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THE IMPACT OF CREDIT MANAGEMENT ON BANKS' PROFITABILITY IN SIERRA LEONE: A CASE OF KAMAKWIE COMMUNITY BANK, KARENE DISTRICT

IBRAHIM MUNU,
Department of Sociology and Social Work, Njala University

ABDULAI B. DUMBUYA,
Department of Economics/Banking and Finance, Njala University

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ABSTRACT

The study's primary aim, to assess the impact of credit management on banks' profitability, is of significant interest and importance to the banking industry. This study uses Kamakwie Community Bank as a case study for management on banks' profitability, using Kamakwie in this crucial aspect of banking.

The study is exploratory, and a mixed approach was used to explore primary and secondary data sources. A well-designed questionnaire was administered to 12 bank staff members, who were surveyed using purposive sampling, a method where participants are selected based on specific characteristics relevant to the research. The data collected was analyzed using simple statistical packages like Excel and frequency counts, and the results were presented in charts.

The study's findings, which revealed that credit management can significantly enhance a bank's liquidity position, thereby increasing its profitability, are paramount to the banking industry.

The paper recommends that potential borrowers be adequately sensitized to the Bank's lending policies and appropriately screened before being granted loans to mitigate delinquency and loan default.

Keywords: Credit Management, Bank, Profitability, Community, Kamakwie, and Karene District.

1.0 INTRODUCTION

As the name suggests, credit is the right to be paid, or the obligation to make payment on demand or later, by immediate transfer of goods or money (Uwuigbe et al., 2012). Credit management is everything directly related to approving customer boarding, extending payment terms, setting credit and payment policies, obtaining credit or financing, and monitoring business cash flow. At its core, credit management is about managing the financial health of the banking business. Good credit management can mean the difference between a company's survival, success, or bankruptcy. Bank lending is significant in every economy as it helps stimulate economic activity through financial intermediation. To fulfill this role, banks act as key participants in the trading process, using their balance sheets to facilitate trading and ensure that the associated risks are absorbed. (Fatima 2013).

A bank's survival depends on how quickly income is generated and how customers are retained for continuity. Commercial banks are entrusted with depositor funds; they typically use them to facilitate their business. A banking business should continuously pursue three fundamental objectives: liquidity, which refers to the ability to meet short-term obligations; security, which involves avoiding undue risk as you protect the deposits in the Bank; and income generation. A good balance of all three is required for successful management. Liquidity allows banks to meet the credit needs of valuable customers with high credit ratings. The second objective, security, involves avoiding undue risk as you protect the deposits in the Bank. A bank's accurate and careful management creates customers' trust. The third is Earnings/Profitability, which allows the banks to grow and expand to meet their goals of meeting interest expense on debt, maximizing shareholder wealth, and surviving competition in the banking industry (Uwuigbe & Ranti, 2015).

Credit risk management is a powerful tool that empowers credit professionals to make informed decisions. It guides them on when to accept loan applicants, thereby avoiding potential damage to a bank's reputation and maximizing profits. This strategic approach to managing risk is key to success in the banking industry.

Against this backdrop, the researchers opted to evaluate the impact of credit management on the profitability of the Sierra Leonean banking industry, using Kamakwie Community Bank as a case study.

2.0 LITERATURE REVIEW ON THE IMPACT OF CREDIT MANAGEMENT ON BANKS' PROFITABILITY

Credit management can be viewed as a written policy setting out the terms of delivery of goods on credit, customer qualification criteria, procedure collection processes, and steps to be taken in case of customer delinquency (Muritala & Taiwo, 2013). A key requirement for effective credit management is managing customer credit lines intelligently and efficiently. To reduce the risk of bad debt, overbooking, and bankruptcy, businesses, including banks, need better insight into changes in their customers' financial health, credit history, and payment patterns (Olabamiji & Michael, 2018). Credit management in our banking sector has taken on a different dimension. The banking industry has adopted many credit control review strategies to maintain business. Therefore, the amount results from the rotation source of the loan commitment and the interest rate position taken. (Bauchi 2022). Prudent lending is one of the most essential principles that strengthen the creditworthiness of financial institutions. Sound lending establishes credit limits and develops lending processes for approving new loans. Credit is vital to a country's economic growth and development (Olabamiji & Michael, 2018).

