an aspect of financial management involving credit analysis, credit rating, credit classification and credit reporting. MFIs should consider two basic issues when managing credit; from one angle it is that how to distribute credit among all sectors of economy so that every sector can develop and they also get profit, and from the other angle, how to grant credit to various sectors, individuals and businesses to avoid credit risk (Alice K. & Dr. Jaya S., 2016).

Good credit management practices involve optimizing cash flow to ensure stability and provide maximum potential for growth. It includes the following elements such as: Credit Policy, Client appraisal, Credit monitoring, interest pricing, credit risk control and staff training. In managing credit, MFIs enhance efficiency and effectiveness in the use of resource to achieve value or wealth maximization objective. At the same time,

it also seeks a fair distribution of resources among the various segments of the economy so that the economic fabric grows without any problem as indicated in the national objectives in general and the MFIs objectives in particular. As a result, MFIs should use effective credit management techniques in order to deploy credit in such a way that it benefits every part of the economy and the nation's system. This is the only part of credit management that you need be concerned about, (2010, Hagos M.).

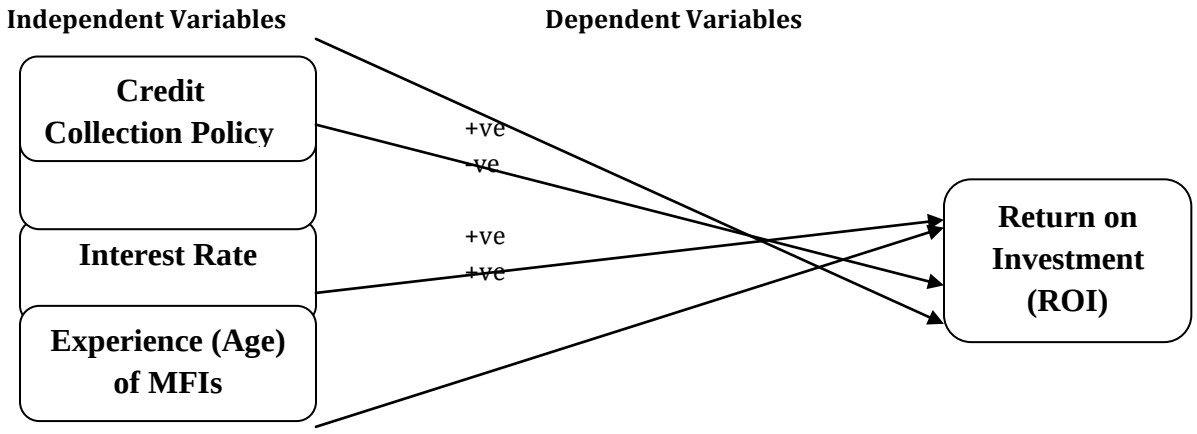
2.3 Financial Performance

Financial Performance is the ability to make profit from all the business activities of financial institutions as the concern of every business organization lies with its profitability. Monetary measurement is utilized for evaluating the performance in the financial service sector. Profitability shows how efficiently the management can make profit by using all the resources available in the market (Onuora & Ifeacho, 2017). Low profit margin would suggest ineffective management and investors would be hesitant to invest and depositors rush away from the business. Hence, As a result, management wants to know how profitable the company's operations are. These metrics look at the net income of a microfinance institution in relation to the balance sheet structure. Return on Equity (ROE) and Return on Investment (ROI) or asset are examples of common metrics. Return on investment is expressed as a percentage and is calculated by dividing an investment's net profit (or loss) by its initial cost or outlay, (Ledgerwood, 1999).

2.4 Conceptual Framework

The figure shows the hypothesized effect of credit management variables on financial performance.

Figure 2.1:-Conceptual frame Work of the study



3. Research Methodology

3.1 Research Design

A research design is a plan for gathering, measuring, and analysing data. The researcher employed explanatory (Ex-post) research design, which explains the relationship between dependent and independent variables, with quantitative approach, in this study. It helps the researcher to examine the effect of credit management on financial performance of micro finance institutions and hence; enables to generalize or infer the findings to a larger population.

