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Credit Risk Management And Loan Portfolio Performance In Selected Commercial Banks In Mogadishu, Somalia

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Abstract: *This study examines the effect of credit risk management on loan portfolio performance in selected commercial banks in Mogadishu, Somalia. The study targeted employees from Salaam Somalia Bank, Amal Bank, Premier Bank, and International Bank, including credit officers, auditors, accountants, financial officers, and bank managers. Using a cross-sectional quantitative research design, data were collected from 146 respondents out of a sample of 167, representing a 96% response rate. Descriptive analysis revealed that both credit risk management and loan portfolio performance were fairly satisfactory, with average mean scores of 3.307 and 3.214 respectively. Regression analysis showed a statistically significant positive relationship between credit risk management and loan portfolio performance ($R^2 = 0.471$, $F = 128.450$, $p < 0.001$). The regression coefficient ($B = 0.759$, $\beta = 0.687$, $p < 0.001$) confirmed that effective credit risk management improves loan portfolio performance. The findings emphasize the importance of timely risk identification, expert involvement, and strong control mechanisms in reducing non-performing loans and improving recovery rates. The study recommends strengthening regulatory oversight and enhancing bank-level credit risk management practices to support sustainable banking performance in Somalia.*

Keywords: Credit risk management; Loan portfolio performance; Non-performing loans; Credit risk identification; Banking performance; Financial stability

1. Introduction

Banking with regard to credit evolved significantly during the expansion of trade in Europe. Contrary to the claim that this occurred during the time of King George VI who reigned in the 20th century (1936–1952) the roots of modern banking trace much further back. The Medici Bank in Italy, established in the 14th century, is widely recognized as one of the earliest examples of a modern bank. In England, banking started taking shape in the 17th century with the founding of institutions like the Bank of England in 1694, spurred by expanding trade and the need for credit facilities.

By the 19th century, during the Industrial Revolution, banking became more institutionalized and profit-oriented, with a focus on providing credit to entrepreneurs and industrialists. This era marked a transition toward more sophisticated financial systems that facilitated industrial growth through loans and investment (Bhat, Tariq & Ahmed, 2020). Africa faces additional challenges stemming from economic underdevelopment. Mohd-Harif (2010) reported that the average unemployment rate in Africa is around 68%, a factor that contributes to high credit risk. The Nigerian government has responded with initiatives such as grants to support aspiring entrepreneurs (Trust Africa, 2015), recognizing that weak economic structures hinder sustainable development and loan repayment capacity.

Somalia's banking sector has undergone various phases of development but continues to face significant challenges, especially in loan performance. The ratio of non-performing loans increased from 9.3% in December 2016 to 12.3% in December 2017, indicating a deterioration in asset quality and overall financial stability (Abdaziz & Oluoch, 2020). The Central Bank of Somalia has since been monitoring credit quality trends to stabilize the sector. Despite these setbacks, the growth of Islamic-compliant banking has shown promise. Between 2008 and 2014, the assets of Islamic financial institutions grew at an annual rate of 13.5%, surpassing US$60 billion (Okpala, Osanebi & Irinyemi, 2021).

Commercial Banks in Mogadishu-Somalia, recognize that the successful performance of their loan portfolios is crucial for the prosperity of their lending operations, provided that proper credit risk management practices are implemented (Rachidi, 2022). However, these banks have encountered difficulties in meeting their loan portfolio performance targets, leading to challenges in recovering loans, despite employing strategies such as collateralization, loan tracking systems, and specialized debt recovery teams. Several banks across Somalia have reported a significant rise in impairment losses on loans and advances.

The root cause of this issue, whether related to challenges in loan recovery, remains a key point of analysis in this study. If the situation persists, the reputations of Somalia's commercial banks could be at risk, potentially leading to bank closures and client dissatisfaction, which could have a detrimental effect on the economy. Although these practices are meant to enhance the management of loan portfolios, the credit risk management efforts, including identification, recovery, and control measures, have

not been successful in resolving the problem (Central Bank of Somalia, 2022). As a result, this study sought to explore how credit risk management impacts loan portfolio performance in selected Commercial banks in Mogadishu, Somalia.

