CREDIT MANAGEMENT

(A Case Study of Wegagen Bank Share Company in Tigray Region)

A Research project submitted to the Department of Accounting and Finance, College of Business and Economics, Mekelle University, for the partial Fulfillment of the Degree of Master of Science in Finance and Investment

By

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Reg. No-- CBE / PRO-021 / 01

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Mekelle, Ethiopia

June, 2010

Study On

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DECLARATION

I, Hagos Mirach, hereby declare that the project work entitled "CREDIT MANAGEMENT- A CASE STUDY OF WEGAGEN BANK SHARE COMPANY IN TIGRAY REGION" Submitted by me for the award of degree of Master of Finance and investment of Mekelle University at Mekelle is original work and it hasn't been presented for the award of any other Degree, Diploma, Fellowship or other similar titles of any other University or institution.

Place: Mekelle   Signature:____________________________

Date: June, 2010   Name: Hagos Mirach

CERTIFICATE

This is to certify that this thesis entitled "CREDIT MANAGEMENT- A CASE STUDY OF WEGAGEN BANK SHARE COMPANY IN TIGRAY REGION" submitted in partial fulfillment of the requirements for the award of the degree of Master of Finance and investment (MFI) to the College of Business and Economics, Mekelle University, through the Department of Accounting, done by Mr. Hagos Mirach Id.No.FBE/PR0021/01 is an authentic work carried out by him under our guidance. The matter embodied in this thesis has not been submitted earlier for award of any degree or diploma to the best of my knowledge and belief.

Place: Mekelle Signature: ---------------------------------

Date: June, 2010 Advisor: Dr. Fisseha Girmay, Ph.D.

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ABSTRACT

This study of credit management– A Case Study of Wegagen Bank Share Company in Tigray Region is an attempt to indicate the importance of credit management in financial institutions such as commercial banks, micro finances and others. Thus, the rationale behind for undertaking this study is to deeply investigate the causes of credit management problems and to suggest the possible solutions that enable the bank to run its operation in a safest way as credit is known to be the main stay of all banks.

The ability of banks to formulate and adhere to policies and procedures that promote credit quality and curtail non-performing loans is the means to survive in the stiff competition. Inability to create and build up quality loans and credit worthy customers leads to default risk and bankruptcy as well as hampers economic growth of a country. However, little work is done to search the ways and means that enable to quality loan creation and growth as well as to determine the relationship between the theories, concepts and credit policies both at country or regional level.

The main objective of the study is to evaluate the performance of credit management of Wegagen bank in Tigray Region as compared to National Bank's requirements in comparison with its credit policy and procedures.

For the purpose of the study both primary and secondary data are used. Primary data is collected using semi structured questionnaires. The secondary data is collected from annual reports, directives, and bulletins of the bank. Descriptive statistical tools are used in analyzing the data collected. Hence, the nature of the Study is descriptive.

Finally, based on the findings possible recommendations are given. These include the issues impeding loan growth and rising loan clients complaint on the bank regarding the valuing of properties offered for collateral, lengthy of loan processing, amount of loan processed and approved, loan period, and discretionary limits affecting the performance of credit management.

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ACRONYMS

BCC- Branch Credit Committee

BOD- Board of Directors

CAD- Cash against Document

CEO- Chief Executive Officer

CIC- Credit Information Centre

DLL- Discretionary Lending Limit

EC- Ethiopian Calendar

EPRDF-Ethiopian Peoples Revolutionary Democratic Party

FIS- Financial Institutions

GC- Gregorian Calendar

L/C- Letter of Credit

LAF- Loan Approval Form

MCC- Management of Credit Committee

NBE- National Bank of Ethiopia

NOW- Negotiable Order of Withdrawal Account

NPLS- Non Performing Loans

NPTL- Non Performing to total Loan

NPTGL- Non Performing Loan to Gross Loan

OBC- Outward Bills for Collection

ODBC- Outward Documentary Bills for set for Collection

ODBP- Outward Documentary Bills Purchased

OPD- Outward Bills Purchased

PSS- Proportionate Stratified Sampling

SC- Share Company

SBB- Supervision of Banking Business

VP- Vice President

ZBA- Zero Balance Account

CHAPTER I

INTRODUCTION

1.1 Background of the Study

Banks are financial institutions that are established for lending, borrowing, issuing, exchanging, taking deposits, safeguarding or handling money under the laws and guide lines of a respective country. Among their activities, credit provision is the main product which banks provide to potential business entrepreneurs as a main source of generating income.

While providing credit as a main source of generating income, banks take into account many considerations as a factor of credit management which helps them to minimize the risk of default that results in financial distress and bankruptcy. This is due to the reason that while banks providing credit they are exposed to risk of default (risk of interest and principal repayment) which need to be managed effectively to acquire the required level of loan growth and performance.

The types and degree of risks to which banks are exposed depends upon a number of factors such as its size, complexity of the business activities, volume etc. It is believed that generally banks face Credit, Market, Liquidity, Operational, Compliance /legal/ regulatory and reputation risks among which credit risk is known to have the adverse impact on profitability and growth. Hence, the success of most commercial banks lies on the achievements in credit management mitigating risk to the acceptable level.

Charles Mensah (1999) stressed the importance of credit management as follows: Credit management process deserves special emphasis because proper credit management greatly influences the success or failure of financial institutions.

This indicates that credit provision should be accompanied by appropriate and attractive credit policies and procedures that enhance performance of credit management and protects the banking industry from failure.

Credit management means the total process of lending starting from inquiring potential borrowers up to recovering the amount granted. In the sense of banking sector, credit management is concerned with activities such as accepting application, loan appraisal, loan approval, monitoring, recovery of non-performing loans, etc (Shekhar, 1985).

According to Hettihewa, 1997, Credit Management is extremely important as granting credit is considered to be the equivalent of investing in a customer.

However, payment of the debt should not be postponed for too long as delayed payments and bad debts are a cost to the company. Thus, Efficiency and effectiveness in performing each steps of loan processing using various parameters has significant effect on performance of credit management.

Wegagen Bank Share Company is one of the financial institutions engaged in providing short and medium credit like other commercial banks in the country in general and in the region in particular. In the last few years, both public and private sectors in the economy underwent encouraging development in investment and business activities, thus becoming the fertile ground for the banking industry. Since its establishment in 1997 G.C, Wegagen Bank has been striving to exploit such and all other opportunities towards achieving its corporate goals. The bank has been providing only short and medium loans and advances to its customers because of its early stage of capital base and liquidity position. The bank has been playing a significant role in providing loans and advances to its customers that enhances the investment need in the country and as means of generating income for its share holders.

Hence, the purpose of this study is to assess the performance of credit management problems and strengths of Wegagen Bank Share Company in Tigray Region from different perspectives in light of the practices of modern credit management in financial institutions.

1.2 Background of the Banking Industry in Ethiopia

As a result of the agreement reached between Emperor Minilik II and Mr.Ma Gillivray, representative of the British owned National Bank of Egypt; modern banking in Ethiopia began in 1905 with the Bank of Abyssinia, a private company controlled by the Bank of Egypt In 1931. It was liquidated and replaced by the Bank of Ethiopia which was the bank of issue until the Italian invasion of 1936. During the Italian occupation, Bank of Italy banknotes formed the legal tender. Under the subsequent British occupation, Ethiopia was briefly a part of the East Africa Currency Board. In 1943; the State Bank of Ethiopia was established, with two departments performing the separate functions of an issuing bank and a commercial bank. In 1963, these functions were formally separated and the National Bank of Ethiopia (the central and issuing bank) and the Commercial Bank of Ethiopia were formed.

In the period to 1974, several other financial institutions emerged including the state owned: The Agricultural and Industrial Development Bank (established largely to finance state owned enterprises); The Savings and Mortgage Corporation of Ethiopia; The Imperial Savings and Home Ownership Public Association (which provided savings and loan services).

Major private commercial institutions, many of which were foreign owned, included the Addis Ababa Bank, the Banco di Napoli, the Banco di Roma.

However, the banking business could not move further because of the nationalization of private investments by the Socialist regime (the Dergue regime) that came into power leaving only three government banks; the National Bank of Ethiopia, the Commercial Bank of Ethiopia and agricultural and Industrial Development Bank.

This was reversed when the Socialist regime was overthrown in 1991. Following the overthrown of the Dergue regime in 1991, the EPRDF declared a liberal economic system. In line with this, Monetary and Banking proclamation of 1994 established the National Bank of Ethiopia (NBE) as a judicial entity, separated from the government and outlined its main function.

Monetary and Banking proclamation No.83/1994 and the Licensing and Supervision of Banking Business No.84/1994 laid down the legal basis for investment in the banking sector (www.nbe.gov.com).

After the proclamation of 1994, the first private bank, Awash International Bank was established in 1994 by 486 shareholders paving a way to the establishment of related private banks such as Dashen Bank (1995), Abyssinia Bank (1996), Wgegan Bank (1997), United Bank (1998), Nib International Bank (1999), Cooperative Bank of Oromia (2004), Lion International Bank (2006), Oromia International bank (2008), Zemen Bank (2006), Buna International Bank (2009), Birhan International Bank (2009), and others which are under establishment.

1.3 Statement of the Problem

According to Shekhar, 1985, credit plays an important role in the lives of many people and in almost all industries that involve monetary investment in some form. Credit is mainly granted by banks including to several other functions like mobilizing deposits, local and international transfers, and currency exchange service.

Hence, the issue of credit management has a profound implication both at the micro and macro level. When credit is allocated poorly it raises costs to successful borrowers, erodes the fund, and reduces banks flexibility in redirecting towards alternative activities. Moreover, the more the credit, the higher is the risk associated with it. The problem of loan default, which is resulted from poor credit management, reduces the lending capacity of a bank. It also denies new applicants' access to credit as the bank’s cash flow management problems augment in direct proportion to the increasing default problem. In other words, it may disturb the normal inflow and outflow of fund a bank has to keep staying in sustainable credit market.

Hence, credit evaluation decisions are important for the financial institutions involved due to the high level of risk associated with wrong decision. The process of making credit evaluation decision is complex and unstructured. This complex and unstructured decision making process of credit evaluation needs proper credit management by the concerned banks.

Adequately managing credit in financial institutions (FIs) is critical for the survival and growth of the FIs. In the case of banks, the issue of credit management is of even greater concern because of the higher levels of perceived risks resulting from some of the characteristics of clients, business conditions and economic environment in which they find themselves.

The very nature of the banking business is so sensitive because more than 85% of their liability is deposits mobilized from depositors (Saunders, Cornett, 2005). Banks use these deposits to generate credit for their borrowers, which in fact is a revenue generating activity for most banks. This credit creation process, if not managed properly, exposes the banks to high default risk which might led to financial distress including bankruptcy. All the same, beside other services, banks must create credit for their clients following prudent credit management procedure to make some money, grow and survive in stiff competition at the market place.

Even though a preliminary study is made in preparing the master business plan for the opening of branches; little work is done in studying the performance of credit management of the branches that would alleviate the problems encountered and contribute to the growth of market share and income generation of the bank. Hence the researcher is interested to the research area in particular and to the contribution and object of the bank in general in assessing the gaps in credit management performance which is crucial to be studied in the prevailing stiff competition in line of the modern financial measurements.

Therefore, the principal concern of this study is to assess the performance of credit delivery and management in Wegagen Bank Share Company in Tigray Regional State.

1.4 Research Questions

1. Does the Bank consistently comply with its policy and procedures in entertaining its loan applicants, loan processing, and collecting?
2. To what extent is the Bank accelerating the performance of credit management in line to its policy and national banks requirement?
3. Do loan customers of the Bank support the prevailing loan policy and procedures that could result long lasting relation ship?
4. To what level is the Bank building up quality loans arresting non- performing loans in line to its policy and National Bank's requirement.

1.5 Justification of the Study

Based on the monetary and Banking proclamation No.83/1994 which laid down the legal basis for investment in the banking sector a number of private commercial banks are under establishment opening their head quarter at Addis Ababa which is the capital city of Ethiopia and striving to stretch their branches to all regions as a strategy to build up market share.

Wegagen Bank Share Company is one of the leading private commercial banks playing its role in opening about 48 branches in the country. Of which 23 branches are in Addis Ababa, the major business center and the capital city of the country, and the rest 25 branches are at different regions.(Annual report of 2008/09)

Out of these branches in different regions 7 (seven) branches are opened in Tigray Region. However, though a preliminary study is made in preparing the master business plan for the opening of branches, little work is done in studying the performance of credit management of the branches that would alleviate the problems encountered and contribute to the growth of market share and income generation of the bank. Hence the researcher is interested to the research area in particular and to the contribution and object of the bank in general in assessing the gaps in credit management performance which is crucial to be studied in the prevailing stiff competition in line of the modern financial measurements.

1.6 Objective of the Study

1.6.1 General objective

The main objective of the study is to evaluate the performance of credit management of Wegagen Bank in Tigray region as compared to National Bank requirements vis à vis its credit policy and procedures.

1.6.2 Specific objectives

1. To evaluate the compliance of the Bank to its policies and procedures in processing loan applications.
2. To evaluate the ability of the Bank in creating credit and collecting its loan on their due date.
3. To asses the perception of the customers towards the Bank's policy in relation to its loan provision.
4. To evaluate the Bank's credit quality as compared to National Bank's requirements and its credit policy.

1.7 Significance of the Study

Loans and advances are known to be the main stay of all commercial banks. They occupy an important part in gross earnings and net profit of the banks. The share advances in the total asset of the banks forms a lion share (almost more than 60 percent) and as such it is the back bone of banking sector. Bank lending is very crucial for it makes possible the financing of agricultural, industrial, construction, and commercial activities of a country. The strength and soundness of the banking system primarily depends upon health of the advances. Therefore the ability of banks to formulate and adhere to policies and procedures that promote credit quality and curtail non-performing loans is the means to survive in the stiff competition. In ability to create and build up quality loans and credit worthy customers leads to default risk and bankruptcy as well as hampers economic growth of a country. However, little work is done to search the ways and means that enable to quality loan creation and growth as well as to determine the relationship between the theories, concepts and credit policies both at country level or regional level.

Hence, this study is assumed to be significant in indicating best practice and concepts for prudent lending to enhance the performance of credit management to all managers and policy makers of the bank as well as to all financial institutions and banks. Moreover, it may help as a benchmark for researchers who are interested in the area to extend it further.

1.8 Scope of the Study

The study is concentrated on Wegagen Bank Share Company branches found in Tigray Regional state. This is because; it is one of the private banks working with leading area coverage in the Region yet.

The study covered credit policies, procedures, and credit operations of the Bank. It assessed whether the loan growth and performance is to the required level of the bank or not. In addition, the study is concerned with identifying the major reasons for best practices of credit management, loan growth, and causes of loan default if any in the region. Since the lending rules and procedures of the bank is the same in all its branches, the result obtained taking case study of this specific region is assumed to reflect the situation of all branches of the bank in the country under normal circumstance.

1.9 Limitation of the Study

Though studying at full-fledged level of the bank would have better result, due to the time and finance constraints the researcher is limited to under take the study in seven branches located in Tigray regional state. The branches are stretched from Mekelle to Humera in the region and this has entailed transportation problem, hardship, and time scarcity. The constraint of time had significant impacts on the study.

1.10 Organization of the Study

The Study is organized into six chapters. The first chapter introduces the background of the study, the research objectives and questions, significance of the study, scope of the study, limitation of the study and organization of the study. The second chapter presents theoretical and empirical review of the related literatures. The third chapter deals with methodology of the study. The fourth chapter is concerned with the background of the organization and the fifth chapter describes the analysis, results and discussions. The sixth chapter presents the conclusion and recommendations drawn from findings of the data in addition with implications for further research.

CHAPTER II

LITERATURE REVIEW

2.1 Introduction

Financial institutions, which are composed of banks, micro finances, and insurances, have comprehensive roles in serving the needs of the society with in the economy. The service is rendered through providing three major financial functions: intermediation, or allocation, operational and payment systems. Operational and allocation functions are the provisions of financial resources to meet borrowing needs of individuals and other economic agents. The main microeconomic function of banks is the provision of facilities to collect deposits and invest these deposits as credits. Provision of a sound payment mechanism is also the other expected service from banks. Hence, the performance of banks is measured in terms of the above major roles of the banking business and relies on the provision of these functions.

As Hoff and Stiglitz in 1990 denoted, in the past decades there have been major advances in theoretical understanding of the workings of credit markets. These advances have evolved from a paradigm that emphasis the problems of imperfect information and imperfect enforcement. They pointed out that borrowers and lenders may have differential access to information concerning a business risk, they may form different appraisal of the risk. What is clearly observed in credit market is asymmetric information where the borrower knows the expected return and risk of his/her business, where as the lender such as bank knows only the expected return and risk of the average business in the economy.