Banks are trying to make the databases in their credit risk management systems more open and functional, allowing banks to request or provide statutory repayments to borrowers. Some banking practices increase bank risk and cannot be easily changed. Credit risk management helps credit professionals know when to accept loan applicants to avoid damaging a bank's reputation and make decisions investigating inevitable credit risks that yield more profits. Managing risk drives rewards for providing internal audits with more technical support and customized training at banks and financial institutions. (Bauchi 2022).

Commercial banks are entrusted with depositor funds, which are typically used for banking operations. Since the funds belong to the customer, a program should be in place to manage them. A program should continuously pursue three fundamental objectives: liquidity, security, and income. A good balance of all three is required for successful management. Liquidity allows banks to meet the credit needs of valuable customers with high credit ratings (Uwuigbe & Ranti, 2015).

The banking sector contributes to the actual productivity of the economy and the general standard of living. Banks can simultaneously meet the needs and preferences of surplus and deficit units, reiterating that banks are essential players in the financial sector of their respective economies as they can provide trading efficiency, market knowledge, and funding capabilities. The failure or success of these banks will have a significant impact on the financial sector and the economy as a whole. Banks are the most important determinant of financial inclusion as they allocate money efficiently from savers to borrowers (Alalade & Effah, 2019).

However, Poor asset quality, such as impairing loans, has been shown by Laryea et al. (2019) to hurt a bank's profitability since interest revenue significantly contributes to a bank's net income. The Banker (2006) claims the commercial banking industry's nonperforming loans were historically high worldwide. According to The Banker (2006), weak credit risk management, an overabundance of outside interference in the lending process, and irregular or insufficient credit guarantees contribute to the rise in non-performing loans. Problem loans are loans where the borrowers seize payments or have significantly delayed repayment. Nonperforming loans can affect a bank’s profitability: reduced interest income, increased provisioning costs, write-offs and losses, operating costs, capital adequacy, and regulatory impact. It is, therefore, important for banks to actively manage and minimize nonperforming loans through effective credit risk management practices, such as rigorous credit underwriting, proactive monitoring of borrower creditworthiness, and credit restructuring or recovery strategies in time (Kargi, 2011).

Kithinji (2018) tested the hypothesis that commercial banks in Kenya may improve their bottom lines by implementing better credit risk management. Furthermore, it should be mentioned that several issues impacted bank performance. Brigham and Houston (2018) provided a comprehensive overview of financial management concepts and discussed the importance of various financial ratios, including ROA and ROE, for evaluating a company's performance. It is explained how these metrics can be used to assess profitability and efficiency. Also, Palepu et al. (2017) focus on financial statement analysis and valuation techniques. The authors highlight the importance of ROA and ROE in evaluating a company's economic performance. They provided examples and case studies to demonstrate how these metrics can be used to assess profitability and measure the return generated by assets and capital as we work with the market for credit banks. In their research, Felix and Claudine (2018) examined how credit risk management affects the success of banks in emerging markets. Indicators of a bank's efficiency and profitability, such as its ROE or ROA, were incorporated into the model. Nonperforming loans as a proportion of total loans were a good indicator of the overall credit risk. As a result of their research, they have determined that there is a weak relationship between performance measurements and credit risk.

2.1 Research gaps

Banks can manage the detrimental effect on dividends and maintain a healthier financial level by decreasing nonperforming loan levels. The rise of such challenges is inimical to the banks' profits. Furthermore, understanding the connection between credit danger and financial institution profitability is crucial because of the critical role loans play in the banking industry and the damage they may do to the economy. While this study found a positive correlation between credit risk management and a bank's performance, using profitability as a metric, other studies found the opposite. Credit risk management is only one component that has been shown to affect a bank's success, according to a different set of research.