2. Literature Review

Theoretical Review

This study was guided by Credit Risk Theory Macleod originally put forth the concept of credit risk theory in 1889, and Merton followed suit in 1974. According to this idea, the borrower's intention to repay the loan and the lender's right to demand payment both affect the credit value. It provides a framework for lenders to recognize, assess, monitor, and control their exposure to credit risk and illuminates the fundamental causes of credit defaults (Chatterjee et al., 2020). Nevertheless, the theory has faced criticism for its lack of clarity in distinguishing various types of credit, as it does not clarify whether the credit pertains to currency, banknotes, deposit accounts, or even physical goods such as products and services.
Credit risk denotes the possibility of loss or damage that may occur when a borrower fails to fulfill their obligations. It encompasses the uncertainty or potential for loss in any business transaction (Kisivuli, 2013). In essence, credit risk emerges when there is a chance that a borrower will not comply with the agreed-upon terms. The credit risk theory provides a framework for lenders to model and manage risk, focusing on the identification, measurement, monitoring, and evaluation of that risk (BASEL Banking Supervision Committee, 2000).

This could further expose the institution to operational risk, as the time and resources spent on litigation may drain its capacity. Moreover, business, market, and strategic risks will emerge as the institution operates in a weakened state, with external assistance potentially being the only way to stabilize the situation. In Somalia, particularly government institutions, have a history of being bailed out when facing operational risks. Lastly, the institution will also face reputational risks, as it may lose the trust of borrowers, which could severely hinder its operations (Makai, 2013Credit risk has been a persistent challenge that has been widely studied in the finance sector.

Credit risk has been a persistent concern that has been thoroughly examined in the realm of finance. Nonetheless, there has been little advancement, especially concerning financial institutions owned by the government. A significant number of people perceive loans obtained from the government as their own funds, stemming from the taxes they have contributed, which has notably obstructed efforts to recover loans. The implementation of portfolio theory aimed at reducing risk has emerged as a key focus for many, as it entails finding a balance between returns and risk. Lending institutions are actively striving to diversify their investment portfolios to shield themselves from the risk of potential defaults (Klimczak, 2005).

The purpose of this study was to investigate the effect of credit risk management on the performance of loan portfolios. Specifically, it aimed to examine how credit risk identification influences loan portfolio performance, assess the impact of loan recovery strategies, and evaluate the role of credit risk controls in enhancing portfolio outcomes. The study also sought to address key gaps in theory, methodology, concepts, and geography.

Theoretical gaps were addressed by referencing the credit risk theory introduced by Macleod (1889) and further advanced by Merton (1974), which emphasizes that the value of credit depends on the borrower's willingness and ability to repay, and the lender's legal right to claim repayment. While this theory explains the foundations of credit risk, it does not explicitly clarify how credit risk management practices influence loan portfolio performance in banking institutions. This research fills that gap by empirically investigating the practical link between credit risk management and loan performance outcomes.

3. Methodology

The study adopted a cross-sectional research design with a purely quantitative approach. According to Creswell and Clark (2015), a correlational research design examines the relationship between two variables without the researcher influencing either variable. This design enabled the exploration of the link between credit risk management and loan portfolio performance, with correlation tests used to analyze the numerical data. Data were collected using structured questionnaires, coded, quantified, and statistically analyzed to produce objective numerical results.

The defined population must consist of individuals or objects that share similar traits. Nevertheless, because the majority of populations tend to large, it is impractical for researchers to examine every individual, as this would have been both costly and time-consuming. Consequently, they rely on an accessible population (Saunders, Lewis & Thornhill, 2017). The target population for this research includes employees from Salaam Somalia Bank, Amal Bank, Premier Bank, and International Bank. Among the eight banks located in Mogadishu, these four were chosen due to their subpar loan portfolio performance. The bank employees, comprising credit officers, auditing officers, accountants, financial officers, and credit and bank managers, number approximately 287, as reported in the banks' Human Resource Report (2022). These employees were selected because they possess relevant knowledge regarding credit management and portfolio performance and the sample of this study is 167 with using Slovenes formula.