2.1.1 Definition of Credit Management

There are many definitions given for credit management by different scholars. Among these some are here cited as follows:

Credit management is implementing and maintaining a set of policies and procedures to minimize the amount of capital tied up in debtors and to minimize the exposure of the business to bad debts. (http://www.smallbusiness.wa.gov.au/assets/Small-Business-Briefs/small-business-brief-credit-management.pdf).

Credit Management, from a debtor's point of view, is managing finances especially debts so as not to have a tail of creditors lurking behind your back. Credit management is a responsibility that both the debtor and the creditor should seriously take (http://www.selfgrowth.com/articles/Tabije3.html). When it functions efficiently, credit management serves as an excellent instrument for the business to remain financially stable.

2.1.2 Process of Credit Management

The process of credit management begins with accurately assessing the credit-worthiness of the customer base and his/her business viability. This is particularly important if the company chooses to extend some type of credit line or revolving credit to certain customers. Hence, proper credit management is setting specific criteria that a customer must meet before receiving the proposed credit arrangement. As part of the evaluation process, credit management also calls for determining the total credit line that will be extended to a given customer.

Several factors are used as part of the credit management process to evaluate and qualify a customer for the receipt of some form of commercial credit. This includes gathering data on the potential customer's current financial condition, including the current credit track record that discloses the character of a customer in meeting obligations as well as collateral value. The current ratio between income and outstanding financial obligations will also be taken into consideration.

Competent credit management seeks to not only protect the bank or any financial institution involved from possible losses, but also protect the customer from creating more debt obligations that cannot be settled in a timely manner.

When the process of credit management functions efficiently, everyone involved benefits from the effort. The financial institution such as banks has a reasonable amount of assurance that loans granted to a client will be paid back within terms, or that regular minimum payments will be received on credit account balances.

Customers have the opportunity to build a strong rapport with the creditor and thus create a solid credit reference (http://www.wisegeek.com/what-is-credit-management.htm).

2.1.3 Types of Credit

There are four basic types of credit. By understanding how each works, financial institutions will be able to get the most solution for their loan recovery and avoid paying unnecessary charges.

- **Service credit** is monthly payments for utilities such as telephone, gas, electricity, and water. You often have to pay a deposit, and you may pay a late charge if your payment is not on time.
- **Loans**: Loans can be for small or large amounts and for short or long periods. Loans can be repaid in one lump sum or in several regular installment payments until the amount borrowed and the finance charges are paid in full. Moreover, loans can be secured or unsecured.
- **Installment credit:** is described as buying on time, financing through the store or the easy payment plan.

The borrower takes the goods home in exchange for a promise to pay later. Cars, major appliances, and furniture are often purchased this way. You usually sign a contract, make a down payment, and agree to pay the balance with a specified number of equal payments called installments.

The finance charges are included in the payments. The item you purchase may be used as security for the loan.

- **Credit cards** are issued by individual retail stores, banks, or businesses. Using a credit card can be the equivalent of an interest-free loan--if you pay for the use of it in full at the end of each month

  (http://www.urbanext.illinois.edu/ww1/04-03.html).

2.1.4 Credit Policies and Procedures

A Credit Policy is not something that is only operated by the Credit and risk Department. All employees involved with customers, in any way, need to be aware of the credit policy and ensure that it is operated consistently (http://www.bwaresolutions.com/).

In order to be effective, credit policies must be communicated throughout the organization, implemented through appropriate procedures, monitored and periodically revised to take into account changing internal and external circumstances.

They should be applied, where appropriate, on a consolidated bank basis and at the level of individual affiliates. In addition, the policies should address equally the important functions of reviewing.

Economic conditions and the firm's credit policies are the chief influences on the level of a firm's account receivable. Economic conditions, of course, are largely beyond the control of the financial manager. As with other current assets, however, the manager can vary the level of receivables in keeping with the tradeoff between profitability and risk. Lowering quality standards may stimulate demand, which, in turn, should lead to higher profitable receivables, as well as a greater risk of bad debt.

The credit and collection policy of one firm are not independent of those of other firms. If product and capital markets are reasonably competitive, the credit and collection practices of one company will be influenced by what other companies are doing.

Such practice related to the pricing of the product or service and must be viewed as part of the overall competitive process.

The examination of certain policy variables implies that the competitive process is accounted for in the specification of the demand function as well as in the opportunity cost associated with taking on additional receivables. The policy variables include the quality of the trade accounts accepted; the length of the credit period, the cash discount, any special terms such as seasonal dating and the collection program of the firm. Together, these elements largely determine the average collection period and the proportion of bad debt losses (Horne, 1995: 361).

2.1.5 Credit Analysis

Credit analysis is the primary method in reducing the credit risk on a loan request. This includes determining the financial strength of the borrowers, estimating the probability of default and reducing the risk of non repayment to an acceptable level. In general, credit evaluations are based on the loan officer's subjective assessment (or judgmental assessment technique).

Once a customer requests a loan, bank officers analyze all available information to determine whether the loan meets the bank’s risk-return objectives. Credit analysis is essentially default risk analysis, in which a loan officer attempts to evaluate a borrower’s ability and willingness to repay.

Similarly Compton (1985) identified three distinct areas of commercial risk analysis related to the following questions: 1) what risks are inherent in the operations of the business? 2) What have managers done or failed to do in mitigating those risks? 3) How can a lender structure and control its own risks in supplying funds?

The first question forces the credit analyst to generate a list of factors that indicate what could harm a borrower's ability to repay. The second recognizes that repayment is largely a function of decisions made by a borrower. Is management aware of the important risks, and has it responded? As Tomothy (1995:665) quoted, the last question forces the analyst to specify how risks can be controlled so the bank can structure to an acceptable loan agreement.

A bank's credit analysts often use the five C's of credit to focus their analysis on the key dimensions of an applicant's creditworthiness.

Lawrence (1997:776-777), identified five C's of credit. They include; Character, Capacity, Capital, Collateral, and Conditions.

1. **Character:** The applicant's record of meeting past obligations, financial, contractual, and moral. Past payment history as well as any pending or resolved legal judgments against the applicant would be used to evaluate its character.

2. **Capacity:** The applicant's ability to repay the requested credit. Financial statement analysis, with particular emphasis on liquidity and debt ratios, is typically used to assess the applicant's capacity.

3. **Capital:** The financial strength of the applicant as reflected by its ownership position. Analysis of the applicant's debt relative to equity and its profitability ratios are frequently used to assess its capital.

4. **Collateral**: The amount of assets the applicant has available for use in securing the credit. The larger the amount of available assets, the greater the chance that a firm will recover its funds if the applicant defaults.

A review of the applicant's balance sheet, asset value appraisals, and any legal claims filed against the applicant's assets can be used to evaluate its collateral.

5. **Conditions:** The current economic and business climate as well as any unique circumstances affecting either party to the credit transaction. For example, if the firm has excess inventory of the items the applicant wishes to purchase on credit, the firm may be willing to sell on more favorable terms or to less creditworthy applicants. Analysis of the general economic and business conditions, as well as special circumstances that may affect the applicant or firm is performed to assess conditions.

The credit analyst typically gives primary attention to the first two C's-character and Capacity-because they represent the most basic requirements for extending credit to an applicant. Consideration of the last three C's-Capital, Collateral, and Conditions- is important in structuring the credit management and making the final credit decision, which is affected by the credit analyst's experience and judgment.

According to Golden and Walker (1993), there are five Cs of bad debt; which represent things to guard against in order to help prevent problems. They include: **Complacency, Carelessness, Communication breakdown, Contingency, and Competition.**

Complacency refers to the tendency to assume that because things were good in the past they will be good in the future. Common examples are an over reliance on guarantors, reported net worth, or past loan repayment success because it's always worked out in the past.

Carelessness involves poor underwriting, typically evidenced by inadequate loan documentation, a lack of current financial information or other pertinent information in the credit files, and a lack of protective covenants in the loan agreement. Each of these makes it difficult to monitor a borrower's progress and identify problems before they are unmanageable.

Loan problems often arise when a bank's credit objectives and policies are not clearly communicated**.** This is **communication breakdown**. Management should articulate and enforce loan policies, and loan officers should make management aware of specific problems with the existing loans as soon as they appear.

A contingency refers to lenders' tendency to play down or ignore circumstances in which a loan might in default.

Competition involves following competitors' behavior rather than maintaining the bank's own credit standards.

2.1.6 Credit Information

Adequate and timely information that enables a satisfactory assessment of the creditworthiness of borrowers applying for a bank loan is crucial for making prudent lending decisions. Prudent lending decisions made on the basis of adequate information on the creditworthiness of borrowers are one of the principal factors in ensuring the financial soundness of banks.

But, there has been serious difficulty in Ethiopia of getting accurate and timely information on prospective borrowers that facilitates the making of such prudent lending decisions. One of the means for alleviating this difficulty of getting accurate and timely information on prospective borrowers is the establishment of a Credit Information Center (CIC) where relevant information on borrowers is assumed to be pooled and made available to lending banks.

According to article 36 of the Licensing and Supervision of Banking Business Proclamation No. 84/1994, the National Bank Ethiopia (NBE) has issued these directives to establish such a Credit Information Center (CIC). Though there is still serious limitations in the accuracy of the credit information extracted the summary of the directive is as follows:

- Banks shall provide, alter and update credit information on each and every one of their borrowers using online system.
- Upon written request by banks, the Supervision Department of the NBE shall provide to the requesting bank, in writing, all credit information available in the Central Database on a prospective borrower within three working days from the date of receipt of the request;

- Access to the Central Database shall be restricted to the user group;
- The role of the NBE shall be restricted to administering the Credit Information Sharing system, providing in writing credit information on borrowers available at Credit Information Center to banks, ensuring that access to online system to update or alter credit information is given only to authorized persons and ensuring that the system is operating smoothly and reliably;
- The NBE shall not be responsible for any damages, claims or liabilities that may arise as a result of inaccurate, misleading or incomplete credit information on borrowers supplied to the Credit Information Center by individual banks and shared, through the NBE, with other banks.
- Each bank shall provide, electronically, the initial credit and other related information to the Credit Information Center on each and every one of its borrower;
- Each bank shall be fully responsible for providing accurate, complete and timely credit information to the Credit Information Center. In cases where errors have been made, such errors shall be corrected promptly by the concerned bank;
- Each bank shall be fully responsible for any damages, claims or liabilities that may arise as a result of providing inaccurate, misleading or incomplete credit information to the Credit Information Center or failure to provide, inadvertently or otherwise, information to the Center that should have been provided in line with these directives;
- Each bank shall use the credit information on borrowers obtained from the Central Database of the Credit Information Center only and only for making a lending decision. Such information shall be treated with utmost confidentiality and shall not be disclosed to any third party or used for any other purpose;
- Each bank shall be fully responsible for any damages, claims or liabilities that may arise as a result of disclosure of credit information on borrowers obtained from the

Credit Information Center to third parties or use of that information for purposes other than for making a lending decision.

2.1.7 Credit Process

The fundamental objective of commercial and consumer lending is to make profitable loans with minimal risk. Management should target specific industries or markets in which lending officers have expertise. The credit process relies on each bank's systems and controls to allow management and credit officers to evaluate risk and return trade-offs.

According to Timothy (1995), the credit process includes three functions: business development and credit analysis, credit execution and administration, and credit review.

2.1.7.1 Business Development and Credit Analysis

Business development is the process of marketing bank services to existing and potential customers. With lending it involves identifying new credit customers and soliciting their banking business, as well as maintaining relationships with current customers and cross-selling non-credit services. Every bank employee, from tellers handling drive-up facilities to members of the board of the directors, is responsible for business development. Each employee regularly comes in to contact with potential customers and can sell bank services. To encourage marketing efforts, many banks use cash bonuses or other incentive plans to reward employees who successfully cross-sell services or bring new business into a bank.

2.1.7.2 Credit Execution and Administration

The formal credit decision can be made individually or by committee, depending on a bank's organizational structure. This structure varies with a bank's size, number of employees, and type of loans handled. A bank's Board of Directors normally has the final say on which loans are approved. Typically, each lending officer has independent authority to approve loans up to some fixed dollar amount.

2.1.7.3 Credit Review

The loan review effort is directed at reducing credit risk as well as handling problem loans and liquidating assets of failed borrowers. Effective credit management separates loan review from credit analysis, execution, and administration. The review process can be divided into two functions: monitoring the performance of existing loans and handling problem loans. Many banks have a formal loan review committee, independent of loan officers, that reports directly to the chief executive officer and directors' loan committee.

Loan review personnel review current loan to verify that the borrower's financial condition is acceptable, loan documentation is in place, and pricing meets return objectives.

2.1.8 Credit Approval and Implementation

The individual steps in the credit approval process and their implementation have a considerable impact on the risks associated with credit approval. The quality of credit approval processes depends on two factors, i.e. a transparent and comprehensive presentation of the risks when granting the loan on the one hand, and an adequate assessment of these risks on the other. Furthermore, the level of efficiency of the credit approval processes is an important rating element. Due to the considerable differences in the nature of various borrowers and the assets to be financed as well as the large number of products and their complexity, there cannot be a uniform process to assess credit risks.

The quality of the credit approval process from a risk perspective is determined by the best possible identification and evaluation of the credit risk resulting from a possible exposure.

According to Oesterreichische National bank Credit Approval Process and Credit Risk Management (2000), the credit risk can be distributed among four risk components.

a. Probability of Default (PD)

b. Loss Given Default (LGD)

c. Exposure at Default (EAD)

d. Maturity (M)

The most important components in credit approval processes are PD, LGD, and EAD. While maturity (M) is required to calculate the required capital, it plays a minor role in exposure review. The significance of PD, LGD, and EAD is described below.

a) Probability of Default (PD)

Reviewing a borrower's probability of default is basically done by evaluating the borrower's current and future ability to fulfill its interest and principal repayment obligations. This evaluation has to take into account various characteristics of the borrower (natural or legal person), which should lead to a differentiation of the credit approval processes in accordance with the borrowers served by the bank.

Furthermore, it has to be taken into account that —for certain finance transactions — interest and principal repayments should be financed exclusively from the cash flow of the object to be financed without the possibility for recourse to further assets of the borrower. In this case, the credit review must address the viability of the underlying business model, which means that the source of the cash flows required to meet interest and principal repayment obligations has to be included in the review.

b) Loss Given Default (LGD)

The loss given default is affected by the collateralized portion as well as the cost of selling the collateral. Therefore, the calculated value and type of collateral also have to be taken into account in designing the credit approval processes.

c) Exposure at Default (EAD)

In the vast majority of the cases described here, the exposure at default corresponds to the amount owed to the institution. Thus, besides the type of claim; the amount of the claim is another important element in the credit approval process.

2.1.9 Credit Collection Techniques

Effective credit collection techniques are one of the necessities for financial institutions in any economic climate. Knowing how to encourage customers to pay their outstanding debts to financial institutions like banks on time can increase the cash flow of banks.

Therefore a number of collection techniques are employed. Under normal circumstances loan clients are expected to pay in cash or deposit or keep their installment repayment as per the agreement made. As the loan account becomes past due or overdue the collection effort becomes more personal and strict. The basic techniques are:

- **Telephone Calls:** If the loan client passes the due date, a telephone call may be made to the customer to request immediate repayment and up to date his or her account.
- **Personal visits:** - If the telephone call made is not resulted positive response vesting his business and discussing the issue with the customer can be a very effective collection procedure.
- **Letters:** - If the efforts made so far is unsuccessful and not resulted positive response a polite letter is to be served reminding the customer of its obligation followed by warning letters for the action to be taken in future and its consequence. Collection letters are the first step in the collection process for past due and overdue loan accounts.

- **Using Collection Agencies:** Firms can turn uncollectible accounts over to a collection agency or an attorney for collection. The fees for this service are typically quite high; the firm may receive less than fifty percent on accounts collected in this way.

- **Legal Action:** legal action is the most stringent step in the collection process. It is an alternative to the use of a collection agency not only is direct legal action expensive, but is may force the debtor in to bankruptcy, thereby reducing the possibility of future business without guarantying the ultimate receipt of overdue amount. (http://www.articlesbase.com/finance-articles/3-top-credit-collection-techniques-that-can-improve-cash-flow-to-your-business-900152.html).

2.1.10 Financial Analysis

Review, appraisal and follow-up are three basic elements in credit management and decision-making. At the time of considering fresh proposals or enhancement proposals, the banker reviews the past operations with to judge the health status of the client. Timothy (1995) identified three basic elements used in credit management to evaluate the creditworthiness of clients.

a) Review is for the past**.** It should enable the banker to find out whether it is safe to lend to a particular client. In order to arrive at this decision, the banker has to satisfy himself about the risk and viability of the unit. Review of any unit involves assessment of solvency, liquidity and profitability of that unit as revealed by its financial statements, i.e. profit and loss accounts and balance sheets. Review, thus, involves classification of profit and loss account and the balance sheet according to bank's requirement and analysis of these statements.

b) Credit appraisal implies consideration of fresh or enhancement proposals on the basis of futuristic data. While appraising proposals, banker tries to find out: financial need of the client, end-use of funds, viability of operations and risk involved.