In their research, Athanasoglou et al. (2008) discovered that credit risk correlates negatively with bank performance. According to the research conducted by Kargi (2011) on Nigerian banks, banks' success is inversely proportional to how well they handle credit risk. It was shown that the Bank's profitability was negatively affected by loan and advance volume, nonperforming loans, and deposit levels.

2.2 Conclusion

As credit risk is unique to only an institution that does not do the needful in using effective credit management strategies, the study highlighted numerous strategies used by the case study Bank to manage their credit. These strategies include sharing the loan portfolio among staff and chairperson, digressing away from commercial loans, concentrating on salary loans, and taking legal actions against defaulters ', incessant calls as a way of immediate follow-ups on clients, and the involvement of chiefdom stakeholders.

However, the reviewed literature from studies conducted by researchers in other sub-Saharan countries has indicated that many of these strategies are unique to Kamakwie Community Bank. Hence, the bank stands apart in successfully managing its credit, positively affecting its profitability.

3.0 METHODOLOGY

3.1 Description of study area

The Kamakwie Community Bank (KCB) Limited is one of the seventeen (17) community banks established and licensed by the Bank of Sierra Leone to facilitate the delivery of financial services in rural areas.

The Bank is located in Kamakwie town, Sella Limba chiefdom, Karene District North-Western province of Sierra Leone, about 137 miles (app. 220 kilometers) from Freetown, the capital city. It is accessible by motor road throughout the year, with approximately 85 miles of paved road from Freetown to Makeni and Kamakwie town.

The Kamakwie Community Bank officially opened on 10 March 2014, when it started its entire banking operation. It is expected to provide financial services to many clients in the district and beyond. The Bank was established by the Global Agricultural and Food Security Programme (GAFSP) in 2014 with the primary objective of providing available, reliable, effective, and affordable (AREA) assistance to economically active peasants to enhance their socioeconomic emancipation and alleviation of poverty. As at 2023 the bank covers six (6)

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chiefdoms in the district, Sella Limba, Sanda Loko, Tambakha, Gbanti, Kamaranka, Sanda Taindaren and Gbendembu. In addition to its wide coverage in the district, the Bank also serves the Portloko District, Bombali District, Tonkolili District, Kenema District, and Western area.

Today, banks serve their customers usefully by collecting funds from surplus economic units in the form of deposits and mobilizing deposits to deficit economic units in the form of credit. As part of the Bank's mandate to transform rural economies and make them sustainable, it has contributed immensely to making this vision realizable over the last seven years. This is evident in the lives of the many customers the Bank serves.

Significant activities of clients are SMEs, (Merchandising, Manufacturing, Transport & Utilities, Building Construction, Agro Inputs) Farming/Agriculture (Production, Processing, Marketing), and Petty Trading in foodstuffs and other local products

3.2 Techniques and Design

The study was exploratory. It used a mixed research approach and utilized both primary and secondary data sources. For the primary data, a well-designed questionnaire was administered to all 12 staff members of the Bank's credit department, who were purposively chosen for the study. A face-to-face interview with the bank manager was also held to elicit sensitive data. Furthermore, this study used articles, bank reports, and the Internet as secondary data. The ensuing data was coded and analyzed using simple statistical packages like Excel and frequency counts, and the results were presented in charts.