The research relied on data from primary sources. Primary data was collected using questionnaires. This data is obtained directly from the original sources by the researcher through methods such as surveys, interviews, or experiments. It is specifically gathered for the research project and comes directly from these primary sources. Primary data is essential for investigating the relationship between credit management and portfolio performance.

The dataset was evaluated through the use of descriptive statistics and inferential analysis with the statistical package for social science (SPSS). This method provides straightforward summaries of the sample data and offers quantitative representations in an accessible format (Gupta, 2004). Descriptive statistics serve as the foundation for a quantitative analysis of the data (Kothari, 2004). The data analysis concerning the first three objectives involved examining the constructs associated with the variables.

The study instrument was evaluated by three experts to assess its content validity out of a total of 30 items reviewed, 25 were deemed valid, resulting in a content validity index (CVI) of 0.833, which indicates strong validity. The reliability of the instrument was further assessed using Cronbach's alpha, yielding a value of 0.806 demonstrating acceptable internal consistency for the study.

4.0 Data Presentation, Analysis and Interpretation

Table 4.1: Respondents Rate

Response Status	**Frequency(n)**	**Percentage(%)**
Questionnaires Returned	146	96.0
Questionnaires Not Returned	6	4.0
Total	**152**	**100.0**

Source: primary data,2025

Table 4.1 presents the response rate of the study out of the 152 questionnaires distributed, 146 were successfully returned, representing a response rate of 96.0% while only one questionnaire 4.0% was not returned. This high response rate is considered adequate for statistical analysis and enhances the reliability and validity of the study findings.

4.2: Demographic Characteristics of Respondents

Gender	**Frequency**	**Percentage**
Male	88	60.3
Female	58	39.7
Total	146	100.0
Age	**Frequency**	**Percentage**
20-29	18	12.3
30-39	47	32.2
40-49	58	39.7
50 and Above	23	15.8
Total	146	100.0
Working experience	**Frequency**	**Percentage**
Below 1 year	18	12.3
1-2 years	66	45.2
3-4 years	62	42.5
Total	146	100.0
Qualifications	**Frequency**	**Percentage**
Diploma	20	13.6
Bachelor's Degree	80	54.7
Master's Degree	46	31.7
Total	146	100.0
Marital Status	**Frequency**	**Percentage**
Single	50	34.2
married	85	58.2
Divorce	11	7.6
Total	146	100.0

Source: primary data,2025

Table 4.2 presents the demographic characteristics of the 146 respondents involved in the study. Regarding gender, the majority of respondents were male (60.3%), while female respondents accounted for 39.7%, indicating a slightly higher male participation. In terms of Age, most respondents were within the 40-49 years' category (39.7%), followed by 30-39 years (32.2%), and 50 years and above (15.8%, showing that the respondents were predominantly young to middle aged adults.

The working experience of respondents was fairly distributed with the largest group having 1-2 years of experience (45.2%), followed by 3-4 years (42.5%) and below 1 year (12.3%). This suggests that most respondents had adequate professional experience relevant to the study. Regarding qualifications, the majority held bachelor's degree (54.7%), followed by a master's degree (31.7%) and diploma holders (13.6%), indicating a generally well educated sample. Lastly, in terms of marital status most respondents were married (58.2%), while 34.2% were single and 7.6% were divorced or widowed.

Overall, the demographic profile demonstrates that the study sample was diverse in terms of gender, age, professional experience. Educational background and marital status providing a representative basis for the subsequent analysis of budget processing and governance reporting.

4.3 Interpretation guide

5.0-4.2	Very Satisfactory
4.2-3.4	Satisfactory
3.4-2.6	Fairly Satisfactory
2.6-1.8	Unsatisfactory
1.8-1.0	Very Unsatisfactory

Table 4.4 Descriptive analysis of credit risk identification of commercial banks in Mogadishu Somalia

Descriptive analysis of credit risk identification	Mean	Std. Deviation	Interpretation
This bank has a credit risk detection policy	3.676	1.191	Good
There are experts in credit risk detection in this bank	3.006	1.699	Fairly good
This bank does timely risk classification	3.143	1.490	Fairly good
Risk classification in this bank involves all employees	3.102	1.663	Fairly good
The risk ascertainment is done timely	3.164	1.575	Fairly good
Risk identification in this bank is progressively reviewed	3.547	1.545	Good
Average Mean	**3.307**	**.635**	**Fairly good**

Source: Field Data, 2025

Table 4.4 show descriptive analysis of credit risk management, The mean score is 3.307, with a standard deviation of 0.635. This outcome is regarded as reasonably good, indicating that these banks' procedures for identifying credit risk are carried out well. This suggests that credit risk identification is thought to be typically successful.