In case of proposals involving working capital finance, the banker can ascertain the aforesaid factors only when he/she is supplied with the business plan of the borrower for the ensuing period. Business plan is expressed through operating statement, balance sheet, funds flow, and cash flow statements, all on projected basis.

c) Follow-up may be defined as a continuous activity aimed at ensuring observance of stipulations laid down by the bank, picking up signals on health status of client's position, remedial action and ensuring results of action on a continuous basis. Safety, need-based finance and end-use are the key assumptions of lending.

A banker needs various types of data and information from the borrowers for taking the credit decisions. Such information is generally available in various financial statements such as income statement, balance sheet, cash flow statement, funds flow statement, etc. But mere collect of these financial data from the borrowers is of little help unless the banker is able to use these statements; arrange or classify them according to his/her needs and analyze them with a view to draw meaningful conclusions.

2.1.11 Criteria for Choosing a Bank

Individuals whose only contact with their bank is through the use of its checking services generally choose a bank for the convenience of its location and the competitive cost of its services. However, a business that borrows from banks must look at other criteria, and a potential borrower seeking banking relations should recognize that important difference exist among banks. Some of these differences are considered here.

***a)* Willingness to Assume Risks**

Banks have different basic policies toward risk. Some banks are inclined to follow relatively conservative lending practice, while others engage in what are properly termed creative banking practices. These policies reflect partly the personalities of officers of the bank and partly the characteristics of the banks deposit liabilities.

Thus, a bank with fluctuating deposit liabilities in a static community will tend to be a conservative lender, while a bank whose deposits are growing with little interruption might follow more liberal credit policies.

Similarly, a large bank with broad diversification over geographic regions or across industries can obtain the benefit of combining and averaging risks.

b) Advice and Counsel

Some bank loan officers are active in providing counsel and in stimulating development loans to firms in their early and formative years. Certain banks have specialized departments that make loans to firms expected to grow and thus to become more important customers. The personnel of these departments can provide valuable counseling to customers.

c) Loyalty to Customers

Banks differ in the extent to which they will support the activities of borrowers in bad times. This characteristic is referred to as the degree of loyalty of the bank. Some banks might put great pressure on a business to liquidate its loans when the firms' outlook becomes clouded, whereas other will stand by the firm and work diligently to help it get back on its feet.

d) Specialization

Banks differ greatly in their degrees of loan specialization. Large banks have separate departments that specialize in different kinds of loans for example, real estate loans, farm loans, and commercial loans. Within these broad categories, there might be a specialization by line of business, such as steel, machinery, cattle, or textiles. The strengths of banks also are likely to reflect the nature of the business and economic environment in which the banks operate. For example, some California banks have become specialists in lending to technology companies, while many Midwestern banks are agricultural specialists. A sound firm can obtain more creative cooperation and more active support by going to a bank that has experience and familiarity with its particular type of business. Therefore, a bank that is excellent for one firm might be unsatisfactory for another.

e) Maximum Loan Size

The size of a bank can be important factor. Because the maximum loan a bank can make to any one customer is limited to certain percent of the banks capital account (capital stock plus retained earnings). It generally is not appropriate for large firms to develop borrowing relationships with small banks.

2.1.12 Default Problems

Non-payment of loans has several undesirable consequences. It gradually destabilizes the credit system. Costs of loan administration of overdue loans are high. And defaults push up lending costs without any corresponding increase in loan turnover. Defaults reduce the resource base for further lending, weaken staff morale, and affect the borrower's confidence.

Sanderatne, (1978), after a comprehensive survey of defaults in Sri Lanka, identified six factors which contributed to defaults:

a) Variability in incomes caused by fortuitous, seasonal, or unforeseen factors;

b) Defects and inadequacies in the organization disbursing credit;

c) Attitudinal conditions not conducive to repayment;

d) Misallocation of borrowed funds;

e) Miscellaneous reasons such as illness, death. Etc.

According to Pandmanabhan (1986: 26-31), causes of delinquencies and defaults are classified as relating to three levels: borrower level, financing institution level, and economy level.

a) Causes at borrower level:

- Borrowers who deliberately divert loans to non-essential consumption find it difficult to meet repayment commitments on time.
- Investments fail to generate sufficient incomes due to improper technical advice; absence of supporting services, inadequate marketing, etc. investments also fail

due to unforeseen causes like floods, drought, etc. in both cases repayment would be affected.

- When borrowers have liabilities towards informal lenders, they get precedence over institutional lenders.
- Contingencies at borrower household like death, sickness, etc, affect repayment performance. Formal institutions which do not extend consumption and emergency loans are liable to have higher default rates.

b) Causes at financing institution level:

- Defective procedures for loan appraisal in the financing institutions could lead to the financing of bad projects and consequent defaults.
- Quality of loan officers, their ability and knowledge in the field, and their capacity to judge borrowers as also the incentive packages available to them affect repayment performance.
- Fixing of inappropriate repayment schedules and lack of flexibility often result in defaults. Similarly, when the procedure for repayment is cumbersome borrowers tend to delay repayments.
- Defaults have a ‘spread effect’ particularly in the marginal cases. When lenders show reluctance to enforce sanctions against conspicuous defaulters, defaults tend to increase through a process of imitation.

c) Causes at economy level:

- When overall government policies, particularly those relating to pricing of inputs and outputs, marketing, etc., discriminate against the specific sector.
- Faulty monetary and fiscal policies of governments could result in high inflationary conditions. Borrowers tend to delay repayments in such a situation to take advantage of the fall in value of currency.

- Interest rate policies of government have a vital role in the promotion of repayments. When the real rate is excessively low, borrowing and consumption will be much more profitable than saving and repayment.
- Excessive government intervention in the day-to-day administration of financial institutions could result in bad loans.
- Calamities like droughts, floods, market glut, etc could result non performing loans.

2.1.13 Principles Formulated By the Basel Committee

As a direction for the achievement of the required level of loan status and healthy financial institutions the Basel Committee on Banking Supervision in September 2000 also formulated the following Principles

a) Establishing an appropriate credit risk environment

Principle 1: The board of directors should have responsibility for approving and periodically (at least annually) reviewing the credit risk strategy and significant credit risk policies of the bank. The strategy should reflect the bank's tolerance for risk and the level of profitability the bank expects to achieve for incurring various credit risks.

Principle 2: Senior management should have responsibility for implementing the credit risk strategy approved by the board of directors and for developing policies and procedures for identifying, measuring, monitoring and controlling credit risk. Such policies and procedures should address credit risk in all of the bank's activities and at both the individual credit and portfolio levels.

Principle 3: Banks should identify and manage credit risk inherent in all products and activities. Banks should ensure that the risks of products and activities new to them are subject to adequate risk management procedures and controls before being introduced or undertaken, and approved in advance by the board of directors or its appropriate committee.

b) Operating under a sound credit granting process

Principle 4: Banks must operate within sound, well-defined credit-granting criteria. These criteria should include a clear indication of the bank's target market and a thorough understanding of the borrower or counterparty, as well as the purpose and structure of the credit, and its source of repayment.

Principle 5: Banks should establish overall credit limits at the level of individual borrowers and counterparties, and groups of connected counterparties that aggregate in comparable and meaningful manner different types of exposures, both in the banking and trading book and on and off the balance sheet.

Principle 6: Banks should have a clearly-established process in place for approving new credits as well as the amendment, renewal and re-financing of existing credits.

Principle 7: All extensions of credit must be made on an arm's-length basis. In

Particular, credits to related companies and individuals must be authorized on an exception basis, monitored with particular care and other appropriate steps taken to control or mitigate the risks of non-arm's length lending.

c) Maintaining an appropriate credit administration, measurement and monitoring process

Principle 8: Banks should have in place a system for the ongoing administration of their various credit risk-bearing portfolios.

Principle 9: Banks must have in place a system for monitoring the condition of individual credits, including determining the adequacy of provisions and reserves.

Principle 10: Banks are encouraged to develop and utilize an internal risk rating system in managing credit risk. The rating system should be consistent with the nature, size and complexity of a bank's activities.

Principle 11: Banks must have information systems and analytical techniques that enable management to measure the credit risk inherent in all on- and off-balance sheet activities. The management information system should provide adequate information on the composition of the credit portfolio, including identification of any concentrations of risk.

Principle 12: Banks must have in place a system for monitoring the overall composition and quality of the credit portfolio.

Principle 13: Banks should take into consideration potential future changes in economic conditions when assessing individual credits and their credit portfolios, and should assess their credit risk exposures under stressful conditions.

d) Ensuring adequate controls over credit risk

Principle 14: Banks must establish a system of independent, ongoing assessment of the bank's credit risk management processes and the results of such reviews should be communicated directly to the board of directors and senior management.

Principle 15: Banks must ensure that the credit-granting function is being properly managed and that credit exposures are within levels consistent with prudential standards and internal limits. Banks should establish and enforce internal controls and other practices to ensure that exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.

Principle 16: Banks must have a system in place for early remedial action on deteriorating credits, managing problem credits and similar workout situations.

2.1.14. Common Sources of Major Credit Problems

1. Most major banking problems have been either explicitly or indirectly caused by weaknesses in credit management. In supervisors' experience, certain key problems tend to persist. Severe credit losses in a banking system usually reflect simultaneous

problems in several areas, such as concentrations, failures of due diligence and inadequate monitoring.

2. Concentrations are probably the single most important cause of major credit problems. Credit concentrations are viewed as any exposure where the potential losses are large relative to the bank's capital, its total assets or, where adequate measures exist, the bank's overall risk level.

3. Banking supervisors should have specific regulations limiting concentrations to one borrower or set of related borrowers, and, in fact, should also expect banks to set much lower limits on single-obligor exposure. Most credit managers in banks also monitor industry concentrations. Many banks are exploring techniques to identify concentrations based on common risk factors or correlations among factors. While small banks may find it difficult not to be at or near limits on concentrations, very large banking organizations must recognize that, because of their large capital base, their exposures to single obligors can reach imprudent levels while remaining within regulatory limits.

4. Many credit problems reveal basic weaknesses in the credit granting and monitoring processes. While shortcomings in underwriting and management of market-related credit exposures represent important sources of losses at banks, many credit problems would have been avoided or mitigated by a strong internal credit process.

5. Many banks find carrying out a thorough credit assessment (or basic due diligence) a substantial challenge. For traditional bank lending, competitive pressures and the growth of loan syndication techniques create time constraints that interfere with basic due diligence.

6. Some credit problems arise from subjective decision-making by senior management of the bank. This includes extending credits to companies they own or with which they are affiliated, to personal friends, to persons with a reputation for financial

acumen or to meet a personal agenda, such as cultivating special relationships with celebrity.

7. Many banks that experienced asset quality problems in the 1990s lacked an effective credit review process (and indeed, many banks had no credit review function). Credit review at larger banks usually is a department made up of analysts, independent of the lending officers, who make an independent assessment of the quality of a credit or a credit relationship based on documentation such as financial statements, credit analysis provided by the account officer and collateral appraisals. At smaller banks, this function may be more limited and performed by internal or external auditors. The purpose of credit review is to provide appropriate checks and balances to ensure that credits are made in accordance with bank policy and to provide an independent judgment of asset quality, uninfluenced by relationships with the borrower. Effective credit review not only helps to detect poorly underwritten credits, it also helps prevent weak credits from being granted, since credit officers are likely to be more diligent if they know their work will be subject to review.

8. A common and very important problem among troubled banks in the early 1990s was their failure to monitor borrowers or collateral values. Many banks neglected to obtain periodic financial information from borrowers or real estate appraisals in order to evaluate the quality of loans on their books and the adequacy of collateral. As a result, many banks failed to recognize early signs that asset quality was deteriorating and missed opportunities to work with borrowers to stem their financial deterioration and to protect the bank’s position. This lack of monitoring led to a costly process by senior management to determine the dimension and severity of the problem loans and resulted in large losses.

9. In some cases, the failure to perform adequate due diligence and financial analysis and to monitor the borrower can result in a breakdown of controls to detect credit-related fraud. For example, banks experiencing fraud-related losses have neglected

to inspect collateral, such as goods in a warehouse or on a showroom floor, have not authenticated or valued financial assets presented as collateral, or have not required audited financial statements and carefully analyzed them. An effective credit review department and independent collateral appraisals are important protective measures, especially to ensure that credit officers and other insiders are not colluding with borrowers.

10. In addition to shortcomings in due diligence and credit analysis, bank credit problems reflect other recurring problems in credit-granting decisions. Some banks analyze credits and decide on appropriate non-price credit terms, but do not use risk-sensitive pricing. Banks that lack a sound pricing methodology and the discipline to follow consistently such a methodology will tend to attract a disproportionate share of under-priced risks. These banks will be increasingly disadvantaged relative to banks that have superior pricing skills.

11. Many banks have experienced credit losses because of the failure to use sufficient caution with certain leveraged credit arrangements. As noted above, credit extended to highly leveraged borrowers is likely to have large losses in default. Similarly, leveraged structures such as some buyout or debt restructuring strategies, or structures involving Customer-written options generally introduce concentrated credit risks into the bank's credit portfolio and should only be used with financially strong customers. Often, however, such structures are most appealing to weaker borrowers because the financing enables a substantial upside gain if all goes well, while the borrower's losses are limited to its net worth.

12. Many banks' credit activities involve lending against non-financial assets. In such lending, many banks have failed to make an adequate assessment of the correlation between the financial condition of the borrower and the price changes and liquidity of the market for the collateral assets. Much asset-based business lending (i.e. commercial finance, equipment leasing, and factoring) and commercial real estate lending appear to involve a relatively high correlation between borrower

creditworthiness and asset values. Since the borrower's income, the principal source of repayment is generally tied to the assets in question, deterioration in the borrower's income stream, if due to industry or regional economic problems may be accompanied by declines in asset values for the collateral. Some asset based consumer lending (i.e. home equity loans, auto financing) exhibits a similar, if weaker, relationship between the financial health of consumers and the markets for consumer assets.

13. A related problem is that many banks do not take sufficient account of business cycle effects in lending. As income prospects and asset values rise in the ascending portion of the business cycle, credit analysis may incorporate overly optimistic assumptions. Effective stress testing which takes account of business or product cycle effects is one approach to incorporating into credit decisions a fuller understanding of a borrower's credit risk.

14. More generally, many underwriting problems reflect the absence of a thoughtful consideration of downside scenarios. In addition to the business cycle, borrowers may be vulnerable to changes in risk factors such as specific commodity prices, shifts in the competitive landscape and the uncertainty of success in business strategy or management direction. Many lenders fail to "stress test" or analyze the credit using sufficiently adverse assumptions and thus fail to detect vulnerabilities.

2. 2 Empirical Studies

Hong and Sung (1995) have tried to analyze Korean banks' performance which was reflected on their financial statements and to provide some comments to improve their banking business. The study was carried out by comparing the eight Korean banks' past five years performance results with other banks in the State of California, other banks include Asian banks other than Korean banks owned by such Asians (e.g., Chinese and Japanese) and American banks owned by other ethnic groups of Americans (e.g., "white" American). The comparative financial analysis indicated that Korean banks were relatively conservative in managing operations and lending and were more actively involved in their services for international business and sales activities. The analyses also indicated that the Korean banks' loan quality was relatively low and their loan market appears to have been saturated.

They recommend on the basis of the analysis that the Korean banks should adopt a more active marketing strategy to expand and create their own market, consider tighter control for their operations with understanding banking regulations (e.g., Financial Institutions Reform, Recovery, and Enforcement Act) and adopt the loan policy in a way that they can make a loan decision with more reliable cash flow analysis.

Abdus (2004) has examined empirically the performance of Bahrain's commercial banks with respect to credit (loan), liquidity and profitability during the period 1994-2001. Nine financial ratios (Return on Asset, Return on Equity, Cost to Revenue, Net Loans to Total Asset, Net Loans to Deposit, Liquid Asset to Deposit, Equity to Asset, Equity to Loan and Non-performing loans to Gross Loan) were selected for measuring credit, liquidity and profitability performances. By applying these financial measures, this paper found that commercial banks' liquidity performance was not at par with the Bahrain banking industry. Commercial banks are relatively less profitable and less liquid and, are exposed to risk as compared to banking industry. With regard to asset quality or credit performance, this paper found no conclusive result.

Non_ performing loans to gross loans (NPLGL) indicates that there was no difference in performance between the commercial banks and the banking industry in Bahrain.