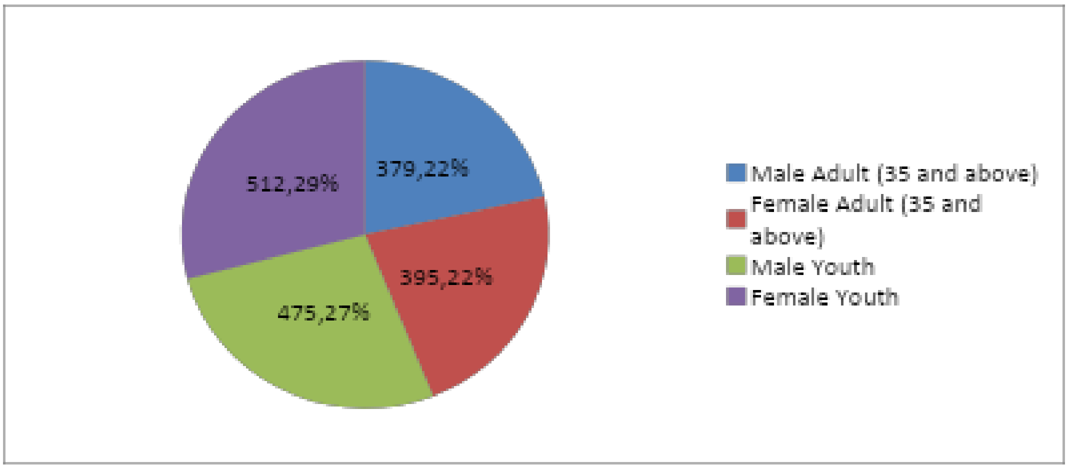
4.0 DISCUSSION OF RESULTS

The study established that the main aim of bank credit management is to maximize profitability. This sector of the Bank is separated from all other sectors. However, to get a clearer picture of this profitability and gain a deep insight into the operationalization of the credit system, we must look into the Bank's clients' profiles.

4.1 Clients' profile

The researchers deem it necessary to explore the clients' profile of the Bank to understand better the nexus it has with credit management, especially in terms of their sex, economic activities, debt capacity, and the effect they have on repayment rate and portfolio management, which are key in effective and efficient credit management.

As indicated in Fig. 1 below, the Bank's client base covers youths and adult males and females. The largest client size is youths compared to adults, represented by 22% of the total client size. Of the youths who constitute most of the Bank's client base, the highest number is female, totaling 512, 29%, while 27% constitute male youths. This indicates that most of the Bank's clients are in the working class, preferably salary earners, who may not find it challenging to repay loans.



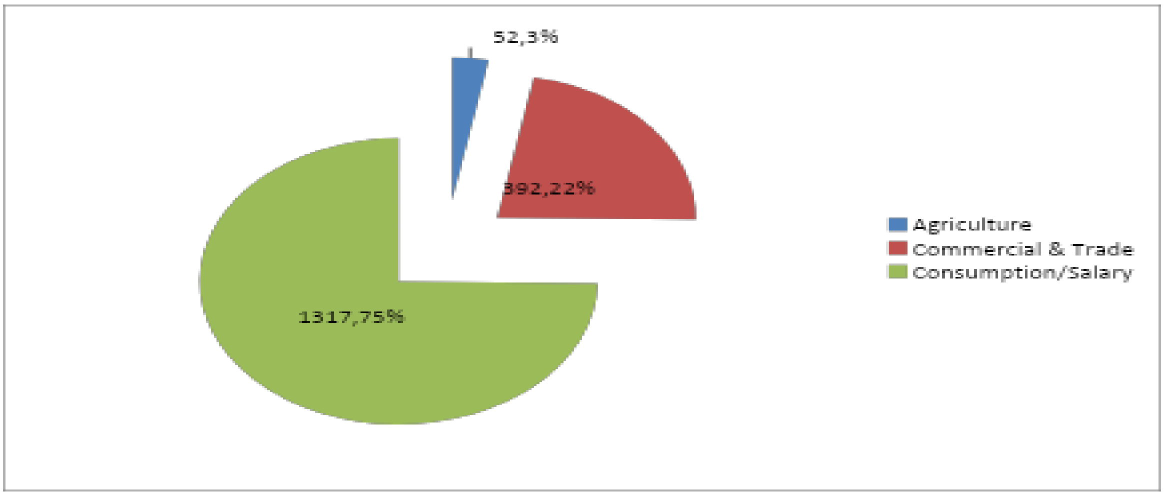
Source: Kamakwie community bank Apex report 2023

Figure 1: Clients' sex categories

However, before the loans are granted, the Bank runs background checks on their clients to determine their reliability for credit. In the process, the Bank also asks for collateral security from clients to award loans or credit facilities. These collaterals include land papers, building certificates, and, sometimes, trusted guarantors. This is done irrespective of the loan product the clients are requesting.

