

ST. MARY'S UNIVERSITY
BUSINESS FACULTY
DEPARTMENT OF ACCOUNTING

**ASSESSMENT OF CREDIT MANAGEMENT POLICY AND
PRACTICE-THE CASE OF DASHEN BANK S.C**

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JUNE 2014
SMU
ADDIS ABABA

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**A SENIOR RESEARCH SUBMITTED
TO THE DEPARTMENT OF ACCOUNTING
BUSINESS FACULTY
ST. MARY'S UNIVERSITY**

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ACCOUNTING**

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Abstract

This paper attempts to examine the credit management in Dashen Bank S.C the paper attempts to research question, raised in statement of the problem and objective of the study. Thus, general objective of the paper is to present the elements of credit management in private commercial banks, like loan processing, loan granting, loan disbursement and loan recoveries are stated.

In conducting the study the student researchers used both primary sources and secondary sources from the bank where collected, analyzed, and interpreted using qualitative and descriptive method to present the findings ,Data collected from secondary sources are processed /tabulating and figures them.

Based on the findings conclusion were drawn and finally, recommendation was made that supposed to be important to solve the existing problems of credit management in Dashen Bank S.C.

CHAPTER ONE

1. Back ground of the study

1.1 Introduction

In the past revolution period, financial sector and institutions were nationalized and consolidated in to specialized Banks. At that period the country was followed the socialist economic system. Hence, all banks including National Bank of Ethiopia were thought to function as government to favor and promote to development and sustenance of the socialites sectors (cooperatives).

In the world of competition, the survival of any organization is directly dependent on the strategy how the firm maximizes profit and minimizes cost. Effective and efficient use of resources in general and finance in particular in any organization is paramount important for the improvement of productivity of the organization, for the country's economic growth and development The effect of good loans and advances process has contributed a lot to the growth of bank loans and has an effect in expanding itself in to the economy at large. Hence, a bank is concerned about the quality of its credit procedure and techniques. (Dashen Bank Training Material 2001, A.A)

Banks are mainly concerned with accepting deposits for the purpose of lending or investment. In any country's economy, there will be people and institutions with surplus funds which they do not require for their immediate use and wish to place these surplus funds in an institution both for security and also to gain some income by way of interest. This institution would then lend the money to the ultimate borrowers at an interest rate higher than what they pay to their depositors.(Leouleseged Teferi 2002, A.A)

The word credit is derived from the Latin word "creditum" which means believers or trust. In economics, "credit "refers to a promise by one party to pay another for money borrowed or goods or service received. (ML JhiNGan, 2002, New Delhi).

Another definition of credit is that it is originated from the Latin word " Credo " which means ' I believe' . Credit is a matter of faith in the person and no less than in the security offered. Credit is purchasing power not derived from income, but by financial institutions either as an offset to idle by depositors in the banks, or as net addition to the total amount of purchasing power. In fact, no economy can function without credit; all economic transactions are settled by means of credit

instruments today. It is the very life blood of modern business and commercial system. (G.D.H.Cole, 2000)

So Dashen Bank S.C is one of the private banks in Ethiopia playing an important role in country's economy and social life. Among the various services provided by the bank, lending has been the primary activity for a decade it advances large sum of money to borrowers. It is equally true that bank loans, as they are profitable, are equally risky. Bank loans fluctuate and are influenced by the changes in the economic policies and the economy in general. It is very important for the banks to formulate and update their loan polices in order to minimize risk associated with them.(Dashen Bank credit follow-up procedures, 2008).

This research focuses on the credit management policy and practice. What are the polices implemented by the bank related to loans, how Dashen Bank measure its loan practice to minimize credit risk and what is the contribution of Dashen Bank in the growth of country's economy regardless of the loan.

1.2 Background of the organization

Dashen bank is a privately owned company established in 1995 with a capital of 50,000,000.00 birr. In accordance with "licensing and supervision of banking business proclamation no. 84/1994 "of the National Bank of Ethiopia to undertake commercial banking activities. The bank obtained its license from National bank of Ethiopia on 20 September, 1995 and started normal business activities on the first of January 1996. Presently, the bank has the current paid up capital of ETB 737 million and 3,390 employees to operate through its head office in Addis Ababa and 108 area banks (branches) established within and outside of Addis Ababa out of which 16 Area Banks operating in the Bank's own building. Currently Dashen bank has 108 ATM machine and 780 merchant with POS throughout the country. (Dashen Bank 17th Annual report for the year 2013)

Dashen Bank provides different kind of commercial bank activities including consultancy service in the area of interest of customer.

- > To meet the needs of the emerging private sector for quality and dependable domestic and international banking services.

- > To expand and diversify commercial banking services in response to the growing demands of customers.
- > To contribute towards the economic and social development of the country and
- > To operate profitably in a sustainable manner.

Major activities

- > To mobilize all types of deposits (savings, demand , time, Hybrid Account, Saving plus Account, Modified Youth Saving, Interest plus bonus, Student Account and Current Account Protection Scheme) and pay interest on interest bearing accounts.
- > To provide loans and advances to its customers, including long-term investment/ project financing.
- > To render domestic and international money transfer services.
- > To provide international banking services such as:
 - Imports operations
 - Exports operations
 - handles foreign currency transactions, namely,
 - Buying and selling travelers' cheques.
 - Buying and selling foreign currency note.
- > Encashment of VISA and MASTER card.
- > Maintain and operating non-resident account.
- > To provide deposit services in foreign currency for Ethiopian nationals and foreign nationals of Ethiopian origin provides advice on banking finance and investment to its customers.

1.3 Statement of the problem

Bank credit can be defined as money provided by the banks for eligible customers to support execution of legally formed profitable business or investment activities that have economic importance, with an agreement to pay back the principal with interest within the period specified in the loan contract.

Dashen Bank is one of private banks in Ethiopia playing an important role in country's economy and social life. Among the various services provided by the bank, lending has been the primary activity for over a decade. It advances a large sum of its income to borrowers. It is equally true that bank loans, as they are profitable, equally risky. Bank loans fluctuate and influenced by the changes in the economic policy and the economy in general. It is very important for the banks to formulate and update their loan policies in order to minimize risk associated with them.

Loans are the most important resources held by banks. Lending activities require banks to make judgment related to the credit worthiness of a borrower. However, the judgments do not always prove to be accurate and the credit worthiness of a borrower may decline due to various factors. Consequently, banks face credit risks. Credit risk is the risk that obligations will not be repaid on time and fully as expected or contracted, resulting in a financial loss or non-performing loans. The borrower may fail to meet the terms of the underlining loan agreement so the major problems of Dashen bank are financial loss or non performing loan.

This research was investigating the credit approval procedure and credit management of Dashen Bank in order to find out:

- > Does the bank use appropriate credit policies and procedures?
- > What are the major causes of Nonperforming Loans?
- > What are the sequences of procedures for borrowers whose payments are overdue?
- > What effort is expected by credit department after disbursement of loan made?

1.4 Objective of the study

It is important to conduct critical assessment of the variable factors, which determine approval of credit mechanism and evaluation of acceptability of loan request presented using appropriate standards. The objective of the study is described as follows.

1.4.1 General Objective

To evaluate the bank's performance in terms of loan portfolio/status

1.4.2 Specific Objective

- > To examine the effort that the credit department of the bank extends to assure the repayment of loans.
- > To assess the procedures that the bank has used to reduce the amount of non-performing loans in the past.
- > To identify the problems associated with the non-performing loans (NPLS) in Dashen Bank.
- > To assess the problems associated with implementing policy manual of the bank.
- > To explore the essence of credit follow up and reviewing the follow up systems and timely settlement of loans.