3.2 Data sources and Collection Methods

The study was based on balanced panel data collected from audited financial statements of microfinance institutions (Omo, Sidama and Vision fund MFIs) in Hawassa. Secondary data was used to support the empirical findings and to back up the arguments related to the study. It is collected from MFIs, mix market, Association of MFIs, journals, text books, websites etc others related to credit management and financial Performance topics.

3.3 Population, Sample Size and method

The target population consists of four micro finance institutions in Hawassa city which participate in loan provision process. The researcher used convenience sampling method to the total population and selected three out of four micro-finance institutions due to recent establishment of Agar MFI in city of Hawassa and, therefore, the researcher was unable to find ten years balanced data. Exclusion of Agar MFI helped the researcher to avoid inconsistency problem and to maintain homogeneity of the study period.

3.4 Data Analysis

The researcher adopted quantitative techniques to analyse the collected data. These techniques include descriptive statistics, correlation and regression analysis. The analysis was done by using STATA Software. Inferential statistics was also used to make valid conclusions from the data.

3.5 Model Specification

Random effect model was adopted to examine the relationship between credit management and financial performance of three microfinance institutions in Hawassa. The econometric model would be as follow:

ROIit = α + b*1CCPit* + b2CRit + b3IRit + b4AGMF + eit

4. Results and Discussions of Findings

4.1 Descriptive Statistics

This section presents descriptive statistics of dependent and independent variables of sampled micro finance institutions (MFIs) used in the study for the period over 2008 up to 2017. From table 4.1 the researcher pointed out that return on investment (ROI), which is computed as net income divided by total asset, had a mean value of 0.1417. This shows that the sampled microfinance institutions (MFIs) on average earned net income of 14.17% from the total asset invested during the study period. This indicates MFIs have generated higher rate of return during the study periods, which reflected good financial performance and efficiency in resource utilization. The standard deviation of return on investment (ROI) was 0.0261 which mean that the average value of 14.17 percent deviates up or down by 2.61 percent. Besides, the maximum value of return on asset was 18% and the minimum value was 7%. This indicates that the most profitable and the least profitable MFI among sampled microfinance institutions (MFIs) earned 0.18 cents and 0.07 cents, of net income respectively, from one birr invested on total assets of during the study period.

On the other hand, regarding independent variables the mean value and standard deviation of average collection period (ACP), which is used as measurement tool for credit collection policy and determined by dividing 365 days to account receivable turnover ratio , is 1.05 years and 0.04 years respectively. This implies that sampled MFIs in average collect loans from borrowers within one year and 18 days. These value deviates up or down by 0.04 year or 18 days.

Table 4.1 Summary of Descriptive Statistics

Descriptive Statistics						
Variables		**Observation**	**Mean**	**Standard Deviation**	**Minimum**	**Maximum**
Dependent Variable	ROI	30	0.1416667	0.0261406	0.07	0.18
Independent Variables	ACP	30	1.053667	0.0417285	1.01	1.19
	TEIR	30	2.668333	0.268971	2.33	3.15
	NPLTLR	30	0.035	0.0246003	0.01	0.11
	AGMFI	30	14.83333	3.074739	9	20

Source: (The Researcher's own computation, 2021)

In addition, the maximum and minimum value of day's loan in receivables is 1.19 and 1.01 years respectively. These shows that sampled MFIs had lenient or liberal credit collection policy. They had been repaid by borrowers with in 1.26 years (434 days) and 1.01 years (369 days) respectively.

The other independent variable used in the study was interest Rate which was measured by times interest earned ratio (TIER). TIER is computed by dividing earnings before interest and tax (EBIT) to interest expense. The mean, standard deviation, minimum and maximum values of TIER for sampled MFIs were 2.67, 0.27, 2.33 and 3.15 respectively. This value shows that an average return on investment of sampled MFIs was 2.67 times greater than interest expense. These means the amount of earnings before interest covers interest expense of the sampled MFIs by 2.67 times during the study period. The standard deviation also confirms that the mean value increases or decreases by 0.27. On the other hand, the sampled MFIs earn net income to recover interest expense to the minimum of 2.33 times and to maximum of 3.15 times .This implied that the sampled MFIs earn high interest income to recover interest expense in addition to others such as operating expense, loan loss expense, depreciation expense, net profit etc during the study periods.