4.2 Clients' loan product

As indicated in Fig. 2 below, the study revealed that the Bank offers clients three main loan facilities: Agricultural, commercial, trade, and consumption/salary loans. Most of the Bank's loan is granted to salary earners, constituting 75% of the total loan product, which is most often granted to help cushion their consumption, especially amid inconsistent monthly salary flows. This resonates with the sex and age profile of the clients, which justifies the emphasis on granting the most significant loans to salary earners for consumption. According to the bank manager, the consumption/salary loan is given mainly for housing, education, and other personal purposes, and the salary earners formed the majority because of their low default rate.



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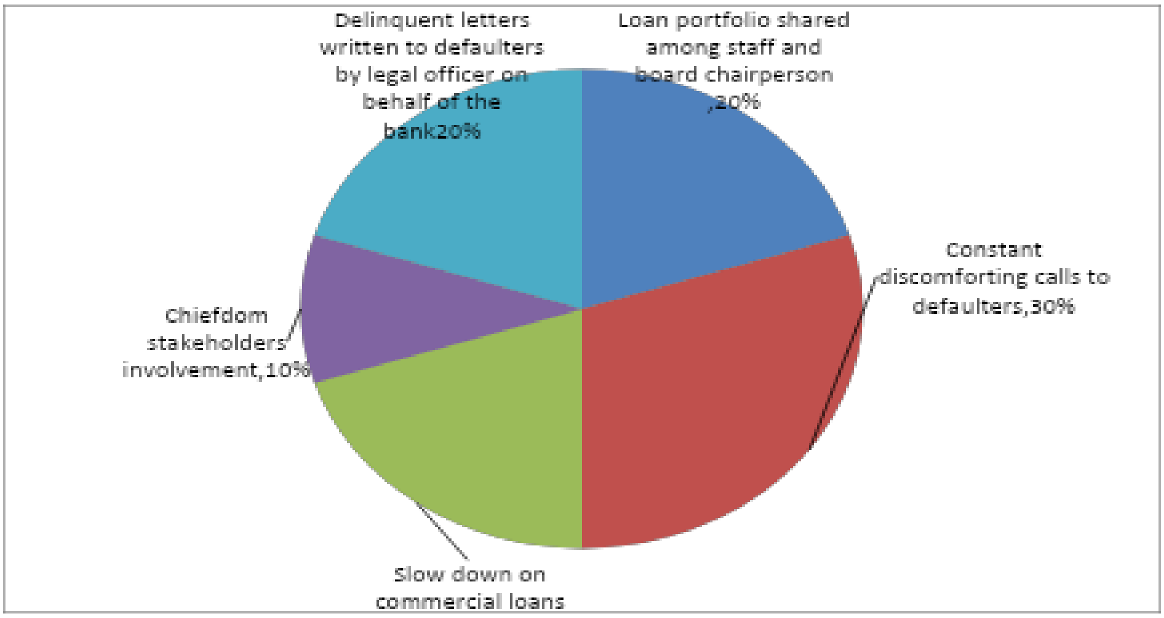
Source: Kamakwie community bank Apex report 2023

Figure 2: Client Loan Product

Despite salary earners' generally low default rate, the Bank does not limit its lending to just this set of clients. Therefore, to safeguard its loan portfolio, the Bank employs a couple of strategies, commonly termed Credit Risk Management Strategies, in the operations of its schemes.

4.3 Credit Risk Management Strategies

The researchers elicited data on the credit management strategies employed by the Bank. As credit risk is unique to only an institution that does not do the needful in using effective credit management strategies, the respondents highlighted numerous strategies the Bank has in place to manage credit risk. The key methods are illustrated in Figure 3 below. These strategies include Sharing the loan portfolio among staff and chairperson, digressing away from commercial loans, concentrating on salary loans, and taking legal actions against defaulters ', incessant calls as a way of immediate follow-ups on clients, and the involvement of chiefdom stakeholders.