1.4 Significance of the study

The student researcher's strongly believes that the proposed research was help to minimize the causes and problems associated with non-performing loans. In addition, it helps as a preliminary study for others who are more interested in this area. Thus the research was help to make the needed adjustment according to the recommendation raised by this study.

The result of this study:

- > Will enrich and update the knowledge of the reader on the loan and advance process of Dashen Bank and to see how the process they develop is used as a measure of their success.
- > Would help the officers and analysts to be aware of what is expected help the officers and analysts to be aware of what is expected from them as professional in managing the loan and advance process, which is a very important part the bank.
- > Provide the basis for planning and using efficient and see the loan and advance of the bank and its legal implications.
- > Would enable the concerned government body to see the loan and advance of the bank and its legal implications.

1.5 Scope of the study

The banking activity of Dashen Bank S.C. covers most areas of the country. There is no difference in credit management at head office and Branches. Therefore, the study is conducted on Head office.

1.6 Limitation of the study

During the preparation of this research study the students researcher was also investigate the personal files of individual borrowers are not possible. Since banks are profit making organization and most information are held secret, assessing information as needed might be a bit difficult. Therefore, the data collected is limited to the bank personnel.

1.7 Research Methodology

1.8.1 Research design

The student researchers have been conducted using descriptive research method. In conducting this study, both primary and secondary sources of data are used. The researchers are try to obtain information from primary sources through administering questionnaire and direct personal interview with concerned officials (i.e. credit Analysts, loan officers, loan clerk and other clerical staffs) of the bank.

1.8.2 Types of data collected

Bothe primary and secondary sources have been used throughout this research paper. The main inputs of primary sources are direct personal interviews and observations. As secondary source company manual, annual reports, various literature reviews and different loan files have been used.

1.8.3 Data Gathering Instrument

Firstly, the data has been collected by using structured questionnaire for the staff members. Secondly, the interview has been made with the manager of the bank.

1.8.4 Population and sample design

The student researcher's has used purposive sampling method based on this of 20 total populations.

1.8.4.1 Sampling Design

Since the target population on this study was employees of Dashen Bank S.C of Addis Ababa in head office. The student researchers used 15 samples from 20 employees has been selected to conduct an interview and questionnaire

1.8.6 Sample method

The sample design has been use in the research is purposive sampling method from loan department. Structured interview is held with staff members. The questioner methods are used to combine qualitative and quantitative data collection using structured questionnaires and few open-ended questions

1.8.7 Method Data Analysis

After the data required for the study are collected, charts and tables are used to present the data and statistically figures like percentages have been use for data presentation and analysis.

1.8 Organization of the study

This study has been organized in to four chapters. The first chapter deals with the problem and its approach. The second chapter focuses on the literature review followed by the third chapter data presentation and analysis. The last chapter presents the conclusion and recommendation part of the study.

Chapter Two

Literature Review

2.1 Introduction

The major activities of the banking industry, among other things, are to mobilize deposit and channel them to the economy in the form of loans. The latter is the core activity and also the primary source of income to commercial banks. It is obvious that loans and advances involve certain percentage of risk. The paradox is, despite the risk, commercial banks have to engage in lending activities. The ultimate logic here is how someone can minimize the risk of lending. (Mengistu G/Hiwot,2007)

2.2 Credit Risk

Banks are financial intermediaries. Bankers take money from depositors, who always expect to get their money back, and lend it to borrowers, who do not always pay it back. The risk of intermediating between depositors and borrowers is called credit risk. Credit risk handled properly is the largest single source of bank earnings. Credit risk handled improperly is the greatest single cause of bank failures. (Gregory L.Haslam, 2007).

Risk is possibility of loss or injury, the degree or probability of such loss. Credit risk is the risk that obligations will not be repaid on time and fully as expected or contracted, resulting in a financial loss or nonperforming loans, According to risk philosophy, risk is the potential that events, expected or unexpected may have an adverse impact on the bank's earning or capital.

According to NBE's Directive (No, SBB/32/2002)

2.3 Credit Risk Management

All organization are in the business of placing capital at risk pursuing ventures, which are uncertain in terms of producing income, and remain as well off at the end as they were at the beginning. They include financial institutions, government bodies, and other organizations. They

all have goals, and allocate resources to pursue them. Because all organizations face uncertainty in achieving their goals, they all face risks that are specific to that organization. Credit needs to be managed well because it is the major source of income and its repayment on time saves the problem of banks in meeting the demand of depositors .If loans are not repaid on time, the lending bank experiences certain risks and the loans will change their character and become non performing loans which mean unpaid for three consecutive repayment times.

Risk management is the process whereby an organization optimized the manner in which it takes risks. All organizations accumulate resources and invest them in activities that are uncertain in terms of their future outcomes. Credit needs to be managed well, because it is the major source of income and its repayment on time saves the problem of banks in meeting the demand of depositors.

For most banks, loan accounts are half or more of their total assets and about half to two-third of their revenue, Moreover, risk in banking tends to be concentrated in the loan portfolio when a bank gets serious financial trouble, its problems usually come from loans that have become uncollectible due to mismanagement, illegal manipulation of loan, misguided lending policies, or unexpected economic downturn.(Lazzare Potier's Neil Murphy,2002,)

2.4 What is Non-Performing Loan?

Loan is considered to be non-performing when principal or interest is due and unpaid for 90 days or more, (According to NBE's directive No.SBB/32/2002) explain non-performing loans as loans or advances whose credit quality has deteriorated, so that full collection of principal and/or interest in accordance with the contractual terms of the loan or advance is in question.

2.5 Loans and Advances

Loan-A lender granting temporary use of a sum of money to borrower, who must repay the money that, was borrowed over a fixed term, in addition to the interest on the loan or debt, that was incurred, defines loan. (SBB/43/2008)

There is a stated due date to the borrower by the lender to repay the money back to the borrower, but if the borrower failed to repay the stated money back, the lender charges late fee from those persons who do not return the money on the due date.

Advance - are credit facilities in the form of written promises and should not necessarily be given on physical money like loans. (SBB/43/2008)

Loans and Advances- are those financial assets arising from a direct lending or unplanned advances :(i.e., advance on L/C and over drawls). It includes accrued interests on performing loans. Commitments of any type (unutilized amount of O/D limit, un-disbursed loans and contingent assets) are not included. (Dashen Bank Credit policy and procedure manual 2013).

2.6 Credit Manager's Basic Function

- a. Assessment of credit standing of both new and existing customers.
- b. Establishment of terms, having regard to the risk involved and the potential profit.
- c. Maintenance of the sales ledger.
- d. monitoring and control of customer balances.
- e. Collection of payment as close to terms as possible without jeopardizing future business.

Banks have to manage different types of risk to earn profit for making shareholders wealth, according to Koch (1995) these are:

1. Credit risk
2. Liquidity risk
3. Interest risk
4. Operational risk
5. Capital or solvency risk

1. Credit Risk

Whenever a bank acquires an earning asset, it assumes the risk that borrower will default, that is repay the principal and interest of timely basis. Credit risk is the potential variation in net income a market value of equity resulting from this nonpayment or delayed payment. Different types of assets have different default probabilities. Loans typically exhibit the greatest risk.