With a mean score of 3.676 and a standard deviation of 1.191, the bank's credit risk detection policy was deemed to be good. Furthermore, the statement about this institution's progressive review of risk identification had a mean score of 3.676 and a standard deviation of 1.191, both of which are viewed as good. This suggests that the bank regularly evaluates its credit risk and has a strong credit risk policy.

This bank's availability of credit risk detection specialists produced a mean score of 3.006 and a standard deviation of 1.699, which is considered to be fairly good and emphasizes the application of specialized knowledge in the field of credit risk management. With a mean score of 3.143 and a standard deviation of 1.490, the bank also demonstrates timely risk classification, indicating that risk classifications are generated in a timely manner.

The mean score for employee participation in risk classification was 3.102 with a standard deviation of 1.663, which is likewise considered to be pretty acceptable and shows that all employees are included in risk classification. A mean of 3.164 and a standard deviation of 1.575, which are regarded as fairly good and indicate that concerns are detected swiftly, further demonstrated the timely nature of risk assessment.

Table 4.5 Descriptive statistics analysis of loan portfolio performance in commercial banks in Mogadishu, Somalia.

Descriptive analysis of loan portfolio	Mean	Std. Deviation	Interpretation
There are very few none performing loans in this bank	3.047	1.678	Fairly Good

The number of written of loans have reduced since last year	3.321	1.562	Fairly Good
Loan recoveries has increased in the last year	3.000	1.513	Fairly Good
Loan recoveries in this bank has been enhanced with management efficiency	3.328	1.472	Fairly Good
The outstanding loans are performing well	3.876	1.191	Good
The loan defaults have reduced in this bank	2.939	1.686	Fairly Good
This bank has attained increased loan customers	2.986	1.618	Fairly Good
Average Mean	**3.214**	**.701**	**Fairly Good**

Source: Field Data, 2024

Table 4.4 show descriptive analysis of loan portfolio performance, The mean score of 3.214 and a standard deviation of 0.701 suggest that the loan portfolio performance is considered fairly good, indicating that the overall loan performance and mechanisms employed by the banks are generally satisfactory.

The first aspect of the study aimed to assess whether there are very few non-performing loans in the bank. This resulted in a mean of 3.047 and a standard deviation of 1.678, interpreted as fairly good, meaning that only a small number of non-performing loans exist. Additionally, the study examined whether the number of written-off loans had decreased since the previous year. This aspect had a mean of 3.321 and a standard deviation of 1.562, indicating a moderate reduction in written-off loans over time.

The study also explored whether loan recoveries had increased over the last year. The mean value was 3.000 with a standard deviation of 1.513, interpreted as fairly good, suggesting an increase in loan recoveries. Furthermore, the research assessed the impact of management efficiency on loan recoveries, yielding a mean of 3.328 and a standard deviation of 1.472, which was also interpreted as fairly good, indicating improved management in handling loan recoveries.

The findings also showed that outstanding loans are performing well, with a mean of 3.876 and a standard deviation of 1.191, interpreted as good, meaning that the performance of outstanding loans is generally positive. Loan defaults have decreased, with a mean of 2.939 and a standard deviation of 1.686, interpreted as fairly good, suggesting that most respondents agreed that loan defaults had somewhat reduced.

The bank has experienced an increase in loan customers, with a mean of 2.986 and a standard deviation of 1.618, interpreted as fairly good, indicating a moderate increase in the bank's customer base and business performance.