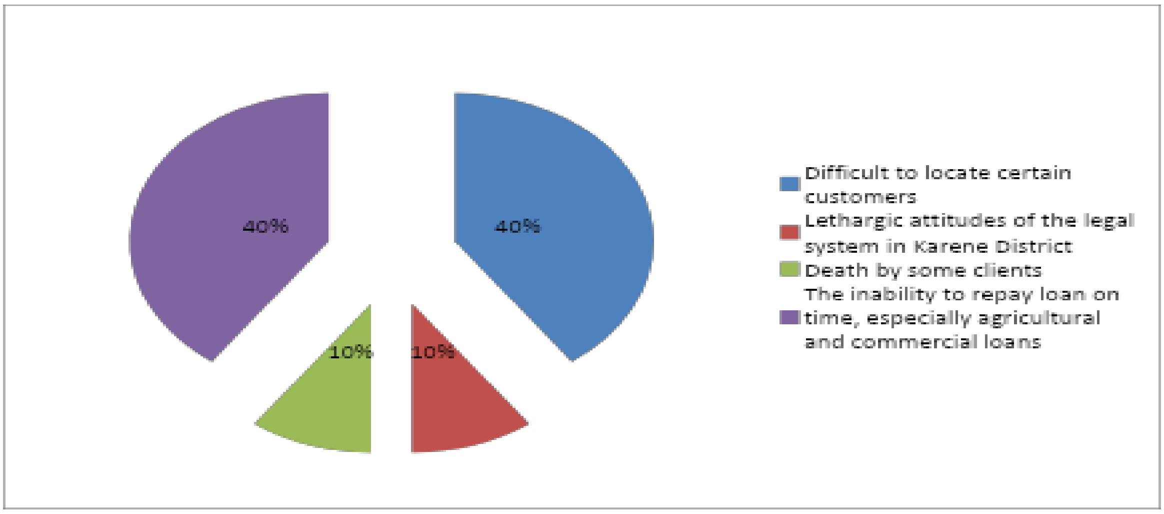


Source: Researchers' survey 2024

Figure 3: Credit Risk Management Strategies

4.4 Challenges Faced in Credit Management

Banks, like every other business endeavor, have challenges. Our bank respondents shared the main challenges they face in implementing effective credit management strategies, which are illustrated in Figure 4 below. It was revealed that the difficulty in locating specific clients and the inability of some clients to repay loans on time are the joint significant factors hampering the implementation of the Bank's effective credit management strategies. The local setting of many clients and the energy problems were among the underlying reasons why some clients were hard to reach via mobile phone or residential visits. Death, a natural cause, and the inability of some clients to repay on time, mainly agricultural and commercial loans, were mentioned as part of the challenges. This results from the country's economic instability and low agrarian yields among farmers.