2. Liquidity Risk

Liquidity risk is the variation in net income and market value of equity caused by a bank's difficulty in obtain cash at reasonable cost from either the sale of assets or new borrowing. Liquidity risk is greatest when a bank cannot anticipate new loan demand or deposit withdrawals and does not have access to new sources of cash.

3. Interest Rate risk

Interest rate risk refers to the potential variability in bank's interest income and market value of equity due to changes in the level of market interest rates. It encompasses the total composition and duration as well as potential changes in interest rates.

4. Operational Risk

Operational risk refers to the possibility that operating expenses might vary significantly from what is expected, producing a decline in net income and firm value. A bank's operating risk is those closely to its burden, number of divisions or subsidiaries, and number of employees. Because operating performance depends on the technology a bank uses, the success in controlling this risk depends on whether a banks system of delivering products and services is efficient and functional.

5. Capital or Solvency Risk

Capital risk represents the possibility that a bank may become insolvent. A firm is technically insolvent when it has negative net worth or shareholders equity. The economic net worth of a firm is the difference between the market value of its assets and liabilities. Thus capital risk refers to the potential decrease in net asset value before economic growth is zero. Capital risk is closely associated with financial leverage, which refers to the use of debt and preferred stock that fixed rates as part of a firm's structure.

2.4. Credit Analysis

Credit analyses refer to the process of deciding whether or not to extend credit to a particular customer. It usually involves two steps; gathering relevant information and determining credit worthiness. (Ross ET. Al 1998)

Once a customer requests a loan, bank officers analyze all available information to determine whether the loan meets the banks 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. (koch, 1995)

Many authors states in their book that the principal factors which may be taken in to consideration which extending or using credit. Among these authors are (pandey, 1990and Koch, 1995). These two authors have different number of credit evaluation, i.e pandey (1990) states three C's of credit, i.e., character, capacity, capital and sometimes also condition is added. But, Koch (1995) mentions five Cs credit: character, capital, capacity, condition and collateral.

The terms character here means the credit character which consists of those qualities of an individual which make him conscious about his debt. These characters may include borrowers' moral qualities such as honesty, integrity, sense of responsibility and trustworthiness. If a person's credit profile reveals that he has been borrowing the loan and also timely repaying the debt then he process ideal credit character and vise-versa. It is quite possible that an individual may posses ideal character in usual sense but may rank low on credit character or vise-versa. Character is one of the basic corner stone in assessing risk bearing ability. A man of high credit character can withstands foreseen events and may save himself from becoming insolvent.

Undoubtedly, character has also bearing on returns and repayment capacity, i.e. a man of high credit character is also quite often outstanding in his business affairs.

The term capacity signifies the ability to pay his debt whenever it becomes due; capacity is a function of income rather than savings, since payments usually depend up on income.

However, income alone doesn't indicate capacity.

Finally, collateral is the lender's secondary source of Repayment or security in the case of default. Having an asset that the bank can seize and liquidate when a borrower defaults reduces loss, but it does not justify lending proceeds when the credit decision is originally made.

Koch (1995, P636) identify the five C's of bad to help prevent a problems. These include:

1. Complacency
2. Carelessness
3. Communication breakdown
4. Contingencies and
5. Competition

1. Complacency

If 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 overreliance on guarantors, reported net worth, or past loan repayment success because it is always worked out in the past.

2. Carelessness

It involves poor underwriting. Typically evidenced by inadequate loan documentation, a lack of current financial information or other pertinent information in the credit files and lack of protective to monitor a borrower's progress and identify problems before they are unmanageable.

3. Communication breakdown

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

4. Contingencies

Refers to lender's tendency to play down or ignore circumstances in which a loan might default. The focus is on trying to make a deal work rather than identifying down side risk.

5. Competition

Involves following competitors' behavior rather than maintain the bank's own credit standards, just because the bank down street is doing something does not mean it is good.

The formal credit analysis procedures included a subjective evaluation of the borrower's request and a detailed review of all financial statements. The initial quantitative analysis may be performed by credit department employees for the loan officer.

The process consists of the following.

1. Collecting information for the credit file
2. Spreading financial statements
3. Projecting the borrower's cash flow
4. Evaluating collateral
5. Writing a summary analysis and making a recommendation

Many small banks do not have formal credit departments or full-time analysis to prepare financial histories. Loan officers personally complete the steps outlined above before accepting or rejecting a loan. Often loan requests are received without detailed information on the borrower's condition. Financial statements may be hand written or unaudited and may not meet Generally Accepted Accountings principles the borrower may possess good character and substantial net worth. In such instances, the loan officer works with the borrower to prepare a formal loan request and obtain the best financial information possible. This may mean personally auditing the borrower's receipts, expenditures, receivables, and inventory.

Sometimes, five P's of credit are also linked with these credit principles. (Pandey, 1990) These P's pertain to: purpose, person, productivity-planning or projections, payment of installment or repayment and protection security.

All these characters, in fact, determine the soundness of credit. i.e., generating adequate income relates to purpose and productivity planning scheme or projections). Repaying the same whenever falls due (payment of installment or repayment) and maintain risk bearing ability (person and protection-security).

Borrower study and status reports

The study of a borrower is a study of his character, capacity, capital condition and collateral as stated before. In order to get a complete of the borrower's credit worthiness, enquires will have to be made about his business, trade experience, assets and liabilities, etc from various sources (Bedi and Hardikar, 1993). His account with the bank or other banks will throw light on his personal habits and business dealings. His financial statements and income tax returns will have to be seen. Probably an interview with him will be necessary to elucidate or supplement the information that may have been collected there are hardly any credit agencies in India which assist banks by giving reports. Even a report on a borrower obtained through banks in India is usually of a practical use. It would appear that banks could be in a better position to serve the business community and themselves, if they evolve a system by which detailed credit reports on customers are communicated to each other.

Status reports on borrowers are sometimes called credit reports, financial reports, banker's condition or confidential reports. All these terms carry more or less the same meaning. A status report is an assessment of the borrower's character capacity, capital, condition and collateral from the point of view of banker.

Banks get information on borrowers through various sources enumerated below:

- a) Loan application
- b) Bazaar reports through friends or rivals mostly from the borrower's trade or business.
- c) Mode of living
- d) Borrower's amount with bank or statements of account with other banks
- e) Statements of assets and liabilities. In the case of companies, their balance sheet and profit and loss accounts for, say three years, records of the registrar of companies, etc
- f) Personal contact including personal interview

Some of the above sources are discussed below.

Loan application

Some banks require borrowers to fill in answers to detailed questionnaire. The customers have to state the name of their concern, its constitution, the year when established, place of business, names of bankers with details of assets owned and particulars of charges there on. They must also state in the source as well as the terms of repayment. They have to specifically mention the nature and particulars of the security offered, if any. They have, moreover, to give their existing liabilities. Such an application gives the banker as a starting point to proceed with the work of making relative inquiries. It may sometimes not be practicable to institution such detailed information from a highly respectable client. In such a case, the information will have to be obtained through a personal interview or other resources.

Financial statements

The borrower should be requested supply the latest statements, preferably of his liabilities and assets. It will be very helpful to a banker if two or three previous statements are available, a copy of his income tax return will be helpful in enabling the bank to know the details of his net income. It will be then possible to trace from the returns the capital resources of the borrower. His wealth-tax statements will similarly enable a bank to form an estimate, of his assets; his tax-sales return will indicate the figures of his sales. In the case of limited companies, the audited balance sheet and profit and loss accounts for the last three years should be looked into.