Credit risk control was also another independent variable measured by non-performing loan to total loan ratio (NPLTLR). The Mean, standard deviation, minimum and maximum values were 3.5%, 2.46%, 1% and 11% respectively. The mean value of 3.5% implied that sampled MFIs on average had lower credit risk with higher variability of 2.46% up or down during the study periods. When compared with the minimum value, the maximum value was also high. This is an indication for the existence of high credit risk exposure if large amount of loan was tied up on non-performing loan categories.

4.2 Correlation Analysis

This correlation analysis presents the relationship between dependent and independent variables included in the course of the study conducted on sampled MFIs for the period of 2008-2017. The correlation coefficient is a number between –1 and 1 that determines whether two paired sets of variables are related. It reflects the magnitude and direction of explanatory variables on explained variable as strong, weak, positive and negative. The higher values which are closer to 1 and -1 indicate the existence of stronger relationship where as the lower values which are closer to zero show the weaker relationship.

Table 4.2 Pearson Correlation Coefficient Matrix

Variables	ROI	ACP	TIER	NPLTLR	AGMFI
ROI	1.0000				
ACP	-0.8182**	1.0000			
TIER	0.6694**	-0.5801	1.0000		
NPLTLR	-0.5175**	0.5761	-0.0164	1.0000	
AGMFI	0.7157*	-0.7422	0.8219	-0.1755	1.0000

***=Significance at 5% (2-tailed) *=Insignificant at 5% (2-tailed)*

Source: (The Researcher's own computation, 2021)

The positive sign also shows a positive relationship in which increased value of one variable tends to increase the other variable in the same direction whereas negative sign shows negative relationship of which increased value of one variable decreases the other variable in opposite direction. On the other hand, if the correlation coefficient is zero, there is no evidence of any relationship.

The above table 4.2 shows that average collection Period (ACP) and non-performing loan to total loan ratio (CRC), as the measurement variables for Credit collection policy and credit risk control were negatively correlated with return on investment with coefficient values of –0.8182 and -0.5175 respectively. These indicate that when the coefficient values for average collection period and credit risk control (non-performing loan to total loan ratio) increase, return on investment would decrease in opposite direction. In addition, they had also strongly significant at 5 percent significant level.

On the other hand, Times interest earned ratio and age of MFIs, which were used as measurement variables for interest rate and operating experience, had positive coefficient values of 0.6694 and 0.7157 respectively. These correlations clearly show that return on investment increases as lending interest rates increase in the same direction with significant level of one percent. However, experience (age) of MFIs had positive correlation with return on investment, but it was not significant at 5 percent significant level.

4.3 Model Selection: Fixed Effect vs. Random Effect

With panel data, the most commonly estimated models are probably fixed effect and random effect models. Several considerations may affect the choice between a fixed effect and a random effect models. The nature of the variables that have been omitted from the model is one of the sign for selecting the model. A random effect model is probably preferable if you feel there are no omitted factors – or if you believe the omitted variables are uncorrelated with the explanatory variables in the model. In the case of a fixed effect model, the opposite is true. If the probability of chi2, in hausman test, is greater than 5 percent, then the researcher should use random effect model. However, if the probability of chi2 is less than 5 percent fixed effect model should be preferred.

Table 4.3 Hausman specification test for model selection

Explanatory Variables	Coefficients			
	(b)	(B)	(b-B)	(V_b-V_B)
	Random Effect (RE)	Fixed Effect (FE)	Difference (RE-FE)	S.E.
ACP	-0.2447319	-0.2270378	-0.0176942	0.0255354
TIER	0.0383816	0.0264929	0.0118887	0.0004125
NPLTLR	-0.2939956	-0.1448256	-0.14917	0.00
AGMFI	0.0004476	0.001888	-0.0014404	0.00
			Prob>chi2	0.320

Source: (The Researcher's own computation, 2021)

In the table 4.3, the probability of chi2 was 32 percent which was insignificant at 5 percent significance level. Therefore, the random effect regression model would be preferred.

