# CREDIT CONTROL ON DEVELOPMENT

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Credit risk management is defined as identification, measurement, monitoring and control of risk arising from the possibility of default in loan repayments (Abdifatah& Ogle, 2010). Also, Ogilo, (2012) defines Credit Risk Management to involve the process of making decisions relating to the investment of funds. Such decisions should be carefully analyzed as they are characterized by an element of uncertainty (Wanjira, 2010).

Credit extended to borrowers may be at the risk of default such that whereas banks extend credit on the understanding that borrowers will repay their loans, some borrowers usually defaults and as a result, banks income decrease due to the need to provision for the loans (Gaitho, Wangui, 2010). Where the commercial banks do not have an indication of what proportion of their borrowers will default, earnings will vary thus exposing the banks to an additional risk ofvariability of their profits (Boateng, 2012). Every financial institution bears a degree of risk when the institution lends to business and consumers and hence experiences some loan losses when certain borrowers fail to repay their loans as agreed (Kairu, 2009).

Principally, the credit risk of a commercial bank is the possibility of loss arising from non-repayment of interest and the principle, or both, or non-realization of securities on the loans. Risks exposed to commercial banks threaten a crisis not only in the banks but to the financial market as a whole and credit risk is one of the threats to soundness of commercial bank (Baker, 2013). Subjectivedecision-making by the management of commercial banks may lead to extending credit to business enterprises they own or with which they are affiliated, to personal friends, to persons with a reputation for non-financial acumen or to meet a personal agenda, such as cultivating special relationship with celebrities or well-connected individuals (Boateng, 2012). A solution to this may be the use of tested lending techniques and especially quantitative ones, which filter out subjectivity (Viru, 2008).

The key principles in credit risk management are; firstly, establishment of a clear structure, allocation of responsibility and accountability, processes have to be prioritized and disciplined, responsibilities should be clearly communicated and accountability assigned thereto (Lindergren, 1987). According to Ogilo, (2012) found that changes in credit risks may reflect changes in the health of a bank's loan portfolio which may in turn affect the bank's performance. Ogilo, (2012) found that the variation in bank profitability are largely attributable to variations in credit risk, since increased exposure to credit risk is normally associated with decreased firm profitability. Further research byAchou, Takang and Tenguh, (2008) found that there is a negative relationship between the credit risk and bank profitability, meaning that the more the banks were exposed to high-risks loans, the higher the accumulation of non- performing loans and, therefore, the lower the profitability. Credit risk management is measured using attributes like; risk avoidance, risk reduction, risk maintenance, risk distribution and risk transfer and risk distribution by Ellul &Yerramilli, (2010).

- **Risk avoidance**

Avoiding risk is one of the technique of risk management in commercial banks; but it is used to a large extent; businesses miss many opportunities and may be unable to achieve their objectives (Achou, Takang and Tenguh, 2008).Therefore commercial banks have to manage risk for their financial, health Boateng, (2012) added that capabilities (organisational routines) are the foundation of competitive advantage, and organisational capability requires the expertise of various individuals to be integrated with tangible and intangible resources.

- **Risk reduction**

Risk may be reduced through loss prevention and through control. From a certain aspect, damage prevention is the most desirable form of risk management, if the possibility of a loss to be completely eliminated, the risk too would be eliminated (Viru, 2008). Even this method may be inappropriate. It doesn't matter how hard we try; it is impossible to avoid all losses, Moreover, in some cases the prevention of a loss can cost more than the loss itself (Ondieki, 2011). A risk may be reduced also through a combination of a large number of risk units and through forecasting (a justifiable estimate, of future losses for the whole group: It is on this principle that, insurance companies operate (Hoyt & Liebenberg, 2010).

- **Risk maintenance**

Risk maintenance is perhaps the safest risk management method. Organisations as well as individuals face an innumerable number of risk factors (Ellul&Yerramilli, 2010). In most cases nothing is done about them. If, however, some positive action is not adopted that would reduce, avoid, or transfer the risk; the possibility of a loss ensuing from this risk remains (McShane, Nair &Rustambekov, 2011). Risk maintenance may also be voluntary or involuntary. In the case of voluntary maintenance, we realize that the risk exists and with silent consent accept losses arisen because no other more promising alternative exists (Ogilo, 2012).

• **Risk transfer**

Transfer of transfer is used for managing speculating as well as risk. An excellent example of managing speculating risk is the process of reinsurance (Mbugua, 2013). Net risk is often transferred into contracts, in which one party estimates the possibility of damage caused to the other party, for instance, tenants can agree that certain conditions, he or she will pay the land lord for damage arisen through using the property (Abdifatah& Ogle, 2010). The contractual transfer of risk is common in the building industry, but also among producers in sellers, where the liability for the product is specified.

• **Risk distribution**

This is a special case of transferring risk and a form of risk maintenance. If the risk is distributed, the possibility of a loss is transferred from the individual to the group (Achou, Takang and Tenguh, (2008). It is necessary however to realize that a risk transferred by an individual to the group is linked to the risk which other members bring to the group. Risk may be distributed among individuals and organisations in various ways (Kairu, 2009). For instance, a joint stock company where a large number of investors exist in the case of the company becoming bankrupt, each of them bears a relatively small part of the risk of loss (Gordon, Loeb & Tseng, 2009).

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