Other sources

Other sources of information about the borrower include press report regarding purchase and sale of property, auctions and decrees Registration, revenue and municipal records can also be referred to with advantage to verify the properties owned by the limited company, a search of the records of the registrar of companies should be made for finding out if there are any prior charges or mortgage on the company's assets.

Personal interview

In addition to the information collected from outside sources, it is advisable and perhaps profitable to arrange for a personal interview with the borrower. An experienced banker armed with the reports he already has with him, can gather information on various points through an interview and should thereby be in a position to assess the five C's of the prospective borrower. A personal interview is one of the most important duties of banker and this responsibility should no case be delegated to an experienced officer.

An interview with the borrower may be held in the bank's office or outside, say in a club where the borrower may be invited, or even at the borrower's place. It may be formal with previous appointment or may be arranged through a common friend.

Points covered in an interview

The main points that will be covered in an interview with the borrower are:

- i. His business
- ii. His capital, with particular reference to his working capital
- iii. His experience in the line
- iv. Working results
- v. Amounts of the advance and period
- vi. Purpose of the advance
- vii. Source of repayment
- viii. Terms of repayment
- ix. Security offered
- x. Type of charge available

Test of successful interview

According to Bedi and Hardikar (1993) as borrower's is essentially a study in human nature, the test of a successful interview is the cordiality, pleasantness and the frankness with it is carried,

Even if the interview does not lead to an acceptable business proposal, it is essential that the customer leaves with the most favorable impression regarding the banker whom he should always be entitled to consider his friend and guide. The entire study should be completed as far as possible in a single interview, so that the customer should not have to be invited occasionally to see the banker.

After the interview

After the interview is over, the banker should, if necessary, obtain further reports on the part from different sources. He should carefully assess the data and form a balanced opinion regarding the acceptability or other size of the proposal. The main point to be emphasized is that if after careful consideration, the banker comes to the conclusion that the business could not be proceeded with, he should not leave the customer in doubt. He should communicate the refusal to the borrower in a polite and tactful manner as early as possible. If he can help the customer by making any counter-suggestion or amendment of the terms of business, such as reduction in the amount of the advance requested, additional security or higher margin, he should not hesitate to do so.

Subsequent interviews

Bedi and Hardikar (1993) indicated in their book there are some general principles of good lending which a banker should follow when appraising a credit request. They include safety, liquidity, purpose, profitability, security, spread and national interest, suitability, etc.

“Safety first” is the most important principle of good lending. When a banker lends, he must feel certain that the borrower is safe; that is, the money will definitely come back. If, for example, the borrower invests the money in an unproductive or speculative venture, or if the borrower himself is dishonest, the advance would be in jeopardy. Similarly, if the borrower suffers losses in his business due to his incompetence, the recovery of the money may become difficult. The banker ensures that money advanced by him goes to the right type of borrower and is utilized in such a way that it will not only be safe at the time of lending but will remain so throughout, and after serving a useful purpose in the trade or industry where it is employed, is repaid with interest.

Liquidity

It is not enough that the money will come back; it is also necessary that it must come back; on demand or in accordance with agreed terms of repayment. The borrower must be in a position to repay within a reasonable time after a demand for repayment is made. This can be possible only if the money is employed by the borrower for short term requirements and not locked up in acquiring fixed assets, or in schemes which take a long time to pay their way. The source of repayment must also be definite. The reason why bankers attach as much importance to 'liquidity' as to 'safety' of their funds is that a bulk of their deposits is repayable on demand or at short notice. If the banker lends a large portion of his funds to borrowers from whom repayment would be coming in but slowly, the ability of the banker to meet the demands made on him would be seriously affected in spite of the safety of the advances.

Purpose

The purpose should be productive so that the money not only remains safe but also provides a definite source of repayment. The purpose should also be short-termed so that it insures liquidity. Banks discourage advances for hoarding stocks or for speculative activities. There are obvious risks involved in advances for hoarding stocks or for speculative activities. There are obvious risks involved there in a part form the anti-social nature of such transactions. The banker must closely scrutinize the purpose of which the money is required and ensure, as far as he can that the money borrowed for a particular purpose is applied by the borrower accordingly purpose has assumed a special significance in the present day concept of banking.

Profitability

Equally important is the principles of profitability in bank advances. Like other commercial institutions, Banks must make profits firstly. Then have to pay interest on the deposits received by them. They have to incur expenses on establishment, rent, stationery etc. they have to make provision for depreciation of their fixed assets and also for any possible bad or doubtful debts. After meeting all these items of expenditure which enter the running cost of banks, a reasonable profit must be made; otherwise, it will not be possible to carry anything to the reserve or pay

Dividend to the shareholders, It is after considering all these factors that a bank decides upon its lending rate. It is sometimes possible that a particular transaction may not appear profitable in itself, but there may be some ancillary business available, such as deposits from the borrower's other concerns or his foreign exchange business, which may be highly remunerative.

Security

It has been the practice of banks not to lend as far as possible except against security. Security is considered as insurance or a cushion to fall back upon in case of an emergency. The banker carefully scrutinizes all the different aspects of an advance before granting it. At the same time, he provides for an unexpected change in circumstance which may affect the safety and liquidity of the advance. It is only to provide against such contingencies that he takes security so that he may realize it and reimburse himself if the well-calculated and almost certain source of repayment unexpectedly fails. It is incorrect to consider an advance proposal from the point of view of security alone. An advance is granted by a good banker on its own merits, that is to say, with due regard to its safety, likely purpose etc, and after looking into the character, capacity and capital, of the borrower and only because the security is good.

Spread

Another important principle of good lending is the diversification of advances. An element of risk is always present in every advance, however, secure it might appear to be. In fact, the entire banking business is one of taking calculated risks and a successful banker is an expert in assessing such risks. He is keen on spreading the risks involved in lending, over a large number of borrowers, over a large number of industries and areas, and over different types of securities. For example, if he has advanced too large a proportion of his funds against only one type of security, he will run a big risk if that class of security steeply depreciates. If the bank has numerous branches spread over the country, it gets a wide assortment of securities against the advances. In the sugar and cotton growing the advance will be against these two highly marketable commodities.

National interest, suitability

Even when an advance satisfies all the aforesaid principles, it may still not be suitable. The advance may run counter to national interest. The reserve Bank of India may have issued a direction prohibiting banks to allow the particular type of advance. The law and order situation at the place where the borrower carries on his business may not be satisfactory. There may be other reasons of a like nature for which it may not be suitable for the bank to grant the advance

Koch (1995) expressed that sound credit culture requires comprehensive and coherent written credit policies and no condoning of habitual disparities between policy and practice. In the regard, Koch as documented elements of a strong credit culture that encourages management to maintain asset quality as follows.

Exhibit 2.1: twenty essentials of good banking fostered by a strong credit culture.