4.4 Regression Analysis

Table 4.4 below presents the result of random effect regression model that examined the effect of independent variables on financial performance of selected microfinance institutions in Hawassa city administration.

Table 4.4 ROI Model: Random Effect Regression Result

Regression	**Explained Variable:- ROA**			
Explanatory Variables	**Coefficient (B)**	**Standard Error**	**t-value**	**P>|t|**
ACP	-0.2447319	0.1236781	-1.98	0.048
TIER	0.0383816	0.0170892	2.25	0.025
NPLTLR	-0.2939956	0.1462197	-2.01	0.044
AGMFI	0.0004476	0.0017984	0.25	0.803
Constant	0.3007684	0.1490559	2.02	0.044
R-squared	0.7648	Adj R-squared	0.7569	
Prob > F	0.0000			
Random Effect Mode				
ROIit =0.3007 – 0.2447ACPit + 0.0384TIERit – 0.2940NPLTLRit + 0.0004AGMFIit + ∈it				

Source: (The Researcher's own computation, 2021)

R-square

Coefficient of determination (R Square) explains the extent to which changes in financial performance can be explained by changes in credit management practices. As shown on table 4.4, R-square value was 0.7648 which implies that 76.48% of fitness could be observed in the sample regression line. This could be further explained as, 76.48% of the total variation in the financial performance (ROI) is explained by the independent

variables (credit collection policy, lending interest rate and credit risk control). The remaining 23.52% of change is explained by other factors which were not included in the model.

Adjusted R-square

An adjusted R-squared value, which takes into account the loss of degrees of freedom associated with adding extra variables were inferred to see the explanatory powers of the models. In other words, the adjusted R-squared indicated very good levels, which mean that nearly 75.69% of the volatility in return on investment was explained by the volatilities of independent variables included in the model. Therefore, an adjusted R square indicated that 75.69 percent of financial performance was explained by the credit management practices included in the equation. The Prob. (F-statistic) value is 0.000, also indicated the existence of strong statistical significance and the reliability and validity of the model.

4.3. Findings

Based on the coefficient values in the table above 4.4, the regression equation of the financial performance measured by return on investment would be written as follows:

$$ROIit = 0.3007 - 0.2447ACPit + 0.0384TIERit - 0.2940NPLTLRit + 0.0004AGMFIit + \epsilon it$$

This regression equation can be used to predict the value of the dependent variable based on a set of values for the independent variables.

According to this equation, taking all independent variables (Credit Collection Policy, lending interest rate, Credit risk and MFI experience constant as zero, return on investment(ROI) of microfinance institutions(MFIs) in Hawassa would be 30.07%. Similarly, if all other variables were held constant, a unit increase in average collection period and credit risk could decrease return on investment of microfinance institutions by 24.47% and 29.40% at 5% significance levels (i.e. at p-values of 4.8% and 4.4%) respectively. Similarly, a unit increase in lending interest rate (measured by times interest earned ratio) could increase return on investment (ROI) by 3.84% at 5% significance level with the p-value of 2.5%. But operating experience of MFIs was insignificant even at 10%. This implies that credit collection policy, credit risk and lending interest rate contributed the most to the financial performance of MFIs' in Hawassa city administration.

4.4. Hypotheses Test

This section presented hypothese test results of each explanatory variable in the study and empirical evidences supporting the result as discussed below.

Credit Collection Policy

Average collection period (ACP), representing credit collection policy, and shows negative and significant effect on return on Investment since the result depicted the coefficient value of negative 0.2447 and p-value of 0.048. From this result the researcher confirmed that when average collection period was high, the credit collection policy would be weak (lenient) and, therefore, return on investment would be less and vice versa. This shows credit collection policy had positive and significant effect on return on investment. The result of previous researchers like Alice Kagoyire & Dr. Jaya S. (2016), Elizabeth M. & Dr. Galdys R. in (2016), Yaw Adu A. (2015), and Haron Moti et. al (2012), also found the same result supporting this finding and stated that credit collection policy had positive and statistically significant effect on financial performance. Therefore, the null hypotheses would be accepted.