Chowdhury and Ahmed (2007) have tried to analyze the development and growth of selected private Commercial Banks of Bangladesh. It was observed that all the selected private commercial banks were able to achieve a stable growth of branches, employees, deposits, loans and advances, net income and earnings per share during the period of 2002-2006. Seven trend equations have been tested for different activities (growth in branch, employees, deposits, loans and advances, net income and earning per share) of the private commercial banks. Among them the trend value of branches, employees, deposits and net income were positive incase of all the selected banks.

The above empirical review of literature emphasizes that all the studies so far conducted are mainly discussing the loan recovery problems, determinant factors for default of borrowers in financial institutions in general at Macro-level. The researcher also observed in the review of literature that there are no studies conducted mainly to identify the problems related to lack of effective credit management with reference to Wegagen Bank Share Company, Tigray region. Thus , the researcher felt it appropriate to take up the present study entitled "CREDIT MANAGEMENT- A CASE STUDY OF WEGAGEN BANK SHARE COMPANY IN TIGRAY REGION" to assess the credit management problems and thereby to recommend courses of action that are assumed to promote quality loan growth and curtail non-performing.

CHAPTER III

METHODOLOGY OF THE STUDY

3.1 Research Design

This is historical and analytical research based on a case study approach.

3.1.1 Target Group

The target group of this study are the loan clients of the bank and the employees who are directly involved in credit processing and administering. This means, senior bank professionals, Department heads, Branch managers, Assistant branch managers, Loan section heads, Loan officers, Loan clerk, and Loan Committee members of all branches are included in the target group.

3.1.2 Sampling Technique

The sampling technique used for the purpose of this study is stratified random sampling as it is assumed to provide more efficient sample considering the sort of loan clients and staff of the bank. Moreover, the sample is assumed to reflect accurately the population on the basis of the criterion used for stratification.

As the bank classifies its clients as performing and non-performing clients based on their repayment status as per their repayment agreement and the regulatory body, National Bank of Ethiopia, (NBE) two stage sampling procedure is employed to select the clients for the study.

Considering the objectives of the study, Proportionate Stratified Sampling (PSS) approach is followed to select the number of respondents. Using stratified random sampling, about 120 loan clients out of whom 90 Performing loan clients and 30 non-performing loan clients is selected out of the 565 performing and 60 non-performing loan clients.

All employees who are involved in credit processing and administrating are considered as other additional target group of the study. They were 20 in number and all are considered in the sample.

3.1.3 Data Collection Procedures

For the purpose of this study, both primary and secondary data are used. Interviews and questionnaires are used to collect primary data. Unstructured interview is prepared and administered to the staff working in the loan area and branch managers and assistant branch managers of the Bank. This helped to address the research questions more specifically or to concentrate more on the topic itself.

Interview is undertaken by the researcher himself in order to effectively gather pertinent information to the study. Secondary data is collected from clients' files, reports, directives, manuals and bulletins of the bank by the researcher.

3.1.4 Data Analysis Method

In order to evaluate the performance of credit management problems of Wegagen Bank, in Tigray Region, more of qualitative method of analysis is employed in addition to quantitative method so as to address the aforementioned problems of the Bank. Both methods of analysis used the data collected through the semi-structured questionnaires, interviews and secondary sources

Findings, which reflect a high magnitude of problems, were selected from interview and questionnaires, the raw data were analyzed, presented, and interpreted to give solutions for the research problem. Moreover, most of the data were summarized and presented in tables and Figures, by the help of the Statistical Program for Social Sciences, version 16.0, (SPSS, 2005). Percentages for these data were calculated in order to facilitate the analysis and to make it presentable for the readers. The data collected were more of qualitative in nature; thus, they were presented by using descriptive analysis. Hence, the nature of the study is descriptive.

CHAPTER IV

PROFILE OF THE ORGANIZATION

4.1 Establishment of Wegagen Bank S. C

Wegagen Bank, S. C. was established in Ethiopia on April 30, 1997 G.C and is registered as a private share company in accordance with the provision of the licensing and supervision of Banking Business Proclamation No.84/94 and the commercial code of Ethiopia 1960 with a subscribed capital of Birr 60 million and a paid up capital of Birr 30 million by 16 major share holders. It is a privately owned share company which started operation in June 1997.

Currently the bank has raised its paid up capital to birr 518 million which is known to be one of its main achievement to improve its capital base and lending limit as indicted in its annual report of 2008|09. Moreover, the number of share holders reached 1,222 in the same fiscal year. The bank had a net work of 48 branches through out the country, out of which 23 branches are in Addis Ababa and the remaining 25 branches spread across the major regional towns of the country. It had an office for international money transfer companies operating under the Bank's agency in Ethiopia and a forex bureau at Bole International Airport.

With regard to the international financial intermediaries' net work the bank had partnership with a large number of correspondent banks and also with international money transfer partners. Out of the 48 branches seven branches are found in northern Ethiopia, in Tgiray region in which the study will be done.

4.1.1 Vision

In order to achieve service excellence and become the preferred destination of customers and other stakeholders and thereafter realize the intent of the founders, Wegagen Bank has coined a vision in the decade under review as: **"Becoming the most preferred Bank in Ethiopia"**

4.1.2 Mission Statement

The bank's mission is "To provide a wide range of quality banking services through a dynamic work force and up to date IT solutions to satisfy the desires of all stake holders"

4.1.3 Principles and Values

Wegagen Bank share company is committed to main business principles such as outstanding customer service; business integrity, Honesty, and loyalty; effective, efficient, and expanding operations; strong capital and liquidity position; prudent lending; reasonable cost control discipline; Fair and objective employment practices; Commitment to comply with the spirit and letter of law; Playing a responsible role in aligning objectives with those of the local communities.

4.1.4 Objectives of the Bank

The Bank has mainly the following objectives

a) To increase the level of capital in order to rise the lending limit of the Bank and obtain a high share
b) To increase market share
c) To maximize profitability and increase efficiency
d) To contribute to the general economic development efforts of the nation.

4.1.5 Major Services of the Bank

Major services of the Bank include

- Accepting different types of deposits,
- Granting variety of loans,
- Offering full-fledged international Banking services, and
- Render local and international money transfer services.

4.1.6 Branch Network

Wegagen Bank has a network of 48 branches of which 23 are located in Addis Ababa which is the main business center of the country and the remaining 25 branches are located in the main regional cities and towns of the country. There is also a coordination office for international money transfer partners that are operating under the bank's agency in Ethiopia, under a forex bureau at Bole international Airport. One of the strategies adopted by the bank is expansion of a network of branches in the capital and outside in all over the regions.

4.1.7 Computerization

Wegagen Bank Share Company has already introduced the first of its kind integrated computer wide area network since July 2000 G.C that had networked its head office and all branches in Addis Ababa and some of the branches in different regions. Its overall goal is to network all its branches phase by phase.

4.1.8 Management and Human Resource

Wegagen Bank is governed by the board of Directors consisting of a chairman, a vice chairman and seven members.

The president/Chief executive office(CEO) who is appointed by the board of directors and is assisted by two Vice Presidents (VP), Eight Department Managers under the two Vice Presidents, and Controller, legal service heads being directly responsible to him/her.

As of June 30, 2009 the number of permanent employee of the bank stood at 1,727 showing the bank's continued efforts to create significant level of employment opportunities for a number of qualified people during the preceding couple of years.

Out of the total number of employees, 923 (53.4%) were semi professionals and professionals with compatible educational background such as University degree or college diploma, while the number of support staff was 804(46.6%) with different levels of educational background.

4.1.9 Product and Services

Wegagen Bank offers banking services and products which includes the following.

4.1.9.1 Deposits

Wegagen bank receives various common and special types of deposits

- Savings Deposits,
- Time Deposits, and
- Demand Deposits such as Checking Accounts, Zero balance Account (ZBA), Negotiable Order of Withdrawal Account (NOW), and Children’s Trust Account.

4.1.9.2 Loan Services

Wegagen Bank offers loans for diverse credit needs bringing flexible borrowing options. The types of loans provided by the bank are Term Loans, Overdraft Facilities, and Domestic Trade and service Loans, Foreign Trade Loans, Agricultural Production Loans, Manufacturing Loans, Building Construction Loan, Bridge Loans, Consumer

Loans, Automobile Loans, Advance Against Export Bills, Letter of Credit Facilities, Pre-shipment Export credit, Revolving Export Credit, Letter of guarantee.

4.1.9.3 Local Money Transfer

The bank provides fast and reliable local money transfer services.

4.1.9.4 International Banking Services

Wegagen Bank provides comprehensive international banking services at the Head office, and through its branches. Among the services provided issuing letters of credit (L/C) for importing and exporting goods and services, ash Against Document (CAD), outward Bills Purchased (OPD), Outward Bills for Collection (OBC), Outward Documentary Bills Purchased (ODBP), and Outward Documentary Bills sent for Collection (ODBC), internationally Money Transfer, and Issuance of Foreign Currency.

4.1.9.5 Term Loan Financing Policy

a. Short-term Loan

The purpose of the short term loans are availed to assist working capital requirements and/or to meet short term financial constraints directly related to the applicants business. This type of loans can be extended up to a maximum period of one year beginning the date the loan contract is signed. The mode of repayment is essentially made by equal monthly, bimonthly, quarterly, half yearly or at maturity depending on the contractual agreement signed.

b. Medium-term Loan

Medium term loans are credit facilities which have duration of over one year but exceeding a period of five year or 60 months with periodic installments.

The purpose of these types of loans are availed for financing projects, purchase of capital goods, light vehicles, Trucks, public transport vehicles, completion of buildings under construction, purchase of residential buildings, and others whose nature justifies or requires such a period of time for effective deployment and repayment of loans.

c. **Long-term Loan**

Long term loans are those loans which have a duration exceeding five years. These types of loans are extended for new investments that involve huge outlay of cash or expansion programs for existing business / projects such as agriculture, industry, mining, building, and construction sectors.

4.1.9.6 Overdraft Financing Policy

Overdraft is a credit facility by which customers may be allowed to draw beyond their deposit balances maintained in their current accounts. It is a bridging finance availed for limited durations normally from six months and in exceptional case for one year to customers who are well known for their best integrity and credit worthiness. It is availed to individuals / business organization whose financial position is strong with voluminous business transactions. Applicants for such facilities have to be customers of the bank with good operation of their current overdraft accounts. It is renewable and subject to improvement if the swimming is as required otherwise can be converted to term loan if the business is stagnated due to unfavorable business situations. Moreover it can be cancelled or revoked at any time when situations demand

4.1.9.7 Merchandise Loan Financing Policy

Merchandise loan is a credit facility which is availed at a certain percentage portion of the value of the merchandise to be pledged as security. The purpose of the facility is to assist customers during tight money situation, when purchases, transport and supply of commodities may take extended time demanding working fund to meet commitments or to smoothly operate the business.

4.1.9.8 Letter of Credit (L/C)

Letter of credit is a payment undertaking given by the issuing bank on behalf of a buyer (importer) to pay a seller (exporter) a given amount of money against delivery of shipping documents within a given time limit and believing that these documents are consistent with the terms and conditions agreed between the buyer and supplier in the letter of credit.

4.1.9.9 Pre-shipment Export Credit

The Bank extends pre-shipment export credit facility in accordance with the National Bank of Ethiopia's Directives of Export credit Guarantee scheme.

4.1.9.10 Advance against Export Bills

Advance on Export Bills is a type of post shipment export credit provided to exporters upon presentation of export documents properly endorsed to Wegagen Bank to bridge the gap between the shipment of the goods and the realization of proceeds.

4.1.9.11 Letter of Guarantee

A letter of guarantee is a written under taking issued by a bank in favor of a customer to compensate for loses in the event of non-completion of the terms and conditions stipulated in the contract concluded with a third party.

4.1.10 Management of Non-performing Loans (NPLS)

The bank has a system to review the loan approval form (LAF) as a first step in post disbursement of credit monitoring. The purpose of the review is to ensure appropriate loan documentation and to gather sufficient information to serve as a reliable basis for monitoring.

The bank has three forms of credit monitoring such as

a) Case-by- Case review

It is exercised to insure that the repayment of the loan is according to the approved repayment schedule.

b) Portfolio Review

It refers to the status of credit portfolio in aggregate exposure analysis with respect to economic sector, customer, product, location, etc.

c)

4.1.11 Basic Requirements for Credit Decisions

Wegagen Bank has uniform basic requirements which applicants are expected to present and become eligible for loan. Thus, credit decisions of the Bank are based on the fulfillment of these requirements as mentioned below.

- ✓ Renewed Trade license existed for one year
- ✓ Marriage certificate for mortgagors or Confirmation letter from authorized office
- ✓ Proof of Tax payer Certificate
- ✓ Loan application letter stating type, amount, purpose and term of repayment of loan requested and type of proposed collateral.
- ✓ And others (*Please refer Appendix-F)*

So as to qualify for credit, every applicant should fulfill the aforesaid requirements. If there is match between the documents provided by the client with that of the requirements set by the bank on the check list, the client will be eligible for the loan.

In the lending process, as per the interview conducted with the branch manager, and loan officers the Bank prefers the business type and applicant creditworthiness as first way out and collateral is the second way out as basis for lending.

In principle, loan can be provided both on clean base and on collateral base. However, the Bank prefers collateral based lending because of the following main reasons:

- The economic level of the country: the living standard of the society, poverty, etc;
- The culture of the society in lending is at its infant stage
- The educational level of the society
- Limited resources of the bank this is to minimize the shortage of finance
- It is believed to be the safest way of lending in minimizing credit risk; and
- Others.

4.1.12 Assessment of Applicants Creditworthiness

Once a customer requests a loan, bank officers analyze all available information to determine whether the loan meets the bank's risk-return objectives. Credit analysis is essentially default risk analysis, in which a loan officer attempts to evaluate a borrower's ability and willingness to repay.

The Bank assesses the creditworthiness of a loan applicant mostly by gathering detail information with regard to:

a. The applicant

- Whether the applicant is customer of any other bank. This is done to check whether the applicant has any loan arrear with other banks. This will be checked by the help of NBE Central Database of the credit information center.
- The exposure of the applicant to credit and his track record in meeting his obligation.
- The educational level and experience of the applicant.
- The character, capacity of the applicant and his social acceptance in trustworthiness.

b. Collateral

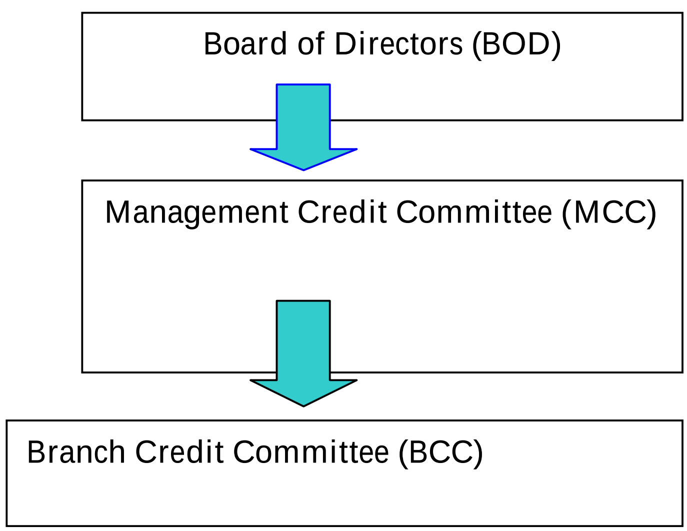
- Credit policy of the Bank, for building collateral (85%), For Vehicles and Machinery (70%), for cash (100%), Merchandise (70%), Leased land (30% less lease amount if construction not started), Treasury bills and Government bonds,(100%), etc.
- Marketability and habitability
- Easily transferability

c. Business viability

Based on the basic financial measurements used to certify the credit worthiness of the business the Bank depends on liquidity rate, solvency, efficiency ratio, sales turnover and profit margin of the business.

Once the Bank assessed the creditworthiness of the applicant, the credit decision flow is as depicted below.

d) Credit Decision Followed by the Bank



Source: Credit policy and procedure of the bank

4.1.13 Discretional Lending Limits (D.L.L)

The Bank follows lending discretion limit starting from the branch tier level up to the supreme decision making committee as indicated below.

Decision Level	D.L.L in Birr	Overriding
1) Board Of Directors(BOD)	Over Birr 7.5 million	----
2) Management Credit Committee(MCC)	BCC up to7.5 million	---
3) Tier One Branch (BCC)	200,000.00	2,000,000.00
4) Tier Two Branch (BCC)	150,000.00	1,500,000.00
5) Tier Three Branch (BCC)	100,000.00	1,000,000.00

The Board of Directors and the executive management committee considers the following points in determining the discretionary limit

- Feedback on the quality of loans (NPLS recovery rate, etc)
- Strength and competence of the members of the credit committees
- Complexity and volume of credit cases handled by the various credit committee
- Change in demand for loan requests due to variations in the economic situations or localities.