1. Commitment to excellence
2. Philosophical framework for day to day decision making
3. Sound value system that will cope with change
4. Uniform approach to risk-taking that provides stability and consistence.
5. Development of a common credit language
6. Historical perspective the bank's credit experience
7. Bank comes first and a head of every profit center
8. Candor and good communication at all levels
9. Awareness of every transaction's effect on the bank
10. A portfolio with integrity and an appreciation of what properly belongs in it
11. Accountability for decisions and actions
12. Long-term vies as well as short-term view
13. Respect for credit basics
14. Reconciliation of market practice with common sense
15. Use of independent judgment and not the herd instinct
16. Constant mindfulness of the bank's-taking parameters
17. Realistic approach to markets and budgeting

18. An understanding of what the bank expects and the reasons behind its policies credit system with early warning capabilities
19. Appreciation that in risk-taking there are not surprises, only ignorance
20. Appreciation that in risk-taking there are not surprises, only ignorance

Source: Koch, T.W. (1995). Bank Management, P.634)

2.5 The credit process

The fundamental objectives of commercial and consumer lending is to make profitable loans with minimum risk. The credit process relies on each bank's system and controls to allow management and credit officers to evaluate risk and return trade-offs (Koch, 1995)

The credit process includes three functions:

1. Business development and credit analysis
2. Credit execution and administration and
3. Credit review.

Each reflects the bank's written loan policy as determined by the board of directors. A loan policy formalizes lending guidelines. It identifies preferred loan qualities and establishes procedures for granting, documenting and review loans.

1. Business development and credit analysis

Where would a bank be without customers? Business development is the process of making bank services to existing and potential customers. With lending, it involves identifying new credit customers and soliciting their banking business, as well as maintains relationships with current customers and cross-selling non-credit services. Every bank employee, from tellers handling drive up facilities to members of board of 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 houses or other incentive plans to reward employees who successfully cross-sell services or bring new business in to a bank.

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 loan 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. Typically, each lending officer has independent authority to approve loans up to some fixed dollar than\$ 100,000, while senior lending officers might independently approve loans up to \$500,000. Larger loans are often formally reviewed by a committee made up of the bank's senior loan officers. This committee reviews each step of analysts, and makes a collective decision Loan committees meet regularly to monitor the credit approval process and discuss asset quality problem's loan committee reviews decision and grants final approval.

Once a loan has been approved, the officer notifies the borrower and prepares a loan agreement. These agreements formalize the purpose of the loan, the terms, repayment schedule, collateral required, and any loan covenants. It also states whit conditions will constitute a default by the borrower; these conditions may include late principal and interest repayments, the sale of substantial assets, a declaration of bankruptcy, and breaking any restrictive loan covenant. The officer then check that all loan documentation is present and in order. The borrower sings the agreement along with other guarantors, runs over collateral if necessary, and receives the loan proceeds.

Documentation

A critical feature of executing any loan involves perfecting the bank's security interest in collateral. A security interest is the legal claim on property that secures payment on debt or performance on an obligation. When the bank's claim is superior to that of other creditors and the borrower its security interest is said to be perfected

Because there are many different types of borrowers and collateral, there are different methods of perfecting a security interest. Inmost cases, the bank requires borrowers to sing security agreement that assigns qualifying collateral to the bank. This agreement describes the collateral

and relevant covenants or warranties. Formal closure may involve getting the signature of the third-party guarantor on loan agreement of having a key individual assign the cash value of a life insurance policy to the bank. In other cases, a bank may need to obtain title to equipment or vehicles. Whenever a security agreement is signed by all parties and the bank holds the collateral, the bank must file a financing statement with the state that describes the collateral and the right of the bank and borrower. They establish the bank's superior interest, this statement must be signed.

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 risk 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 (Koch P.639). Many banks have a formal loan review committee, independent of calling officers that report directly to chief executive officer and directors' loan committee. Loan review personnel audit current loans to verify that the borrower's financial condition is acceptable, loan documentation is in place, and pricing meets return objectives.

2.6 Classification of credit (loan)

Panedeey (1990) states that credit can be classified on the basis of time, purpose, security lender and borrower.

2.6.1 Time classification

It classifies the credit into three groups, i.e., short-term, medium-term and long-term.

2.6.1.1 Short-term loans

These are generally advanced for meeting annual recurring purchases such as, seed, feed, fertilizers, hired labor expenses, pesticides, weedicides, hired machinery charges, etc, generally termed as seasonal loans, (crop loans) or production loans. It is expected that the loan plus interest would be repaid from the income received through the enterprise in which it was invested. The usual time limit to repay such loans is a year or at most 18 months.

2.6.1.2 Medium - term loans

It is advanced for comparatively longer lived assets such as machinery diesel engine, wells irrigation structure, threshers, shelters, crushers, draught and milk animals, dairy sheds, poultry sheds, etc. where the returns accruing from increase in farm assets is spread over more than one production period. The usual repayment period for such type of loan is from fifteen months to five years.

2.6.1.3 Long - term loans

The long life assets such as, heavy machinery, land and land reclamation, erecting of farm building, construction of a permanent drainage or irrigation system etc, require large sums of money for initial investment. The benefits generated through such assets are spread over the entire life of the asset. It would be normally very difficult to accumulate funds sufficiently to repay the initial loan plus interest from income generated through such assets in less than five years. The normal repayment period for these loans, therefore, ranges from five to fifteen years or in a few cases even up to 20 years.

2.6.2 Purpose Classification

Credit is also classified according to the purpose of loan such as, crop loan, forestry, fisher, piggery loan, poultry loan, irrigation loan, machinery and equipment loan, etc these loans signify the close relationship between time and use on the hand rate of return (or profitability) on the other. Sometimes, loans are also classified as production and consumption purposes more particularly by the weaker sections. Consequently, the banks have also started financing for consumption purposes (exclusively for home consumption expenditure) besides financing for the production purposes. It is expected that once from the purpose and returns would be enhanced. The consumption loans are also repaid from the sale proceeds of the crop.

The purpose classification can facilitate the profitability of a specific loan, if proper records on incomes and expenses are kept. It also provides information about the distinction of different type credit use which significantly influences the repayment capacity of the farmer.

2.6.3 Security Classification

The security offered / obtained provides another basis for classifying the loans. The secured loans are advanced as against the security of some tangible personal property such as land, livestock and other capital asset, i.e. medium and long term loans. The borrower's credit worthiness may act much more than the security offered, which if doubtful may result in willful default in spite of collateral security. Moreover, the secured loans are further classified on the basis of type of security, example, mortgage loans for tangible property such as, machinery and equipments. The private money lenders in developing countries usually possess items such as gold ornaments or jewelry of the borrowers as a security, which remains the borrower about his obligation of loans repayments. On the contrary, unsecured loans are generally advanced without offering any security example, short-term crop loans.

2.6.4 Lender Classification

Credit is also classified on the basis of lender such as:

- a) Institutional credit, example, co-operative loans, commercial bank loans and government loans
- b) Non-institutional credit, example, professional and agricultural money lenders, traders and commission agents, relatives and friends, etc.

2.6.5 Borrower classification

The credit also classified on the basis of type of borrowers (i.e. production or business activity as well as size of business activity as well as size of business) such as, crop farmers, dairy farmers, poultry farmers, fisherman rural artisans, etc or agricultural laborers, marginal farmers, small farmers, medium farmers, large farmers, hill farmers or tribal farmers, etc such classification has equity consideration

Koch (1995) also indicated in his book different types of loans. These include:

1. Commercial loans
2. Real estate loans
3. Agriculture loans and
4. Consumer loans

1. Commercial loans

There are as many types of commercial loans as there are business borrowers/ banks lend large amount to manufacturing companies. Services companies, farmers and securities dealers, as well as others financial institutions. Because of many commercial loans and finance current assets. The commercial loans can be classified for working capital requirements seasonal versus permanent working capital needs, short-term commercial loans, seasonal working capital loans, open credit lines asset based loans, term commercial loans and revolving credit.