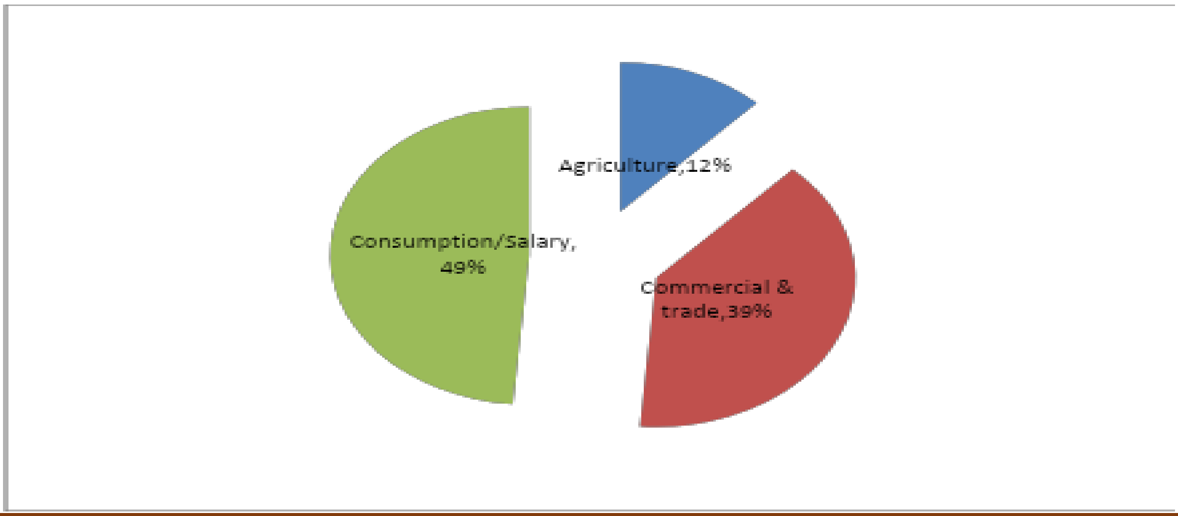


Source: Researchers' survey 2024

Figure 4: Main Challenges faced in credit management

4.5 Annual Loan Portfolio

Of the three loan products offered by the Bank, the researchers explored to know which one has the highest outstanding portfolio. The data revealed that 49% of the Bank's portfolio goes to salary earners for consumption. The second highest was for commercial and trade purposes, constituting 39% of the Bank's annual portfolio. The least goes to the farmers for agricultural purposes, representing 12%. It was further revealed that irrespective of the fact that the predominant activity by the residents of the chiefdoms is agriculture, the Bank concentrates more on salary earners as a measure to manage loan delinquency and default (See Figure 5 below).

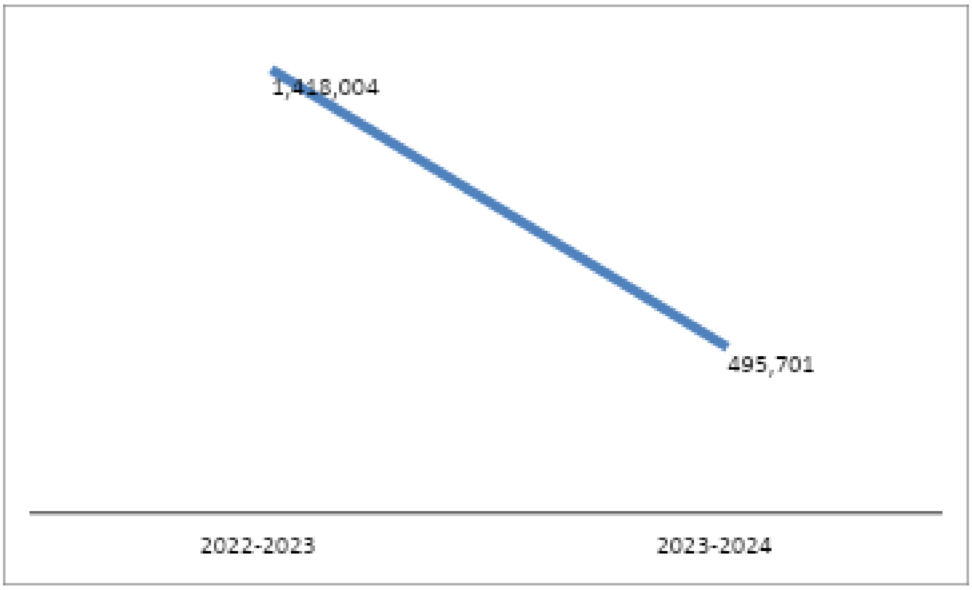


Source: Kamakwie community bank Apex report 2023

Figure 5: Annual Loan Portfolio

4.6 Annual Loans in Arrears

Data on the annual loans in arrears for successive years was collected to draw an objective conclusion and make an informed judgment on credit management and its effect on banks' profitability. As indicated in Fig. 6, the amount in arrears for the two successive years shows an improved success from 2022 to 2023. In 2023, the Bank minimized the annual loans in arrears from NLe 1 418 004 in 2022 to NLe 495 701. These calculations suggest a repayment rate of 92% for the financial year 2023/2024 and a 71.19% rate for 2022/2023. This results from the robust credit management strategies the Bank employs, irrespective of the challenges encountered in the process.