The overall discretionary limit of the Bank is used to be revised periodically by the core Management or the Board of Directors under the following conditions

I. Change in the macro economic and marketing environment in certain; geographic areas
II. Competence of the credit committee
III. Change in the rate of recovery of loans
IV. Due to unchecked growth in Non-performing loans.

4.1.14 Provisions

Loans and advances are financial instruments originated by the bank by providing money to the debtors. It is stated at costless impairment losses. Impairment losses comprise specific provisions against debts identified as bad and doubtful and general provisions against losses which are likely to be present in any loans and advances portfolio. The Bank follows the National Bank of Ethiopia Supervision of Banking Business Directives SBB/43/2008 in determining the extent of provisions for impairment losses. The Directive classifies loans and advances into the following.

a) Pass Loans

Loans and advances in this category are fully protected by the current financial and paying capacity of the borrower and are not subject to criticism. It is fully secured, both as to principal or interest payments, by cash or cash substitutes are classified under this category regardless of past due or other adverse credit factors.

b) Special Mention

Any loan or advance past due 30 days or more, but less than 90 days.

c) Substandard

Non- performing loans or advances past due 90 days or more but less than 180 days.

d) Doubtful

Non- performing loans past due 180 days or more but less than 360 days.

e) Loss

Non-performing loans or advances past due 360 days is classified as loss.

4.1.15 Extent of Provision Required

As per the directive of the national Bank of Ethiopia the extent of provision required for impairment of losses is determined as follows.

I. Pass loans — 1 percent of outstanding loan balances

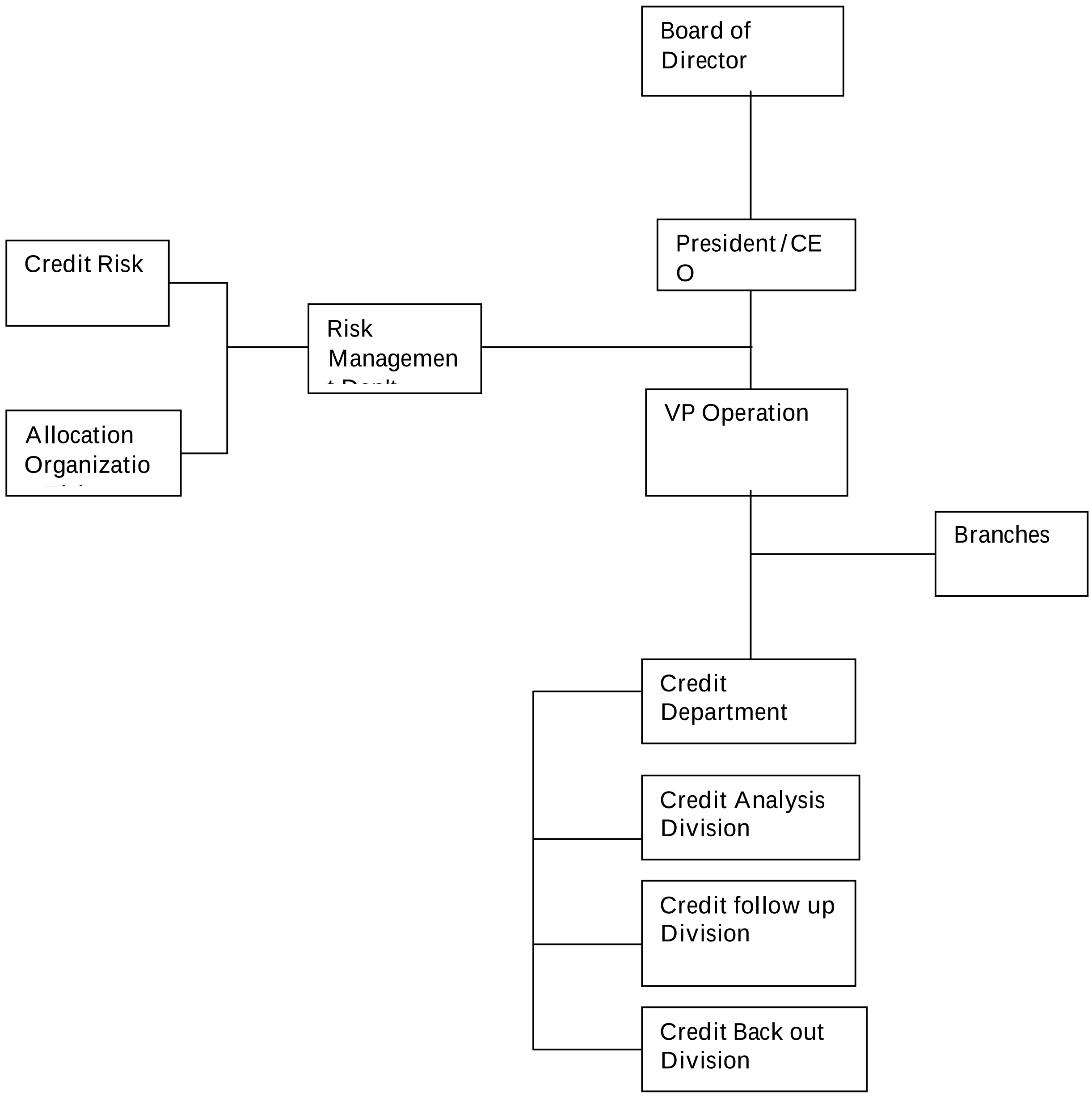
II. Special mention loans — 3 percent of outstanding balance

III. Substandard loans 20 percent of the net loan balance

IV. Doubtful loans 50 percent of the net loan balance

V. Loss 100 percent of the net loan balance

4.1.16 Credit Processing Line Followed By the Bank



Source: From the documents of the Bank

CHAPTER V
ANALYSIS, RESULTS, AND DISCUSSIONS

This chapter is concerned with the presentation, analysis, and interpretation of the data gathered via primary sources both questionnaires and interviews and secondary sources collected from the bank's annual reports, manuals and data bases.

Questionnaires Distributed and Collected

Table 5.1: Performance of Questionnaires Administered

Questionnaires	Respondents							
	Laon clients						Employees	
	Performing		Non-performing		Total			
	N0.	%	N0.	%	N0.	Total	N0.	%
Distributed	90	100	30	100	120	100	20	**100**
Collected	**90**	**100**	**30**	**100**	**120**	**100**	**20**	**100**

Source: Researcher's Survey Result from Primary Data Sources

As it can be seen from Table 5.1, 140 questionnaires were distributed to both loan clients which are 90 to performing loan clients and 30 to non performing loan clients in the target branches and in the same manner 20 questionnaires were distributed to employees of the Bank who are working and experienced in the loan area. In all cases 100.0 percent of the distributed questionnaires were collected.

As the distribution and collection of questionnaires is managed by experts in the area together with high cooperation rendered from the employee and clients the achievement was to the required level and this has enabled to extract sufficient and relevant information to the objective of the research.

5.1 Responses from Loan Clients (Performing and Non-performing)

5.1.1 Demographic Characteristics of Respondents

Demographic factors are assumed the most indicators of performance in the financial sector. Thus, in this research process the demographic characteristics of respondents like gender, age, marital status and educational level are assessed.

Table 5.2: Gender of loan clients

	Performance		Non performance		Total	
Gender	Freq.	%	Freq.	%	Freq.	%
Female	16	13.33	6	5	22	18,33
Male	74	61.67	24	20	94	81.67
Total	90	75.00	30	25	120	100

Source: Researcher's Survey result from Primary Data Sources

As it can be clearly seen from table 5.2, majority of the respondents that is 81.67 percent are male while 18.33 percent are female. From both performing and none performing loan clients, 61.67 percent and 20 percent are male respectively. While about 13.30 percent from performing and 5 percent from non-performing loan clients are female. Generally this reveals that the majority of loan clients of the bank are male parts. From this it seems that the participation of females is low in borrowing from the Bank as compared to males which further indicates their insignificant business participation in the region which might be the character of most developing nations including Ethiopia. It also indicates relative to male parts few number of female loan clients had failed to be in the non performing category. Females are known for their regular repayment of loans certifying their credit worthiness. This is certified in most researches made in the financial sector both in banks and micro financial institutions.

Table 5.3: Age of loan clients

Age group	Performing		Non-Performing		Total	
	Freq.	%	Freq.	%	Freq.	%
18 – 25	**3**	**2.50**	**0**	**0**	**3**	**2.50**
26 – 35	**25**	**20.83**	**6**	**5.00**	**31**	**25.83**
36 – 45	**42**	**35.00**	**16**	**13.33**	**58**	**48.33**
Above 45	**20**	**16.67**	**8**	**6.67**	**28**	**23.34**
Total	**90**	**75.00**	**30**	**25.00**	**120**	**100**

Source: Researcher's Survey result from Primary Data sources

Age is one of the socio economic variables that determine performance. As table 5.3 visibly shows, out of the total respondents 48.33 percent are in the age interval from 36-45 while 25.83 percent and 23.34 percent are in the interval 26-35 and above 45 years respectively. Moreover, 35 percent and 13.33 percent of the respondents' age lay within the interval age of 36-45 for performing and non-performing loan clients respectively. This indicates the interval where most of the business people lay. 16.67 percent and 6.67 percent of the respondents from performing and non-performing loan clients are above 45 years old. While, 25 percent and 20 percent of the respondents from performing and non-performing loan clients are in the interval of 26-35 respectively. As the request for bank loan is high in the age interval of 36-45 the failing to non-performing status is also high (13.3%) in the same interval similarly.

Table 5.4: Educational status of loan clients

Educational status	Performing		Non performing		Total	
	Freq.	%	Freq.	%		
Illiterate	5	4.17	3	2.50	8	6.67
Primary education	27	22.50	16	13.33	43	35.83
Secondary education	37	30.83	10	8.33	47	39.16
Above Grade 12t	21	17.50	1	0.84	22	18.34
Total	90	75	30	25	120	100

Source: Researcher's Survey result from Primary Data sources

With reference to table 5.4, 39.16 percent completed secondary, 35.83 percent completed primary, and 18.34 percent are above grade twelve. While 6.67 percent are illiterate. Of which, 30.83 percent of performing and 8.33 percent of non-performing loan clients completed secondary education. While 22.50 percent of performing and 35.83 percent of non-performing loan clients completed primary education. This clearly depicts that most of the loan clients of the Bank's educational level was secondary education. As educational level increases the skill to manage and understand the business also increases accelerating productivity and this protects loan clients from financial distress. This is clearly denoted in table 5.4, the number of non-performing loan clients, 13.30 percent is completed primary education while 8.33 percent completed secondary and 0.84 percent are above grade twelve. That is, as level of education increases performance also increases contributing to the required level of bank-client relationship and business reputation.

Table 5.5: Marital Status of loan clients

Marital status	Performing Freq.	Performing %	Non performing Freq.	Non performing %	Total Freq.	Total %
Married	75	62.50	6	5.0	81	67.50
Single	15	12.50	24	20.0	39	32.50
Total	90	75.00	30	25.0	12o	100

Source: Researcher's Survey result from Primary Data Sources

The importance of knowing the marital status of clients for the Bank helps to protect itself from lawsuit by other spouse on common property, to avoid seizer of the project due to dispute of the couples, and to attract the family's attention to business success or to create responsibility, accountability, and belongingness among the family members to their business.

With regard to the marital status of respondents, referring to table 5.5, out of the total respondents 67.50 percent are married and 32.50 percent are single. From performing loan clients 62.5 percent are married while 12.50 percent are single. From the non-performing clients 6 percent are married while 24 percent are single. Thus, it can be said that most of the Bank's clients are married.

This clearly indicates how marital status contributes to responsibility and accountability in business risk management.

5.1.2 Loan Application and Processing

Loan processing starts from loan application and gathering information from various sources confidentially and interviewing the applicants in order to screen thier eligibility. This enables to mitigate risks that can face after the loan is granted. Nevertheless the manner of application denotes the integration of the bank to wards potential loan applicants and the effort of the employee in mobilizing and treating loan applicants as loan is the main source of income to banks

Table 5.6: Manner of application of clients

	Performing		Non performing		Total	
First application	Freq.	%	Freq.	%	Freq.	%
By self initiation	64	53.33	18	15.00	82	68.33
By effort of former client of the bank	15	12.50	7	5.83	22	18.33
By Staff effort of the bank	11	9.17	5	4.17	16	13.34
Total	90	75.00	30	25.00	120	100.00

Source: Researcher's Survey Result from Primary Data Sources

As it is denoted in table 5.6, 68.33 percent of the applicants approached the bank by own initiation and 18.33 percent of the new applicants were approached to the bank by former loan clients of the bank. In addition 13.34 percent of the new applicants approached the bank through the efforts of the employee. The survey result also indicates out of the respondents, 53.33 percent who approached the bank by their own initiation are performing while 15 percent are non-performing clients. Similarly 12.5 percent and 9.17 percent of the performing loan clients are approached to the bank by former loan clients and the employee respectively. Out of the respondents who are non-performing clients, 5.83 percent and 4.17 percent were approached to the bank by former clients and the employee respectively. From these it can be concluded that the bank has already created dependable awareness among the potential applicants and well integrated with in the business community. It also shows when the former loan clients and employees participate in the effort of mobilizing and screening new clients the number of non-performing decreases.

Loan processing is one of the measurements of credit management in banks and other financial sectors such as micro finances. Hence, the processing procedure, transparency, and length of time are some of the factors determining the convenience of lending facilities which contributes to loan growth and lasting client - bank relationship.

From the table 5.7 bellow, 88.90 percent of the respondents disclosed the convenience and simplicity of the application requirement while 11.10 percent of them commented to further simplify it by excluding the criteria of marital status while legally the trade license is substituting it for personally owned businesses. However, for mortgagors the criteria regarding marital status is recognized as mandatory.

Table 5.7: Loan processing and client relation

Loan client relation	Yes		No	
	Freq	%	Freq	%
Have you met the bank service as expected	**44**	**48.90**	**46**	**51.10**
Employees visit during loan request	**90**	**100.00**	**0**	**0.0**
Simplicity of application requirement	**80**	**88.90**	**10**	**11.10**
loan processing time convenience	**30**	**33.30**	**60**	**66.70**
Access to relevant information	**83**	**92.22**	**7**	**7.78**
Extension of relation with the bank	**59**	**65.56**	**31**	**34.44**

Source: Researcher's Survey Result from Primary Data Sources

As business visiting and assessment is part of the viability assessment for loan processing, 100 percent of the respondents replied positively regarding the importance of visiting of the employee such as branch manager/assistant branch manager, loan officer, and property assessor to their business and property. This confirms that as part of prudent credit management system when ever there is loan request the concerned bank employee uses to visit and supervise and gather some important information that helps for loan processing and decision making minimizing risk.

Further, most of the respondents, 92.22 percent revealed that they get the required information and counseling/answers to their questions in what ever time from any of the branches. This indicates the level of competence of the staff in treating clients and promoting the vision of the bank.

Adequate and reliable information enhances prudent credit management and long lasting loan client – bank relationship and business reputation.

However as it is denoted in table 5.7, 51.10 percent of the applicants disclosed the deviation of the information from what they had before about the convenience of loan processing procedures and requirements. This is due to their reservation on property estimation, loan approving time, and amount of loan and repayment schedule of the Bank. While 48.90 percent stated what they found in the bank was as expected.

While 65.56 percent of the respondents are confidently explaining their interest to extend their business relation with the bank 34.44 percent hesitated whether to continue or not with the bank. The reason stated is the low collateral estimation value, small loan approving practice, long loan processing time, and short repayment period.

In table 5.8, it is disclosed that 33.33 percent of the respondents of the bank have between one and two years experience, 29.17 percent have three years, 18.33 percent have four years, 6.67 percent have five years, and 12.50 percent have more than five years experience in relation to the branches which have three to thirteen years old.

Table 5.8: Loan experience of clients

Experience of loan clients	Performing		Non performing		Total	
	Freq.	%	Freq.	%	Freq	%
1- 2 years	34	28.33	6	5	40	33.33
3 years	23	19.17	12	10	35	29.17
4 years	14	11.67	8	6.67	22	18.33
5 years	7	5.83	1	0.83	8	6.67
Above 5 years	12	10.00	3	2.50	15	12.50
Total	90	75	30	25	120	100

Source: Researcher's Survey Result from Primary Data Sources

In addition as the number of years increase, the number of experienced loan clients of the bank decreases disclosing the turnover of clients as they accumulate loan experience that enable to access other competing banks and this impedes the performance and loan growth of the bank.

This means the bank is entertaining new applicants while the experienced loan clients are shifting to other banks due to the high computation in the sector. This is contrary to the policy of building long lasting bank- borrower business development and relation.