2. Real estate loans

Real estate loans can be highly speculative; however, if banks lend against properties that do not generate predictable cash flows. Real estate can be classified as: short - term real estate and long - term real estate loans.

3. Agricultural loans

Agricultural loans are similar to commercial and industrial loans in that short-term credit finances seasonal operating expenses, in this case those associated with planting and harvesting crops. Long- term credit finance livestock, equipment and land purchases. The fundamental source of repayment is cash flow from the sale of livestock and harvested crops in excess of operating expenses.

4. Consumer loans

Non mortgage consumer loans differ substantially from commercial loans. Their usual purpose is to finance the purchase of durable goods, although many individuals borrow to finance education, medical care, and other expenses. The average loan to each borrower is relatively small. Most loans have maturities from 1 to 4 years, are repaid in installment, and carry fixed interest rates.

2.7 Recoveries of advances

Bedi and Hardikar (1993) indicated in their in what form bank advances are, granted, they are repayable on demand or at the expiry of some fixed period. Bills of exchange discounted are repayable. On demand, although the bank seldom exercises the right except in circumstances mentioned below. Loans are repayable on the expiry of the periods for which they are granted. In case4 the loan is repayable on the expiry of the periods for which they are granted. In case4 the loan is repayable on the expiry of the periods for which they are granted. In case the loan is repayable in installments and default occurs on the payment of any installment, the entire loan usually becomes immediately recoverable at the option of the bank.

Notice

If the advances in on a pledge basis, the notice should state that in case the advance is not fully finally adjusted within, say, a fortnight, the pledged would be sold by private sale or public auction at the discretion of the bank and the net sale proceeds would be applied in repayment of the advance with interest. The notice should also state that the borrower as well as the guarantor, if any, would be liable for any balance that might remain due, after the security has been sold. If it is unsecured advance, the borrower and the grantor, if any, should be threatened with a suit after the period mentioned in the notice has expired.

Goods under pledge

If the account is by way pledge and the pledge makes default in payment of the debt, the bank as a pledge has two alternatives. It may bring a suit against the borrower up on the dept and retain the goods pledged as a collateral security or it may sell the goods pledged after giving the borrower a reasonable notice of the sale. No bank would ordinarily exercise the firs right unless the security has become unsalable. This position may arise only in every rare case. If the security has to be ultimately disposed of, it is always expedient to do as quickly as possible, preferably with the consent and cooperation of the borrower. The person best suited to assist the bank in the sales of the pledged goods is the debtor himself, whose business is to deal in them. Care should

However, be taken that the borrower does not enter in to conclusive transactions fro his own benefit (Bedi an Hardikar, 1993).

Mortgages

In both types of moorage simple and equitable a suit will have to be filed against the mortgagor to enforce recovery and sell the mortgaged property. A preliminary decree is passed by the court against the mortgagor in the first instance giving him time to redeem the mortgaged property. If the mortgagor (judgment debtor) fails to pay the dues to the mortgagee (decree-holder) with in the stipulated time, a suit may have to be filed, after carefully assessing the chance or recovery of the debt.

2.8 Collection Effort of the Loan

According to Ross et al., (1998) a firm usually goes though the following sequence of procedures for customers whose payments are overdue:

- 1) It sends out a delinquency letter information the customer of the past-due status of the account
- 2) It makes a telephone call to the customer
- 3) It employs a collection agency
- 4) It takes legal action against the customer

At times, a firm may refuse to grant additional credit to customers until arrearages are cleared up. This may antagonize a normally good customer, which points to a potential conflict of interest between the collections department and sales and department and sales departments (Ross et.al., 1998)

CHAPTER THREE

Data Presentation & Analysis

Introduction

The primary objective of commercial banks like any other business institution is to grow and survive. This can mainly be achieved by making profit. In the case of banks, profit is a function of both the volume and the quality of loan, among others; good quality of credit can only be considered as a good source of profit. The effect of poor quality loans is not limited to that of affecting the profit of one particular bank but has an effect that extends itself in to the economy at large. Hence, prudent bank is concerned about the quality of their loans. This study is concerned with the Credit Management and Practice of Dashen Bank s.c.

In this Chapter, the student researcher's used both primary & secondary data sources. The primary data was collected through questionnaire, interview and researcher's observations. The secondary data collected from different literatures, manuals and reports of the bank.

From a target population of 20 staffs, questionnaires were distributed to 15 staffs of the bank judgmentally, all (100%) had completed and returned. So the following analysis and discussions are done on the collected data from the questionnaires. The purpose of this section is to assess the credit practices and management of the bank. The major findings from the responded questionnaire are compared and presented here under by respective questions.

Analysis of responses given by the lone Department start

Table 3.1

Background of Respondents

Item	Responses	Number of start	Percentage
Level of education	Diploma	-	-
	1 st Degree	14	93.3
	Above 1 st Degree	1	6.7
	Other	-	-
	Total	15	100%
Your status	Top management	-	-
	Senior management	-	-
	Middle Management	2	13.3
	Line Management	9	60
	Other clerical	4	26.7
	Non clerical	-	-
	Total	15	100%
Work experience	Below five years	8	53.33
	5-10 Years	5	33.33
	Above 10 years	2	13.33
	Total	15	100%

Source of Data: - Collected through the Questionnaire

The staff educational level is very attractive as 100% of them have either BA Degree or above these shows that the Banks has qualified staff members.

The Branches having a good loan portfolio has a credit Structure as head office manager, Deputy Manager, Division head, loan section head, three or four loan officers and one loan clerk, all are responsible for Credit Duties as per their Authority. As shown on the same table (53.33%) of the respondents have less

than 5 years work Experience, and (33.33%) have between 5-10 years and the rest of (13.33%) have above ten years work experience.

Table 3.2 Loan Application Processing?

How long will it take to process a given loan application?	Reponses	
	Number	Percentage
Below 7 days	5	33.3
8-14 days	6	40
15-21 days	-	-
22-28/30 days	4	26.7
Above one month	-	-
Total	15	100%

Source of Data: - Collected through the Q uestionnaire

As per the above table 40%, of the respondents replied that within 8-14 days a given loan application can be processed and finalized, while 33.3% of respondents said that loan application can be processed below 7 days, but 26.7% of them agreed as 8-14 days. In addition the respondents also mentioned that depending on the nature and merit of the loan, the processing

Period will vary.

Table 3. 3 Granted taking collaterals?

Are there loans, which are granted without taking collaterals?		
	Number	Percentage
Yes	11	73.3
No	4	26.7
Total	15	100%

Source of Data: - Collected through Questionnaire

Table 3.3 shows, 4 respondents, which are 26.7% of the sample size have viewed that loans granted without taking collateral that is granted to prominent customer on clean basis (a loan with out or partial collateral). On the other hand, 11 respondents, which are 73.3% of the respondents, replied that there is a consideration of collateral before extending the loan.

Table3. 4 Approval by the bank is satisfactory?

	Do you believe the procedure followed for loan approval by the bank is satisfactory?	Respondents	
		No.	%
	Yes	15	100
	No	-	-
	Total	15	100

Source of Data; - Collected by Questionnaire

From Table 3.4, there is a clear indication that 100% of the respondents largely viewed that they are satisfied with the procedure followed for loan approval by the bank which is mentioned in the literature review.