Source: Kamakwie community bank Apex report 2023

Figure 6: Loans in arrears for the period 2022/2023 and 2023/2024

5.0 SUMMARY OF THE MAJOR FINDINGS

The study's main aim was to analyze the importance of credit management in financial institutions in Sierra Leone, using the Kamakwie Community Bank as a case study. To analyze the importance of credit management and its impact on the Bank's profitability, the Bank's client profile, annual loan portfolio, annual loans in arrears, and repayment rates were all considered, amongst other indicators.

The study found that the Bank's client base mainly consists of youths, with females forming the most significant portion.

The study clearly showed that most of the Bank's loans are granted to salary earners; this constitutes 75% of the total loan product. These loans are usually given to help cushion their consumption, especially when salaries sometimes take a random walk. According to the bank manager, the consumption/salary loan is provided mainly for housing, education, and other personal purposes, and the salary earners formed the majority because of their low default rate.

Incessant calls to clients as a way of immediate follow-up are the primary strategy the Bank employs to avoid delinquency, which, if not handled with care, will end in default. This represents 30% of the strategies used by the Bank.

It was revealed that the difficulty of locating specific clients and the inability of some clients to repay loans on time are the joint significant factors that hamper the implementation of the Bank's effective credit management strategies; both constitute 40% each. The local setting of many clients and the energy problems were among the underlying reasons why some clients were hard to reach via mobile phone or residential visits.

In 2023, the Bank minimized the annual loans in arrears from Le 1 418 004 in 2022 to Le 495, 701. This is due to the robust credit management strategies the Bank employs, regardless of the challenges that hamper the process.

It was also discovered that the repayment rate improved to 92% in 2023 compared to 71.19% in 2022, as depicted in Fig. 6 above.

6.0 CONCLUSION

Irrespective of fragile laws and other situations surrounding the Bank over the years, Kamakwie Community Bank improved its deposits, advances, and credit management strategies, which led to a significant increase in its profitability. From the findings, the Bank has been able to deploy its loan efficiently and effectively to its clients due to proper credit management. The Bank's Apex Report 2023 shows that its repayment rate has significantly improved over the past 2 years.

Finally, credit management reinforces banks' portfolio position, and Kamakwie Community Bank is no exception. It has also improved its portfolio and lowered the amount of annual loans in arrears, which is a determinant of a healthy portfolio that leads to profitability.

7.0 RECOMMENDATIONS

7.1 Recommendations to Kamakwie Community Bank

Based on the study, the researchers recommended that the Kamakwie Community Bank should implement the following strategies in order to maintain their positive credit management in the same trajectory:

- Conduct effective screening before disbursing customer loans. The screening process will help the Bank better understand its clients' debt capacity, repayment ability, and credit history, enabling effective loan disbursement.
- Provide staff incentives for maintaining a healthy portfolio
- Develop risk-minimizing loan policies (e.g., stepped-up loans, etc.)

- Set up accurate, timely information management systems so there is a high response rate to loan delinquency before it gets out of hand.
- Provide incentives to clients, such as awards, interest waivers, etc., to the best-performing clients to motivate timely repayment.
- Develop a Comprehensive Credit Risk Management Policy. This policy should outline the roles and responsibilities of stakeholders, the processes for identifying and assessing credit risks, and the risk management strategies that will be implemented.
- Conduct Regular Credit Risk Assessments: Regular credit risk assessments should be conducted to identify potential credit risks and develop appropriate risk management strategies. This includes identifying potential credit risk scenarios, assessing the likelihood and impact of each scenario, and developing risk management strategies that mitigate the risk effectively.
- Provide Regular Employee Training: Regular employee training is critical to ensuring employees understand the importance of credit risk management and how to do so effectively. This includes training on credit risk management policies, credit scoring models, underwriting practices, and response plans.

7.2 Recommendations to other banks

The researchers also recommended that other banks in Sierra Leone have a separate department responsible for credit management. This would guarantee effectiveness and efficiency, as with Kamakwie Community Bank. Follow up immediately on late payments and maintain a good track record.

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