5.2 Response from Performing Loan clients

5.2.1 Loan Processing and Lending

Loan processing and lending function is the core product of all banks in general as it contributes the major shares of revenue to its profitability. In other words loans and advances are known to be the main stay of all banks. They occupy an important part in gross earnings and net profit of the banks. The share advances in the total asset of the banks forms a lion share (almost more than 60%) and as such it is known as the back bone of banking sector. The strength and soundness of the banking system primarily depends upon health of the advances.

Therefore, in order to promote the lending function to the required level the Bank should produce and follow, up to date, convenient credit policies, and procedures to attract potential loan clients and develop a long lasting borrower-bank relationship. In table 5.9, the loan client relationship with the bank is indicated. Among the respondents from performing loan clients the relation is rated good by the majority (50 percent), Excellent (7.78 percent), Very Good (37.78 percent), Fair (2.22 percent), and Poor (2.22 percent). This discloses the status of relation of the bank to its loan clients is on average as most of the client explained to be good (50 percent), and very good (37.78 percent).

Table 5.9: Loan client relation with the Bank

Variables	Frequency	%
Excellent	7	7.78
Very good	34	37.78
Good	45	50.00
Fair	2	2.22
Poor	2	2.22
Total	90	100.0

Source: Researcher's Survey Result from Primary Data Sources

This result indicates that as loans and advances is the main product of the banking business, the client relation to the bank has to be improved to the excellent and very good level through improving the current credit issuing procedures.

Most of the respondents as indicated in table 5.10 bellow discloses that, 55.56 percent and 33.33 percent have complaining in the low estimation value of properties provided to the bank as collateral and long time loan processing and small loan approving practices relative to the current business competition and market situation.

Table 5.10: Credit managing procedures

Needs improvement	Frequency	%
In accepting loan applicants	2	2.22
In collateral estimation	50	55.56
In follow up and loan collection	8	8.89
In loan processing and approving amount	30	33.33
Total	90	100.0

Source: Researcher's Survey Result from Primary Data Sources

Moreover, 2.22 percent and 8.89 percent of the respondents exposed the need of improvement the prevailing procedures in accepting loan applicants, follow up and collection procedures respectively.

With regard to the problems in collateral estimation and reduction of loans as well as long loan processing time as exposed in table 5.11, 84.44 percent of the respondents explained their complaining is at head office level, 4.44 percent at branch level and 11.11% at all level. Thus, this reveals the policy and guidance of collateral value estimation, the time of processing and decision at head office loan analyst and loan approving committee needs improvement in order to be in position to entertain potential loan clients and assure loan clients long lasting relationship.

Table 5.11: Client's complain in loan processing

Complain in loan processing	Freq.	%
At branch level	4	4.44
At head office level	76	84.44
At all levels	10	11.11
Total	90	100

Source: Researcher's Survey Result Primary Data Sources

5.2.2 Loan Collection and Supervision

In order to ensure the sound execution and operation of businesses, banks should carry out timely follow-up or supervision visits, because they have to ascertain the utilization loans granted is per the purposes for which they were intended to and to ensure timely repayments as planned.

The purpose of supervision or follow-up in banks is, to enable loan clients improve their efficiency in business implementation and loan utilization that improves income and loan repayment status. If there is continuous follow up and supervisions to evaluate the loan utilization and repayment, this makes borrowers to observe their obligation and improve the proper utilization of the loan thereby improving repayment performance.

As shown in table 5.12, 88.9 percent of the respondents agree to the importance of follow up and supervision to be made by the bank employee and 11.10 percent responds negatively of its importance.

In table 5.12, 94.40 percent of the respondents reflected the relevance of supervision and follow up to their business growth as it provides them encouragement while 5.60 percent reflects that its relevance is not to such emphasized level.

Table 5.12: Credit follow up status

Follow up	Yes		No	
	Freq,	%	Freq.	%
Status of follow up	**80**	**88.90**	**10**	**11.10**
Sufficiency of loan granted	**25**	**27.80**	**65**	**72.20**
Convenience of loan schedule	**41**	**45.60**	**49**	**54.40**
Relevance of business follow up	**86**	**94.40**	**5**	**5.60**

Source: Researcher's Survey Result from Primary Data Sources

As Table 5.12 clearly shows, 54.40 percent of the respondents said that the repayment schedule of the bank is not sufficed to discharge their obligation while 45.60 percent of them replied positively. Similarly, 72.20 percent of the respondents complained that the loan granted is not sufficient for the intended purpose of business while 27.80 percent reflected positively.

Most of the loans delivered are for the purpose of working capital and lays in the range of short term and medium term period that is for one year and to some extent below two years respectively. This leads to say the amount of loan used to be granted in the region as well as in general is not meeting the demand of clients. Moreover, the periodic repayment schedule of the Bank is very short and not convenient to discharge their responsibility.

Table 5.13: Factors motivating Loan repayment

Factors motivating repayment	Freq.	%
Not to lose collateral	4	4.4
Expectation of getting another loan	6	6.7
To be ethical and meet obligation	80	88.9
Total	90	100.0

Source: Researcher's Survey Result from Primary Data Sources

If loans are not repaid as per the contract agreement and when due credit risk is involved, hence the value of the bank's business will be reduced. In order to continue lending, the bank must be able to collect its outstanding loans on time. Hence, in order to minimize the occurrence of bad loans strict follow up must be carried to the utmost degree and take timely action when necessary.

As it is shown in table 5.13, 88.90 percent of the respondents revealed that they manage to pay their loan convincing themselves that loan repayment being an obligation and ethical while the rest 4.40 percent and 6.70 percent exposed that they repay their loan for the sake of protecting their property held as collateral and also to secure getting another loan from the bank.

Table 5.13 shows most of the clients of the bank are loyal and credit worthy in meeting their obligation and accepted loan repayment as ethical and moral obligation. This is an indicator of cultural change that has moved a step forward which was a problem to most banks and micro finances in the previous decades.

5.3 Response from Non - performing

5.3.1 Reasons for Default

There are different reasons why customers of banks become unable to pay their periodic repayment. They include market problems, environmental problems, loan diversion, credit policy of the bank, lack of follow-up, and so on.

It is obvious that these factors are not similar from place to place. Thus, to find out the major causes for default in the study area, the researcher raised questions and interviewed the clients as well as the employees of the Bank. Accordingly, the summaries of responses given are depicted in the subsequent tables. Some of these problems were from the Bank's side while the others were from the clients' side. The remaining factors were from external factors, like environmental and market problems.

Table 5.14: Reasons for default

Factors for default	Non Performing	
	Freq.	%
Market problem	14	46.60
Environmental problem	3	10.00
Loan diversion problem	10	33.40
Bank policy problem	3	10.00
Total	30	100.00

Source: Researcher's survey Result from Primary Data Sources

According to Table 5.14, 46.60 percent of the respondents who are unable to pay their periodic repayment indicated that the major reasons for default were market problem, 33.40 percent used the loan for other purposes like consumption (loan diversion), and 10 percent are due to credit policy problem of the bank like repayment time schedule, loan granting period (season), and loan amount provided.

The remaining 10 percent responded that environmental problem like shortage of rain was the main problem which affected the success of their business especially agricultural business in the west part of the region like Humera and around.

In most commercial banks loan diversion is the most common problem of defaults which banks usually take care of and exert possible efforts to protect from it through proper business viability assessment analysis, supervisions, and loan reviewing made before and after the loan provision.

In order to further investigate the reasons for default, the researcher asked the employees of the Bank as well.

Based on the question, they replied that in addition to what the clients of the bank mentioned, in adequate information about customer's creditworthiness, lack of follow-up and supervision are the other major reasons for default.

Table 5.15: Factors contributing to non-performing

	Yes		No	
Factors	Freq.	%	Freq.	%
Loan experience in other bank	13	43.33	17	56.67
Was the amount per your request	12	40.0	18	60.0
Convenience of repayment duration	4	13.33	26	86.67
Are measures taken fair and legal	25	83.33	5	16.67

Source: Researcher's survey Result from Primary Data Sources

In assessing the factors contributing to non performing loans as shown in table 5.15, 56.67 percent of the new applicants had no credit relation or credit experience (luck of loan Experience) with other banks or microfinance while 43.33 percent had credit experience. With regard to the credit duration 86.67 percent were disappointed with loan provision period. This happens especially when loan processing takes long time and the season for which loan required is elapsed. This is the case mostly faced in agricultural loans in the western part of the region. The deviation between the amount requested and loan approved is also observed as another factor for non performing loan (NPLS) creation.

In table 5.15, 60 percent of the respondent remarked the bank used to approve loans with high reduction than the amount requested. This happened especially on loans sent to head office for approval when it is above the branch discretion.

Due to the aforesaid reasons or others, loans fail to non-performing and various banks use various measures for recovery. Hence, the researcher asked questions to know the perception of the clients on the measures the Bank is using. As it is shown in table 5.15, 83.33 percent of the respondents agree on the fairness and justice of the forcing measures taken by banks. Only 16.67 percent reflects negatively.

These remarks loan clients have developed reasonable understanding in the measures which are taken by the Bank in time of default. Hence, clients who are non-performing can protect themselves from unwanted consequences of the forcing measures such as foreclosing and legal proceeding by devising mechanisms to settle their debt ahead.

Table 5.16: Mechanisms designed by the loan clients to settle the NPLS

Mechanisms	Freq.	%
Change of business type	16	53.33
Sell of property	11	36.67
Borrowing from relatives, friends and family	3	10.0
Total	30	100.0

Source: Researcher's Survey result from Primary Data Sources

As a common practice loan clients exercises various efforts to settle the loan in time of default and bankruptcy to settle their debt using various mechanisms like changing business type, selling property which are marketable, used to borrow from friends, relatives, and money lenders etc. As disclosed in table 5.16, 53.30 percent manages to settle their debt by changing business type, 36.70 percent sells own property, 10 percent borrows from relatives, friends, and family.

Table 5.17: Measures taken by the bank to recover the NPLS

Measures taken	Freq.	%
Refusal of additional loan	3	10.0
Foreclosing	1	3.3
Warning	26	86.7
Total	30	100.0

Source: Researcher's Survey Result from Primary Data Sources

When loans failed to non-performing status the Bank uses various mechanisms. Out of the mechanisms, rescheduling is advisable if the causes of non-performing is reasonable as well as if the background, experience, and track record of the loan client in his/her previous record was trustworthy. Additional loan is not recommended unless the case is very justifiable. If there is no promising ground for rescheduling a forcing measure is used such as strict follow up and counseling followed by reminding and warning letters.

These are the efforts that help to settle amicably. If these all are exhausted foreclosing and court proceeding are to be taken as a last solution of recovery. In table 5.17, 86.70 percent of the non performing loan clients are served warning, 10 percent are refused from entertaining for additional loan, and the rest 3.30 percent are under foreclosure.

5.4 Responses from the Bank's Employees

5.4.1 Demography of the Employee

The demographic nature of the employee has a great contribution in the credit management of loans and advance in understanding the credit policies and procedures as well as exercising and improving it when demanded.

Table 5.18: Gender issue

Gender	Freq.	%
Male	19	95.0
Female	1	5.0
Total	20	100.0

Source: Researcher's survey Result from Primary Data Sources

The mix of gender of the employee in the loan area is, 95 percent dominated by the male parts and 5 percent is female as it is shown in table 5.18. This is due to the education and experiences required to work in the loan area as loan officers or analysts and this indicates the existence of female fulfilling the requirement in the market is yet insignificant in number relative to male parts. Employees with high experience and qualification are needed to work in the loan area as they have to understand the responsibility and accountability for prudent credit management and minimizing credit risks to the required level

Table 5.19: Age

Age	Freq.	%
26 - 35	17	85.0
36 - 45	3	15.0
Total	20	100.0

Source*: Researcher's Survey result from Primary Data Sources*

The age of the employee shows as indicated in table 5.19, 85 percent are in the range of age between 26 to 35, and 15 percent are also between the ranges 36 up to 45. This implies the bank has the human resource that can work energetically and competitively understanding the mission and goals of the bank.

Table 5.20: Marital status

Marital	Freq.	%
Single	6	30.0
Married	14	70.0
Total	20	100.0

Source: Researcher's Survey Result from Primary Data Sources

By its nature the financial industry is very sensitive and risk exposed requiring human resources who are responsible, trust full, and accountable for the prudent management of the finance. Hence if the employee working in such risk exposed area is tied up with such social responsibilities it adds value. In the table 5.20, 70 percent of the bank employees are married while 30 percent are yet single.

Table 5.21: Educational Qualifications of Respondents

Qualification	Freq.	%
Diploma	0	0
First Degree	20	100
Second degree	0	0

Source: Researcher's Survey Result from Primary Data Sources

Educational background of employee is an important factor to be considered with regard to making business decision. Education improves the skill, capacity, communication and access to development endeavors.

As it can be reviewed from table 5.21, 100 percent of the respondents are degree holders. This denotes that the majority of the Bank's employees working in the loan first area are well experienced and trained. This enables the Bank to perform most and become competitive in the region in particular and at national level in general.

5.4.2 Credit Policy and Procedure

Table 5.22: Credit policy, processing, and collection procedures

	Yes		No	
Credit policy, processing and collection	Freq.	%	Freq.	%
Have you credit policy	20	100	0	0
Is the credit policy up to date	16	70	4	30
Is the credit policy compliance to NBE	19	95	1	5
Is loan growth as required	7	13	35	65
Is loan service as client's preference	8	40	12	60
Is Lending and overriding limit convenient	16	70	4	30
Is the collection technique effective	20	100	0	0

Source: Researcher's Survey Result from Primary Data Sources

Producing and developing credit policy and procedures as well as other pertinent manuals and guidlines help to creat common understanding and uniformity amoung all employees. Lending is the core product line which contributes the bigest share to the profitability of a banking organization. It is crucial to have credit policy document to protect the bank against over exposure, mal-administration of credit arresting the creation of non-performing loans, and arrive at a trade-off between returns and risks. In the table 5.22, 100 percent of the bank employee replied posetivly for having credit policy and procedure manuals.

70 percent of the employees have comment on the existing credit manuals which was revised in July 2005 G.C needs to be up to date as so many amendment was made over it. While 30 percent of them are yet recognizing it as up to date.

Moreover, 95 percent of the employees have agreed on the compliance of the credit policy and credit procedures to the regulation and directions of the National bank of Ethiopia (NBE), which is the regulatory body of the nation.

Though loan provison is the main product of the bank as it is the main source of income its growth is not as expected almost in all branches in the region. This is disclosed by 65 percent of the repondents and by the interviews made with the senior staff.

In the table 5.22, 65 percent of the employees are not satisfied of the prevailing growth of loans while 35 percent accepted the current status of growth as satisfactory. 70 percent of the bank employee have agreed on the impediments for the loan growth being the branch lending and overriding limit, as well as 60% of them have recognized the divation of the loan service provided with the preference and expectation of the potential loan clients.

Table 5.23: Collection techniques of the bank

Collection technique	Freq.	%
Debiting client account per pre undertaking	9	45.0
Cash payment	5	25.0
Transfering	2	10
All	4	20.0
Total	20	100.0

Source: Researcher's Survey result from Primary Data Sources

The collection technique so far adopted by the Bank is cash/check payment, debiting own account per the given authorization, and transferring through the bank's branch exculuding commission charge. As it is shown in tabel 5.23, 100 percent of the bank employee have agreed on the convenience of the collection technique. Moreover, 45 percent adopts debiting the clients account, 25 percent uses cash collection system, and 20 percent uses either cash or debiting account system of collection technique.

While 10 percent uses transferring when the clients are out of the branch. Hence, the most common collection techniques used by the bank is cash payment and debiting clients account.

Table 5.24: Ccredit Creation by the bank

Credit creation	Freq.	%
By Staff approaching promoted clients	6	30.0
By New client approaching with request	14	70.0
Total	20	100.0

Source: Researcher's Survey Result from Primary Data Sources

As it is shown in the table 5.24, 70 percent of the loan is created by new applicants approaching the Bank with credit request while 30 percent is created by the employees approaching potential loan clients.

These shows the Bank employees should further exert efforts to approach potential loan clients as it is the best way of creating quality loans as well as to win the prevailing so stiff competition.

Table 5.25: Credit policy and procedure of the Bank

Credit policy and procedure	Freq.	%
Rigid	3	15.0
Flexible	3	15.0
Average	14	70.0
Total	20	100.0

Source: Researcher's Survey Result from Primary Data Sources

In compliance to the policy of the regulating body, all banks formulate their own credit policies and procedures which assist to provide different type of credit within each credit policy to their loan customers. Therefore, knowing the outlook of loan clients for each bank is very important in reshaping its credit policy and procedures.