Table 3.5 Implementing policy manual banks as desired?

Are there problems as associated with implementing policy manual of the bank as desired?	Reponses	
	Number	Percentage
Yes	5	33.4%
No	10	66.6 %
Total	15	100%

Source: - Collected through Questionnaire

Table3. 5 indicates 66.6% of the respondents for question replied that there are no problems associated with the policy manuals, but 33.4% said that there is some problem associated with it.

The following are the factors and reasons behind the respondents.

- > The reason for the factor is the policy manual is set as per the rules & regulations set by the controller Bank or Ethiopia, i.e. National Bank of Ethiopia (NBE). So the Bank connect Implement the policy as desired.
- > Misinterpretation of the manual Deliberate violation some time the manual gets abused by the management the manual fails to address newly Emerged problems due to lack of continuous update.

The Engineering Department Estimation is net practical by other Bank and there is a challenge for implementation because of under estimation of collateral.

Table3. 6 Detailed financial Analysis before extending the loan?

Does the bank assess borrowers past financial history? Credit worthiness and perform detailed financial analysis before extending the loans?	Reponses	
	Number	Percentage
Yes definitely	4	26.7
Yes to some extent	10	66.6
Not at all	-	-
I am not quite aware of it	1	6.7
Total	15	100%

Source Data; - collected through Questionnaire

Table 3 .6 indicate 4 (26.7%) of the respondents replied that ‘yes definitely’ for the question the bank assess borrowers past financial history, Credit worthiness and perform detailed financial analysis before extending the loans 10 (66.6%) and 1(6.7%) of the respondent answers that ‘yes to some extent’ and not quite aware of it respectively.

Distributions of Loans by Sectors

Table 3.7 Loan and advance in which sector usually focus?

	Response	Rank
From the loans and advances granted to the Customer in which sector dose the bank usually focus?	Domestic trade & service	1 st
	Manufacturing	2 nd
	Building & construction	3 ^d
	Export	4 th
	Import	5 th
	Transportation	6 th
	Agricultural sector	7 th

Source of data: - Collected through Questionnaire.

All of the respondents respond that, from the total loans and advances granted of the customers, Domestic Trade and Services sector is usually the bank focused and followed by Manufacturing, Building and Construction, Export, Import, transportation and Agricultural Sector. From the above observation we can conclude that the bank emphasized on Domestic Trade and Service due to business viability and high demand on the sector.

The following are the factors and reasons behind the respondents

- > Most of the customer request fall under this sector because of the capacity and overall Level of economy this category.
- > You cannot give exact justification on the matter as things Depends on External and internal factors for the purpose of ranking OTS, MFG, Trans Build and construction, import & Export.
- > Because the sector has un interpreted Demand or not seasonal as far as it provides consumable goods
- > The shares are given to each sector based on their Demand past credit history.

Table 3.8 Techniques and procedure designed & implemented by the bank?

Responses		
Is there any credit follow up techniques and procedure designed & implemented by the bank?	Number	Percentage
Yes	15	100%
No	-	-
Total	15	100%

Source of Data: - Collected through Questionnaire

Table 3.8 indicates that 100% of respondents replied that there is credit follow up techniques and procedures designed and implemented by the bank.

The following are the factors and reasons behind the responds answer “yes “

- After loan is booked and have explicitly loan policies and ongoing risk analysis processing and monitoring employ to entertain a minimum risk by using the guiding procedures.
- Programmed visits to the work place of borrow.
- It is a project loan, periodical visit to check.
- Whether according to the action plan and the loon to the intended purpose or not.
- Following the disbursement of loan area bank credit officers and the man contract argument or not and take further action.
- At the sometimes the head office credit manager and credit follow up section work together.

Table 3.9 The Follow up mechanism of your Customer after granting the loan?

Do you have any follow up mechanism of your customer after granting the loan	Number	Percentage
Yes	12	80%
No	3	20%
Total	15	100%

Source Data;-collected through Questionnaire

As per the above table 80% of the Employees respondent Reply that saying yes' Regarding the follow up mechanism of your Customer after grating the lean and the Rest of 20% Of them are saying 'NO' is Regarding to follow up Mechanism of your customer after granting the loan.

Table 3.9.1 The follow up mechanism of your customers after granting loan?

Item	Response	Rank	
		Number	Percentage
What often the follow up mechanisms of your customer after granting the loan?	Monthly	9	60%
	Quarterly	1	6.67
	Semi annually	-	-
	Annually	-	-
	Suddenly	1	6.67
	Others	1	6.67
	Total	12	

Data collected through Questionnaires

As per above table the follow up mechanism your customer after granting the loan, 60% of the respondent are monthly and the rest of them 6.67% Respondent are quarterly 6.67% are suddenly 6.67% and are others.

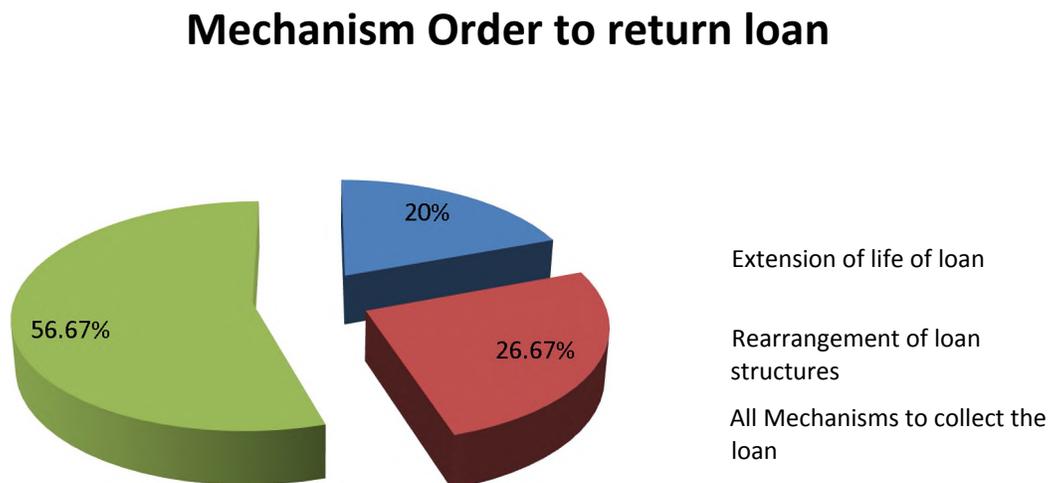
The following are the factors and reasons behind the respondents

-Reporters regarding the loans are prepared by the Area Bank monthly. These reports are also viewed by status at the loans are determined by the head office credit follow up section and reports are prepared for the higher officials and to the control department monthly.

- We could not be certain that all granted loans will be 100% sure to be collected so we will start following the loon status or the customers from the very beginning.

Some Mechanisms of Preventing NPLS

Chart 3.10 Mechanisms of Preventing NPLS?



Source of Data;- through Questionnaire

Chart 3.10 indicates that 56.67% of the respondents replied that the bank used all mechanisms in order to collect the loan, but 26.67% of the respondents said that repayment of loan structure

as a major mechanism. Some of the respondents mention that other mechanism such as taking legal action and sale of mortgage properties as last resort. In addition as per the interview conducted for question no 4, regarding the preventive measure Dashen Bank has taken an action to control or minimize the banks non performing loan in the past, and also they suggested that setting corporate targets to reduce NPLs to a single digit number, encouraging and closely following up each organ towards materialization of the target, undertaking follow up through visits and consultation, evaluation of the quality of the credit process as well as compliance with the Bank’s policy and applying proper work out loan practice has done as a measure to minimize NPL in the past.