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Table 4.1: Simple linear Regression analysis results for the effect of credit risk management on loan portfolio performance in selected Commercial Banks in Mogadishu, Somalia

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimates
1	0.687[a]	0.471	0.468	.51192
a. Predictors: (Constant), Credit Risk Identification				

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	33.661	1	33.661	128.450	.000[b]
	Residual	37.737	144	.262		
	Total	71.398	145			

a. Dependent Variable: Loan portfolio Performance

b. Predictors: (Constant), Credit Risk management

Coefficients'

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.705	.225		3.129	.002
	Credit Risk management	.759	.067	.687	11.334	.000
a. Dependent Variable: Loan portfolio Performance						

Source: primary data,2025

The regression coefficient analysis in the table reveals that the R-squared value for the impact of credit risk identification on loan portfolio performance in selected commercial banks in Mogadishu, Somalia, is 0.471. This means that credit risk management explains 47.1% of the variation in loan portfolio performance within these banks. The standard error estimate of 0.51192 suggests that the data points are fairly close to the regression line. Additionally, the findings indicate that for every one-unit increase in credit risk identification, there is a 0.471 change in loan portfolio performance.

The analysis of variance (ANOVA) further supports the significant effect of credit risk identification on loan performance, as shown by the 0.000 significance level. These results suggest that credit risk identification plays a key role in influencing the loan performance of commercial banks in Somalia.

Further regression analysis highlights that without credit risk identification, the loan performance rate of the banks would be 0.705. The t-values for the constant and β coefficients are (3.129) and (11.334), respectively, with their corresponding significance levels at (.002 and .000), both of which are less than 0.05. This confirms that there is a statistically significant effect of credit risk identification on loan performance in the selected commercial banks in Somalia.

The hypothesis H1, which posits that credit risk identification has a statistically significant effect on loan portfolio performance in selected Commercial banks in Mogadishu, Somalia, is supported. The study concludes that credit risk identification is a key factor in driving loan performance. These findings are consistent with the interview results, which also indicate the presence of credit risk identification in Mogadishu's banks

5. Discussion

The study discovered that credit risk management **has** a statistically significant positive effect on the performance of loan portfolios in a subset of Mogadishu, Somalia's commercial banks. These results are consistent with those of Akinselure and Akinola (2021), who looked at the connection between the loan portfolios of Nigerian deposit money banks and the identification of credit risk. Using secondary data from thirteen Nigerian banks' certified financial accounts, their analysis found a substantial relationship between deposit money institutions' profitability and credit management, with p-values below the 5% level.

Likewise, the findings align with those of Karanja and Simiyu (2022), who examined how credit risk identification affected loan performance in Kenyan microfinance organizations. For data analysis, the study employed a linear regression model using a descriptive research methodology. The findings showed that the bank's debt policy worked well and that it evaluates borrowers' creditworthiness before making any loan offers. These results are consistent with those of Francis et al. (2022), who looked at how credit risk management affected loan performance in Ugandan commercial banks located in Mbarara City.

In a similar vein, Olobo et al. (2021) looked into how credit identification methods affected the performance of loan portfolios in Juba, South Sudan. 124 respondents were chosen for their study using a cross-sectional survey and cluster, purposive, and random selection techniques. A multiple regression model was used to examine the data, and the results indicated a strong positive correlation between banks' financial success and credit risk management.

6. Conclusion

The study revealed that credit risk management has a statistically significant positive impact on the loan portfolio performance in selected commercial banks in Mogadishu, Somalia. Based on these results, the researcher concludes that recognizing credit risk can moderately improve loan portfolio performance in these specific banks. Therefore, it is essential to highlight that managing credit risk is a vital factor in enhancing the loan portfolio performance in these banks.

7. Recommendation

For government and financial regulators: Strengthen credit risk management regulations by requiring standardized loan monitoring systems and timely reporting to improve oversight of loan portfolio performance.

For banks and financial institutions: Ensure regular internal and public disclosure of key loan portfolio indicators, including non-performing loans, to enhance transparency and accountability.

For development partners and donors: Support the development of locally appropriate credit risk management tools and performance measures to promote sustainable improvements in loan portfolio quality.

For future researchers: Conduct longitudinal and comparative studies to better understand the long-term effects of credit risk management practices on loan portfolio performance.

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