Hence, In order to know the nature of the Bank's credit policy, the researcher raised questions for the employees of the Bank and interviewed senior bankers and branch managers. Consequently, as revealed in Table 5.25, 70 percent of the respondents said the credit policy and procedure of the bank is on average in its workability and 15 percent claimed as it is rigid. While, 15 percent of them said that the credit policy of the Bank is flexible. In the unstructured interview made most of the senior bankers and branch managers have agreed on the importance, attractiveness and convenience of flexible credit policies and procedures as it assists for loan creation and growth.

Table 5.26: Credit providing procedures

Credit provision	Freq.	%
Based on creativity	1	5.0
Conservative	4	20.0
Moderate	15	75.0
Total	20	100.0

Source: Researcher's Survey Result from Primary Data Sources

In table 5.27, 75 percent of the respondent revealed the credit providing procedure of the Bank is moderate and 20 percent acknowledged it as conservative. While 5% of the respondents stated the credit delivery is based on creativity. All of them have significant impacts on the performance of the credit management and growth.

5.4.3 Credit Analysis

Loan requests should be carefully analyzed and appraised in accordance with the prevailing credit policy and procedures. Financial statements should be analyzed to determine the financial soundness of the applicants. All type of risks such as ownership risk, management risk, business risk, financial risk, collateral risk and legal risk should be assessed with utmost care.

Table 5.27: Rate of credit analiysis and processing

Rate of analysis and process	Freq.	%
Excellent	0	0
Very good	5	25.0
Good	13	65.0
Fair	1	5.0
Poor	1	5.0
Total	20	100.0

Source: Researcher's Survey Result from Primary Data Sources

In relation to credit analysis, as indicated in table 5.26, 65 percent of the bank employees have rated the credit analysis of the bank good, 25 percent rated very good, 5 percent rated fair while 5 percent rated poor. Hence, there is a gap needed to improve the quality of credit analysis and loan processing at both head office and branch level to the status of excellent level that enables to create quality loans arresting non-performing loans.

Table 5.28: Loan recommending/aproving

Loan recommending / approving procedure	Freq.	%
By Loan committee at all level	20	100
By President and Credit department manager	0	0
By Branch manager and loan officer	0	0

Source: Researcher's Survey Result from Primary Data Sources

All loans and advances of the bank is recommended or approved by the loan committee both at branch and at head office as per the discretions provided. As it is shown in table 5.28, 100 percent of the bank employees have confirmed it. The branch loan committee includes Branch Manager, Assistant Branch Manager, Accountant and Loan Officers while the credit approving management at head office level includes the President, Vice President Operation, Vice President Support Service, Credit Manager, Finance Manager, Domestic Banking Manager.(credit policy: July,2005)

5.4.4 Credit Recovery

The credit recovery method, used by the bank is treated in the same fashion as of credit collection methods. The measures that are used include strict follow up and insisting the client, debt rescheduling, court proceeding, and foreclosure.

In the bank, credit is transferred to the legal service when it fails to regularize or settle the loans in default and when all efforts to amicably settle the loans fail and it is ascertained that legal action is to be the last alternative.

Table 5.29: Methods used to improve repayment

Measures	Freq.	%
Loan rescheduling	4	20.0
Frequently insisting the client	9	45.0
All	7	35.0
Total	20	100.0

Source: Researcher's Survey Result from Primary Data Sources

As it is indicated in table, 5.29, 45 percent used to settle the non-performing loan through frequent follow up and insisting the loan client. Moreover, 20 percent of the bank employees have replied the bank reschedules loans when the cause of default occurs justifiable.

Table 5.30: Enforcement measures

Enforcment measures used	**Freq.**	**%**
Court proceeding	**4**	**20**
Foreclosure	**13**	**65**
Both	**3**	**15**
Total	**20**	**100**

Source: Researcher's Survey Result from Primary Data Sources

If the efforts made to settle loans in default is exhausted the legal proceeding is taken as enforcing measurement. In the table 5.30 bellow, 65 percent of the respondents replied foreclosure is used while 20 percent replied court proceeding is used. Out of the respondents, 15 percent replied that both measures are used to settle the loan in default.

Table 5.31: Effectivness of forcing measures

Fourcing Measures	Freq.	%
Effective	**15**	**75**
Ineffective	**5**	**25**
Total	**20**	**100**

Source: Researcher's Survey Result from Primary Data Sources

With regard to the enforcing mechanisms, the researcher raised questions and made interviews to asses their effectiveness and as shown in table 5.31 bellow, 75 percent of the respondents confirm the effectiveness while 25 percent disclosed its ineffectiveness. The main reason for the ineffectiveness is that in most cases people do not want to buy others property which is held as collateral by banks. This is mainly observed in the regional cities and towns as a behavior of the cultural society observed to be the most burdens to all commercial banks.

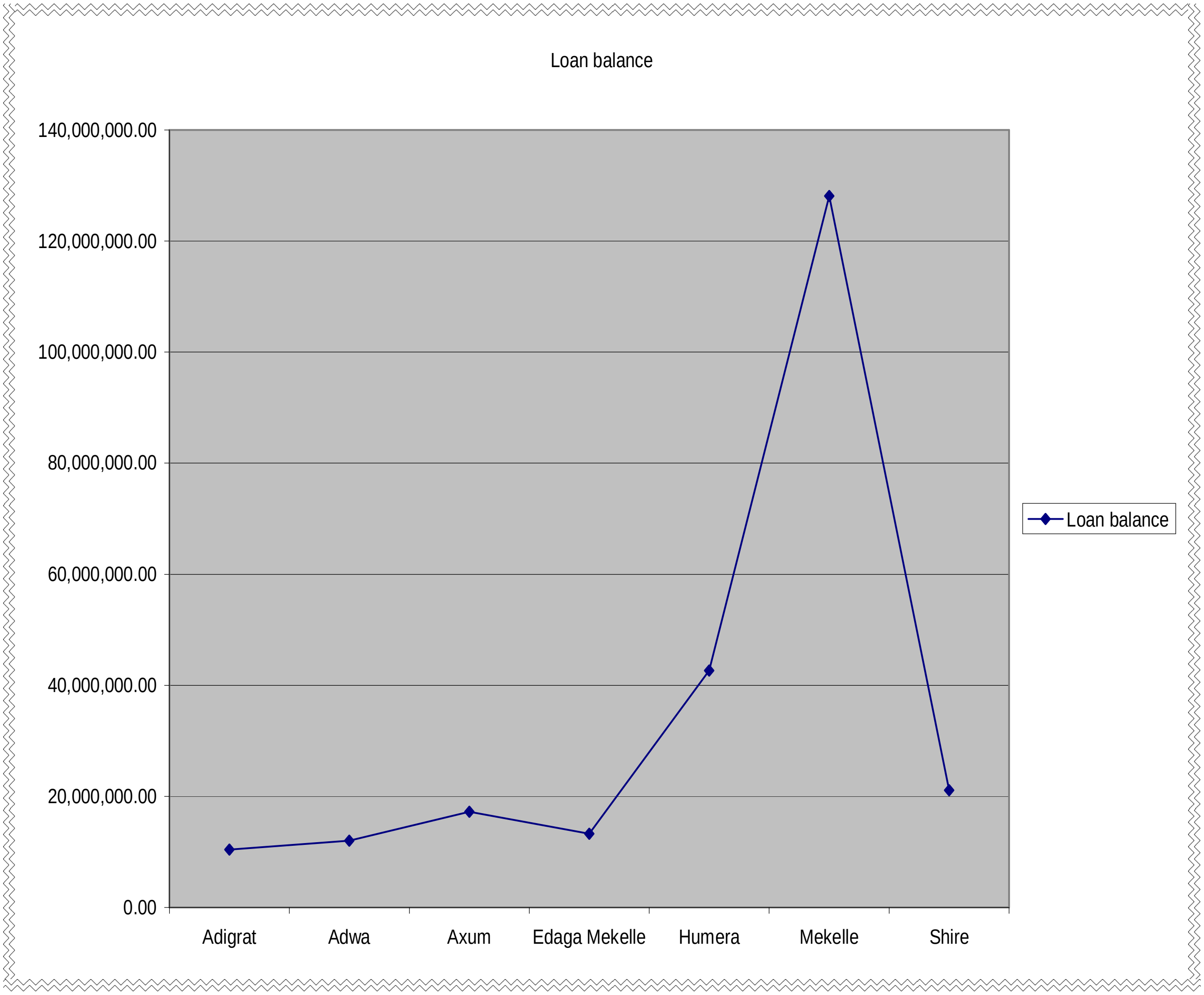
5.5 Credit Operations of Wegagen Bank Tigray Region

The credit operation of the Bank shows how much the Bank is performing in terms of disbursing, collecting and arresting non-performing loans from period to period and the compliance of the credit management to the requirement of National Banks Regulation.

In figure 5.1 the loans and advances granted by all branches is reached only birr 244.828 million as of April 30, 2010. The highest amount is granted by one of the long aged branch known as Mekelle branch, birr 128.13 million, which is located in the regional city, the main business center of the region, and it is followed by the Humera branch, birr 42.67 million, which is known for its location in the agricultural and commercial center of the region.

However, this shows the loan growth performance of all branches relative to their years of establishment is not to the required level.

Figure 5.1 Summary of Loans granted by branches



Source: The Banks's Progress Report of branch

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As most of the branch managers and loan officers disclosed in the questioners administered and unstructured interviews made, the reason behind is not due to lack of potential loan clients or due to competition but due to lack of common understanding for the same mission between the branch loan officers, loan committee and head office loan analysts and credit approving management committee. As most of the respondents from loan clients and bank employees commented, the lack of up to date credit policy and guidelines regarding property estimation, branch loan discretion, loan processing time, and loan repayment duration are the main factors impaired the loan growth.

5.5.1 Non- performing Loans to Total Loan Ratio (NPTL)

This is one of the most important criteria to assess the quality of loans or asset of any commercial bank. Non- performing Loans to Total Loan Ratio (NPTL) measures the percentage of gross loans which are doubtful in banks' portfolio. The lower the ratio of Non-performing loans to total loan ratio (NPTL), the better is the performance.

Table 5.32 bellow shows the non-performing loans to total loan ratio of each branches of the Bank in the region is below the requirement set by the National Bank of Ethiopia which is below 10 % except Humera branch which is 38.21 percent. Hence this denotes the ability of all branches except Humera branch in creating quality loan and arresting the level of Non-performing loan is above the standard of the credit policy of the bank which is set in compliance to the regulation of the National Bank of Ethiopia.

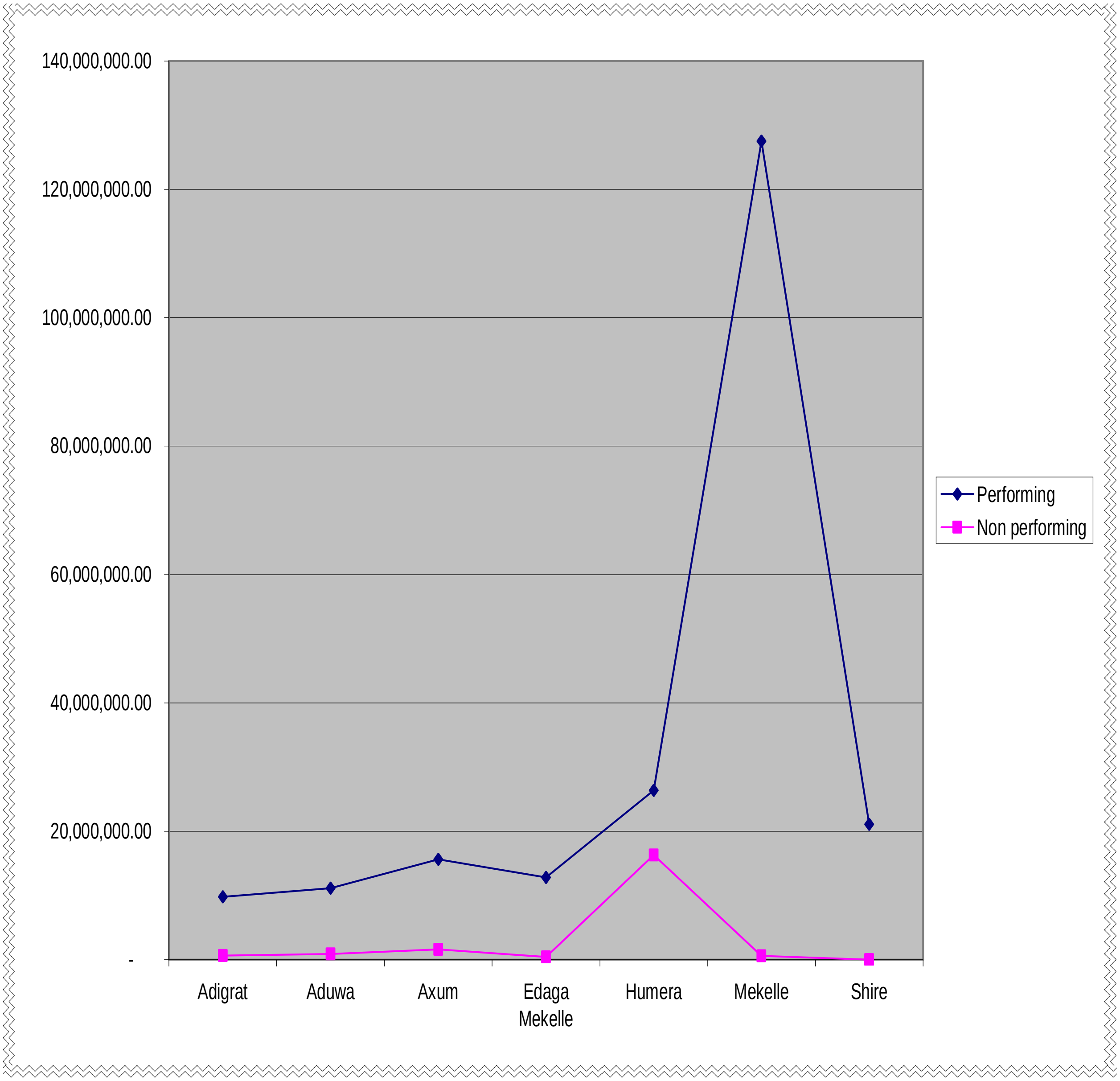
On the other hand, the high ratio of Non-performing loan to total loan ratio in Humera branch was caused by the fraud of checks occurred among the business community around and market price fluctuation in 2008/09.

Table 5.32 Summary of total loan balance and Non-performing by branches

Branches	Loan balance	No-performing	%
Adigrat	10,421,591.17	617,007.78	5.92
Aduwa	12,003,455.24	868,074.26	7.23
Axum	17,235,869.55	1,603,067.20	9.30
Edaga Mekelle	13,250,293.25	437,786.96	3.30
Humera	42,667,379.19	16,301,453.37	38.21
Mekelle	128,130,844.6	586,956.81	4.58
Shire	21,118,743.10	17,586.17	0.08

Source: Progress Report of each branches of the Bank

Figure 5.2 Performing and Non-performing Loans



Source: : Progress Report of each branches of the Bank

Figure 5.2 shows the performance of loan as compared to the total loan granted in the region in each branch. As it can be seen from Figure 5.2, in general the amount of non-performing loan is small in size confirming the collection rate is at its required level.

5.5.2 Provisions

Loans and advances are financial instruments originated by the bank by providing money to the debtors. It is stated at costless impairment losses. Impairment losses comprise specific provisions against debts identified as bad and doubtful and general provisions against losses which are likely to be present in any loans and advances portfolio. The bank follows the national Bank of Ethiopia Supervision of Banking Business Directives SBB/43/2008 in determining the extent of provisions for impairment losses.

The Directive classifies loans and advances into: Pass, Special Mention, Substandard, Doubtful, and Loss. The bank also classifies the loan categories in consistence to the National Banks criteria and manages as follow:

Table 5.33: Summary of loans in Tigray region by status

Loan category	Loan balance	Provision	Percentage
Pass	**211,560,070.37**	**2,115,600.70**	**86.41**
Special Mention	**12,836,133.26**	**385,083.99**	**5.24**
Substandard	**4,988,592.70**	**997,718.54**	**2.0**
Doubtful	**1,584,880.57**	**792,440.29**	**0.65**
Loss	**13,858,459.28**	**13,858,459.28**	**5.70**
Grand Total	**244,828,136.18**	**18,149,302.80**	**100.00**

Source: The Banks's Progress Report of branches.

Pass and Special mention are categorized as performing while the others are categorized as non-performing. Accordingly, Table 5.33 shows 91.65 percent of the loan size is performing while 8.35 percent is non-performing implying that the Non-performing loan percent is below the requirement of the National Bank of Ethiopia (10 percent).