Interest Rate

As an explanatory variable, lending interest rate, represented by times interest earned ratio, for sampled microfinance institutions, in the regression equation had positive and significant effect on return on investment (ROI) at 95% confidence interval as the result shows the coefficient result of positive 0.0384 and p-value of 0.025. The empirical result found by Alshatti (2015) also supported this finding and stated that lending interest rate had significant effect on the financial performance of the Jordanian commercial banks. Thus, the null hypothesis would not be rejected.

Credit risk

The regression result indicate that Credit risk, which was represented by non-performing loan to total loan ratio (NPLTLR), negatively affect return on investment at 5% significance level as the p-value was 0.044 and its coefficient value was -0.2940. This shows that one unit increase in credit risk, assuming other variables constant, reduces return on investment (ROI) by 0.2940 and a unit decrease in credit risk would increase return on asset by the same amount. From this the researcher depicted that strong credit risk control mechanisms reduces credit risk, hence, financial performance would be improved. This finding was in agreement with the study result of Dr.Shaik Abdul et al. (2017); Alice K. & Dr. Jaya S. (2016); Adeusi, Akeke, Adebisi and Oladunjoye (2013); Raad Mozib L. (2015); and Ogboi & Unuafe (2013), whose result revealed that there exists a negatively significant relationship between credit risk and financial performance. Therefore, the null hypothesis would not be rejected.

5. Conclusions and Recommendations

5.1. Conclusions

- This section presents the conclusion drawn from findings of the study. The result of regression analysis revealed that credit management variables such as credit collection policy, interest rate, and credit risk control plays the most significant role in influencing financial performance of microfinance institutions in Hawassa city administration, whereas; operating experience of MFIs had insignificant effect on financial performance.
- Microfinance institutions experienced with high average collection period. This might lead to the accumulation of non-performing loans. Higher amount of non-performing loans, with higher repayment rate due to implementation of lenient or weak collection policy, reduces return on investment. Therefore, developing and implementing stringent credit collection policy and adopting optimum interest price reduces the amount of non-performing loans, increases repayment rate and helps to maintain optimum liquidity position.
- When lending rate is at optimum level, micro finance institutions were able to provide loans to borrowers and earn high income, whereas; pricing interest beyond optimum level, without considering risk rating, discourages borrowers to receive loan, reduces income, and finally increases credit risk. Clients will also visit other MFIs that have lower interest rates and may contribute to a low repayment and thus; lead to the maintenance of poor loan portfolios. Pricing interest below optimum point also increases credit risk. The finding confirmed that the interest rate charged on loans affects the sale of the loan, the repayment ability of the customers, loan performance, and also may contribute to low financial performance. Therefore, the researcher concluded that interest rate statistically and significantly affects financial performance.
- The finding also reveals that, among other independent variables, Credit risk had negative and the most statistically significant effect on financial performance of microfinance institutions in Hawassa city, hence; return on investment increases as credit risk decreases. These means if credit risk was

high, credit risk control practices would be weak, thus; financial performance of sampled microfinance institutions (MFIs) would also be low. Based on empirical result the research concluded that credit risk negatively and significantly affects the financial performance to a great extent.

5.2 Recommendations

Based on empirical results, the following recommendations were drown by the researcher.

- ❖ Microfinance institutions should give great emphasis to its credit provision and collection activities by considering it as a way to survival. They should adopt stringent collection policy and monitor it from time to time considering the nature of their business in general and the status of average collection period in particular.
- ❖ Micro finance institutions are highly credit risk sensitive. The risk of non-performing loan is increasing these days and micro finance institutions are facing this risk, as such, they must continuously ensure their financial performance with profit through adopting strong risk protection and mitigation mechanisms which is essential for their growth and sustainability and building depositors' thrust and confidence.
- ❖ The researcher also recommended that the management of microfinance institutions should continuously assess their risk management practices to see if they are still practical in the face of a continuously changing operating environment. To make it real, management should be able to draw useful lessons from past experiences, have a keen awareness to monitor and control credit risk and price loans or interest, on the bases of risk rating, to ensure adequate risk compensation, and maintain adequate capital against these risks.
- ❖ Further research should also be conducted in performance of microfinance institutions by giving due attention to the whole microfinance institutions in the country level. It should also focus on Sustainability and social measures in the future study.

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