CHAPTER SIX
CONCLUSION AND RECOMMENDATION

In this chapter, conclusions of the research findings that has been discussed and analysed in detail in the previous chapters is briefly presented. In addition, general conclusions that are highly related with the research objective of this paper is offered. Furthermore, possible recommendations based on the findings are made. Lastly, implication for further research is indicated.

6.1 Conclusions

Based on the findings, the following conclusions are drawn.

- As qualified and experienced manpower enhances competence, majority of employees of the bank are Degree holders and highly experienced, this enables the bank to accelerate its service delivery and become competitive in the growing stiff competitive industry, to meet its vision of "Becoming the most preferred Bank in Ethiopia."
- The Bank has yet considerable area coverage in the region relative to other banks so far easing access of the society to finances and other bank services such as deposit, transfer, and currency exchange service. However, the loan growth and client reputation is not as required due to the weakness which most of the clients and employees have disclosed in valuing the collateral offered, in loan processing and approving, and in repayment schedule.
- Most potential and experienced loan clients are leaving the bank after accumulating experience and ascertained bankable which is considered as a factor for appraisal by others and this is highly affecting the client reputation.

This problem is observed when the loans above the branch discretion are sent to head office for approval. The complaints are due to underestimation of properties offered for collateral, length of loan processing time, excessive reduction of loans requested and recommended by the branch.

- Most of the loans provided are on short term repayment schedule (Mostly for the purpose of working capital). This is may be due to the limitation of capital base of the bank. However, it is currently causing burden of installment repayment and most of loan clients preferred to be improved as most of the time faces difficulty to manage it accordingly. It is one of the causes for loan client termination.
- The collection techniques so far adopted by the bank is appropriate and convenient to most loan clients to manage it. Consistent to the convenience of the collection techniques, the repayment behavior of most loan client is improved to the required level revealing one step forward in the culture of meeting obligation and trustworthiness. Most of loan clients now a day are considering loan repayment per the contract agreement as ethical and obligation. Moreover, most business people understand the advantage of creating friendship ground with the financial sector as a best strategy to their business growth and success.
- The Bank is compliant to all directions of the regulating body in all of its activities of credit management. Hence the way of categorizing and holding provisions for the non performing loans is as per the direction and requirement of the National bank of Ethiopia.
- The default problem in the bank is due to market problem, environmental problem, loan diversion, and policy problem like the credit policy of the bank related to loan duration and amount. These all leads to credit risk that has bad consequences on the Bank's financial stability, clients' business performance, and economy of the region.
- The credit analysis and procedures which is being followed by the bank is lengthy and reluctant to approve adequate amount per the requisition and

intended purpose of the business, requiring improvement so as to speed up and satisfy the delivery of loan to its clients and become acceptable in the eyes of potential customers.

6.2 Recommendations

On the basis of the results and conclusions of this study, the following policy implications are suggested so as to be considered in the future intervention strategies which are aimed at improving the credit management of the bank.

- The credit policy and procedure of the Bank should incorporate the ideas of the clients and employees to become more competitive in the banking industry and meet its vision. In other words, it is better for the Bank to make its credit policy flexible to meet its potential loan clients and thereby putting a good administrative set up that improves Credit lending and administration. The periodic repayment schedule of the Bank should be flexible by considering the operation of the clients' business as repayment duration has its impact on the performance of loan collection.
- As it is disclosed in the analysis part of the study most of the loan clients and bank employees have complaints on the credit policy and guidelines regarding valuing property offered for collateral, loan discretion, length of loan processing time, repayment schedule, and excessive requirements for analysis. These are the major factors impeding client reputation and retarding to attract potential loan clients. Hence, the bank should made remarkable changes on its credit policy and procedure guidelines regarding the above aforesaid drawbacks in order to solve the current problems and achieve the client reputation.
- The current loan processing and approving direction of the bank is moderate inclined to be conservative especially regarding collateral and analysis. This is highly retarding the loan growth of the branches in particular and the Bank in general. Hence, the bank should follow creative way of loan processing and

approving direction that assists to meet the loan demand of potential loan applicants and the required level of loan growth as it is the main source of income for the banking industry.

- The system of loan approving and decision based on committee level as well as the lending and overriding limit both in branch and head office is acceptable as a direction for prudent credit management and control. But most often it is observed as impediment when loans are forwarded to head office causing long time loan processing and reduction of loans without substance and offends potential applicants. Hence, the amount of lending and overriding limit of each branch should be improved and the head office credit management committee should focus on big loans and on loans that are complex in nature. Moreover the head Office Management of Credit Committee is (MCC) is high in number and taking excessive time in decision making. So the number should be reduced to executive numbers with three or four members.
- Though the bank has followed the strategy of large area coverage as to create easy access of the society to the financial sector by opening considerable branches in all regions like the region under the study, it did not follow the strategy that assist the branches to be functional as required. Opening a branch is not an end by itself. Hence, the bank should assist the newly established branch in a flexible way in order to have the required loan growth.

6.3 Implications for Further Research

This study is under taken in Wegagen bank Share Company as a case study of credit management performance of the Bank by considering the seven branches in Tigray Region. It has focused on credit while there are also other performance measurements like profitability, liquidity etc. Therefore, it is worth to study in comprehensive level in order to solve the persistent problems and promote the bank as per its vision to the competitive level.

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APPENDIXES

Appendix- A

Questionnaire on Credit Management case study of Wegagen Bank share company Tigray region

(Performing loan clients)

Instruction:

Please encircle or/and fill in the blank spaces your possible answer to the corresponding question and comment on open questions.

I. **Personal Details:**

1. Gender:

a) Male b) Female

2. Age:

a) 18__ 25 b) 26-35 c) 36-45 d) Above 45

3. Marital Status:

a) Single b) Married

4. Educational level:

a) Illiterate b) Primary education

c) Secondary education d) Above Grade 12th

II. **Loan application and processing:**

5. Who initiates you to approach the bank for your first loan request?

a) Self b) loan clients of the bank c) Staff

6. Have you met the loan provision service as your expectation?

a) Yes   b) No

7. If your answer to Q no, 6 is “No”, Please explain the problems observed ________.

8. Does the bank staff visit your business site during your loan request or before loan approval?

   a) Yes   b)No

9. Do the application requirements and procedures convenient and simple?

   a) Yes   b) No

10. If your answer to Q 9, is “No”, please specify that you assumed un necessary

____

11. Is the loan processing time short and convenient for you?

   a) Yes   b) No

12. If your answer to Q no.11 is “No”, where do think the problem

   a) At branch level   b) At head office level

13. When you approach the branch do you get relevant information to your request/need?

   a) Yes   b) No

14. If your answer to Q no.13 is no, please specify the problems you faced

____

III. Loan provision and Loan collection

15. For how long are you loan client of the bank?

   a)1- 2 years   b) 3 years   c) 4 years d) 5 years e) >5 years

16. How do you evaluate your so far relationship with the bank as a loan client?

   a) Excellent b) very good c) good d) fair e) bad

17. If your answer Q no, 16, is fair or bad please specify the reason

____

18. In which part do you think the bank needs improvement? (Hint. tick that Apply)

a) In accepting loan applicants c) In follow up & collection of loans

b) In collateral estimation. d) In processing & approving loans e) both b & d

19. Would you please indicate the reason for any answer of Q no., 18?

____

20. Do you think to extend your relation further with the bank?

a) Yes b) No c) It depends

21. If your answer for Q. no, 20 is "No" or It depends with whom do you think the Problem

a) Branch level b) head office level c) at personal level

22. What solutions or amendments do you think required to the bank in future for long lasting client relationship_____________________________

23. Do you think the existence of the bank add value to your business growth?

a) Yes b) No

24. If your answer to Qno.23 is "No", please explain the reason

____

25. Does the bank visit your business sites after loan granting?

a. Yes b) No

26. Do you think visiting to your business has significance?

a) Yes b) No

27. Explain your answer to Q no, 26 for any one of your answer

____

28. Do you think the amount of loan approved was enough for the intended Purpose per your request?

   a) Yes   b) No

29. If your answer to question no. 28 is "No", specify the problem you think

____

30. Do you think the loan repayment duration convenient to your business?

   a) Yes   b) No

31. If your answer to question no. 30 is "No", can you suggest the most suitable repayment schedule which you think is appropriate? Why?

____

32. Which of the following is/are the most important one/s motivating you to repay your loan on time?

   a) not to lose collateral
   b) to keep social status
   c) expectation of getting another loan
   d) knowing that paying bank loan per the agreement is ethical and an obligation
   e) Others, (specify); ______________________

33. If you have any idea, or comment towards improvement of overall credit management of the bank, please write them on the space provided below.

____

Thank you!

Appendix-B

Questionnaire on Credit Management case study of Wegagen Bank share company Tigray region

(Questioner for non performing loan clients)

Instruction

Please encircle or / and fill in the blank spaces your possible answer to the corresponding question and comment on open questions.

I. Personal Details:

1. Gender:

   a) Male b) Female

2. Age:

   a) 18__ 25 b) 26-35 c) 36-45 d) Above 45

3. Marital Status:

   a) Single b) Married

4. Educational level:

   a) Illiterate b) Primary education

   c) Secondary education d) Above Grade 12^{th}

II. Loan provision and Loan collection

5. Did you have any experience of loan with other banks before?

   a) Yes b) No

6. How many times did you take loan from the bank?

   a) once b)Twice c) three times d) four times e) more than five times

7. If you settled the previous loans regularly what do you think the problem with the current one? ________________________________

8. Was the amount you took enough for the intended purpose and per your Interest?

b) Yes b)No

9. If your answer to Q no. 8 is “No”, explain if it has any impact on your business Performance

____

10. Would you please mention any problem/s/that affects your performance you encountered during loan delivery of the bank?

____

11. Do you think the loan repayment duration was convenient to your business?

a) Yes b) No

12. If your answer to Q no, 11, is “No”, can you suggest the most suitable repayment schedule which you think was appropriate? Why?

____

13. You became unable to pay your periodic loan repayment, what is/are the major reason/s/ for failure?

a) Market problem
b) Environmental problem
c) Contingencies problem such as death, sickness, etc
d) Usage of the loan for other purposes like consumption
e) Policy problem like credit policy of the bank
f) Lack of appropriate management
g) Other, (specify), __________________________

14, who do you blame for the failure

a) Your self b) the bank c) others, specify ________________

15. If your answer to Q no, 14 is the bank, specify the reason

____

16. What mechanism have you designed to pay the unpaid loan balance?

a) Change of the business type

b) Sell of property

c) Borrowing from other financial institutions

d) Borrowing from relatives, friends, and family

e) Others, (specify) ___________________________

17. What measures are taken by the bank for delay?

a) Legal under taking

b) Refusal of additional loan

c) foreclosing

d) Others, (specify), ____________________________

18. Are the measures used to be taken fair and legal?

a) Yes b) No

19. If your answer to Q no, 18 is "No", please suggest the possible solution should be

____

20. If you have any idea, or comment towards improvement of credit management of the bank, please write them on the space provided below.

____

Thank you!

Appendix-C

Questionnaire on Credit Management case study of Wegagen Bank Share Company

Tigray Region.

(Response from the Bank Employees)

Instruction:

Please encircle or/and fill in the blank spaces your possible answer to the corresponding question and comment on open questions.

I. Personal Details:

1. Gender:

   a) Male b) Female

2. Age:

   a) 18__ 25 b) 26-35 c) 36-45 d) Above 45

3. Marital Status:

   a) Single b) Married

4. Your educational qualification

   a) 12th complete c) Degree holder b) Diploma holder d) Master and above

5. In which department/ section/unit/ of the bank are you working?

   ______________________________.

6. The responsibility that you are involved in is: ___________

7. Years of experience?

   a) In the bank ______years. b) In the current position______ years.

II. Details on manuals:

8. Do you have a credit manual or policy?

   a) Yes b) No

9. If your answer to Q no, 8, is "Yes", when was the manual or policy revised?

   ____

10. Do you think it is up to date & convenient for loan creation?

    a) Yes b) No

11. If your answer to Q no, 10, is " No", specify the impediments encountered

    ____

12. How can you see your institution's credit policy and procedure?

    a) Rigid b) Flexible c) Average

13. Do the policies and procedures exactly comply with regulations of national bank

    a) Yes b) No

14. If your answer to Q no, 13, is "No", please specify the gaps

    ____

III. Credit creation and procedure

15. Do you think your branch's loan growth is as required?

    a) Yes b) No

16. If your answer to Q no, 15 is, "No", pleas specify the most reasons

    ____

17. Most of your current loan is created

    a) By approaching promoted clients b) by clients approached with request

18. How do you rate the credit analysis and procedure followed by the bank in

    Extending credit?

    a) Excellent b) Very good c) Good d) Fair e)Poor

19. Does the bank provide loan service that fit to the preference of the borrowers?

    a) Yes b) No

20. If your answer to Q no,19, is "No", please specify the reasons

21. How do you evaluate your bank's credit providing procedure?

    a) Based on creativity b) conservative c) moderate

22. Do you think the branch lending limit and overriding limit has any impediment in you branches loan providing capacity and growth

    a) Yes b) No

23. If your answer to Q no,22, is yes please suggest other most convenient procedure

    ____

24. What are the main reasons to loan clients dissatisfaction in loan processing

____

25. Your banks loan approving / recommending procedure of the credit proposal of clients is based on

a) Loan committee at all level b) Branch Manager and president c) Loan department d) board

26. Would you please indicate the pro and cons facing due to your answer to Q no, 24

pro_________________ Cons____________________

IV. Follow-up collection

26. Which of the following credit collection technique / s / are adopted by your

Bank?

a) Cash / check payment c) Using Collection Agencies

b) Debiting client account per pre undertaking d) Personal visit e)Telephone f) a and b g) a and d h) All

i) Other, (specify) ____________________________________

27. Do you think the credit collection technique used by your bank is effective?

a) Yes b) No

28. If your answer to Q24 is "No", please specify the appropriate technique / s / that you think is best? ____________________________________

29. How often does your institution visit clients' business?

a) Monthly b) quarterly c) Semi-annually d) in time of default

30. What do you think is / are the major reason / s / for default in your Branch? (Hint: Check all answers that apply)

a) Lack of follow-up

b) Lack of training

c) Inadequate information about customer creditworthiness

d) Loan diversion

e) Absence of book-keeping

f) Lack of market for clients' product

g) Unfavorable Environmental conditions

h) Others, (specify) ________________________

31. What preventive measures do you think effective to be used before failing loans to default?____________________________________

32. What measure / s is / are taken on the side of the bank to improve the repayment situation? (Hint: Check all answers that apply)

a) Loan rescheduling

b) Additional loan

c) Frequently insisting the client

d) Others,(specify) _________________________

33. Do the measures bring an improvement in repayment?

a. Yes b) No

34. If your answer to Q 33 is "No", what measure are taken by the bank to enforce repayment (Hint: Check all answer that apply)

a. Foreclosure

b. Court proceedings

c. Others,(Specify) ______________________________

35. How do you evaluate the loan enforcement mechanism?

a) Effective b)Ineffective

36. If your answer to Q 32 is "Ineffective", what is/are the reason/s/ behind this?

(Hint: Check all answers that apply)

a. Buyers don't want to buy some one's property because of bank loan

b. Limited purchasing power of the society

c. High initial bid amounts

d. Others, (specify) ____________________________

37. Which one of the forcing measurements do you think most effective and convenience?

a) Foreclosure b) court preceding c) both

38. Would you please specify any problem/s/ of credit management that your institution faces so far apart from the above raised issues? _____________

39. Would you please specify the major credit problems you assume_________________

40. For the problem/s/ that you mentioned above, please list out all the possible and better solution/s/ that can improve the credit management system of your bank.

____

Thank you!

Appendix-D

Interview questions for Department and Branch Managers of the Bank

1. What is the basis up on which the bank depends on to pass credit decisions
2. How do you assess the creditworthiness of a loan applicant
3. Does your bank prefer collateral based lending? Why?
4. How do you see clean loan based lending or lending without collateral
5. If the bank has ever seized collateral, has it encountered difficulties?
6. What do you think the strengths and limitations of your bank?
7. What **do** you think should be done to overcome these limitations?
8. How do you evaluate your bank in the current stiff competition and what

   Policy and procedures, strategies are you realizing to be the best

Thank you!

Appendix-E

Summary of Loans and Advances by Branches as at April 2010.

Branches	Performing loans	Non-performing Loans	Total Loan Balance
Adigrat	9,804,583.39	617,007.78	10,421,591.17
Aduwa	11,135,380.98	868,074.26	12,003,455.24
Axum	15,632,762.35	1,603,067.20	17,235,869.55
Edaga Mekelle	12,812,506..29	437,786.96	13,250,293.25
Humera	26,365,925,.82	16,301,453.37	42,667,379.19
Mekelle	127,543,887.87	586,956.81	128,130,844.68
Shire	21,101,156.93	17,586.17	21,118,743.10