Table 3.11 Provision NLP sufficient In relation to its respondent?

Do you think the level of provision for NPL held by Dashen Bank is sufficient In relation to its NPL?	Number	Percentage
Yes	15	100%
No	-	-

Source of Data collected through Questionnaires

According to Table3. 11 100% of the respondents said that the bank holds sufficient provision for NPLs as per the directive of NBE which is always inspected by its external auditors and the regulatory organ (NBE).

The provision is made in proportion to the amount of NLP Provision held by Dashen Bank is sufficient because the amount of provision considered not only these for NPL rather for pass and special men status also.

Table 3.12 Causes of nonperforming loan at borrower level ?

Item	Response	Rank
What are the major causes of nonperforming loan at Borrower level?	Diversion of the Borrower fund to other purpose	1 st
	Lack of proper businesses plan	2 nd
	Willful default/ unwillingness to pay	3 rd
	Contingencies at borrower of death sick	4 th
	In sufficient credit awareness	5 th
	Unwilling customer to Disclose the information required	6 th

Sources of data;-collected through Questionnaire

Graph 3.12 indicates, 75% of the respondents, replied that due to diversion of the borrowed fund to other than initially intended purposes stands 1st, while as per 20% of the respondents believe that lack of proper business plan takes the 2nd place. Besides, this some customers intentionally will not pay their loan and this holds the lowest percentages which is 5% stands at 3rd place.

Table3.13 Causes of non-performing loan at Bank level?

Item	Response	Rank
What is the major cause of nonperforming Loan	Lack of Continuous follow up and proper risk assessment	1 st
	Lack of Consultation and Communication with defaulter	2 nd

bank level?	Problems associated with loan eligibility criteria	3 rd
	Mistake on estimation of collateral and evaluating the borrower's financial reports	4 th
	Lack of sufficient credit information from other commercial banks	5 th

Source of Data: collected through Questionnaire

From the above table, lack of continuous follow up and proper risk assessment is the first and the most major cause of nonperforming loan at bank level. Followed by the bank of consultation and communication with defaulter, problems associated with loan eligibility criteria, Mistake on estimation of Collateral and evaluating the borrower's financial report and lack of sufficient credit information from other Commercial banks.

Table 3.14 causes of nonperforming loan at Economic level?

Item	Response	Rank
What are the major causes of nonperforming loans at Economic level?	Weak economic plan and strategy implementation	1 st
	Change in fiscal and Monetary's policies	2 nd
	Political Power of the borrower	3 rd
	Un stable political situation	4 th
	Excessive government intervention	5 th

Source of data: collected through Questionnaire

Graph 3.12 shows that most of the respondents replied weak economic plan and strategy implementation as a major (1st) cause at economic level. On the other hand, change in fiscal and monetary policies by government could result

in high inflationary conditions stands in the 2nd place. The rest of the respondents said excessive government interventions are the causes of NPL at economic level stands at 3rd.

3.13 Analysis of Interview Questions

This topic discusses the interview questions that are forwarded to staffs of Dashen Bank who are engaged in Credit Department particularly Head Follow up section and one Credit follow up expert. They were interested to cooperate and entertain my questions with the necessary responses.

Based on the interview conducted for interview question No.4, both respondents replied that the bank management evaluates and ensures profitability and protects its depositors against bank's lending risks by:

- o Knowing customer (character, capacity, capital, Collateral and condition)
- o Keeping some rate in deposit and loan
- o Reserving money with NBE and other banks (apply in government regulation having provision for NPL)
- o Providing prudent credit
- o Providing other banking services
- o Assessing customer past credit history etc.

The interviewees forward their opinion on “Do you believe the procedure followed for loan approval by the bank is satisfactory?” The required procedure is not satisfactory and their reason is it is time taking as compared to other banks since the loan is approved at the area bank and head office level.

As per the interviewees Ethiopia agriculture is characterized by a subsistence level of farming. Since bank grant a loan against collateral and farmers have no valuable capital assets that can be used as collateral purpose to request loan

from formal financial institutes like banks. But recently there is introduction of commercial farming like horticultural, floricultural etc in Ethiopia.

The effect of nonperforming loan as per the interviewees it has an overall effect on the bank.

- Income decline
- Receivables Loss
- Interest Loss
- NBE recognizes as a loss

Generally misguiding the lending policy manual of the bank is another factor of a loan to turn sick.

CHAPTER FOUR

SUMMARY, CONCLUSION AND RECOMENDATION

4.1 Summary

This chapter highlighted and emphasized certain findings summary, conclusion and recommendation of the data analysis.

The main concern of this study is to collect necessarily information about credit management practice of the Dashen Bank S.C and to seek solution for the problem that is mentioned.

The Researcher's used Descriptive research method to make the study complete all relevant primary and secondary Data were collected through interview and Questionnaires. Head office of the bank was interviewed. The Questionnaires give to employees and all staffs who have direct relation with crudites Duties.

The following are major findings of the study. Regarding the staff of Dashen Bank S.C

- > Out of the total Respondents, 93.3% are a first Degree holder.
- > 53.3% of the respondents worked in Bank are below five years.
- > 40% of the respondents believe that the processing time is in between 8-14 have taken.
- > 73.3% of the respondents accept the loans which granted without taking collaterals.
- > 100% of the respondents believe that the procedures followed for loan approval by the bank are satisfaction.
- > Out of the total respondent 66% are agreed that are not a problem as associated with implementing policy manual of the bank as desired.
- > 66% of the respondents' assure that the bank assess borrowers past financial history before extending the loan.
- > The bank usually focus on domestic trade and service sector area
- > Out of the total respondent 100% of them are replied that there is a credit follow up technique and procedure designed and implemented by the bank.

- > 80% of the respondents assure that the bank have the follow up mechanism of your customer after granting the loan
- > 100% of them are replied that he do have sufficient in provision of NLP to its respondent.
- > Out of the total respondent 56.6% are replied that the bank used all mechanism of preventing NPLS.
- > The main cause of non-performing loan at borrower level is diversification of the borrower fund to other purpose.
- > The main cause of non-performing loan at the bank level is lack of continuous follow up.
- > The major cause of non-performing loan at economic level is weak economic plan and strategy implementation.

4.2 Conclusion

In light of the finding and analysis the students researchers made, it is possible to conclude the following major points. In the current competitive environment most business sectors which need a huge investment are financed through different sources. Among these sources banks are the leading financing institutions with respect to this, Dashen Bank s.c plays a major role in most of the economic development of the country. To do this, an appropriate credit approval procedure and good management practice is vital, so as to make the disbursed loan productive, effective and profitable. However, if these financed funds/ loan are not collect or paid back on regular and timely bases to the bank , they have deteriorating effect on the development of country.

Dashen Bank performed well in deposit mobilization and loan disbursement over the last decades through improving and increasing its services and branches network respectively. It also provides various credit lines to different economic sectors. These economic sectors also defined as loaned categories in banking industry.

4.3 Recommendations

The following are some of the suggestion that we try to recommended To Dashen Bank S.C management and concerned parties

- To increase credit quality of the Head office loan section staff members advisable gets adequate and recent training. The training advisable be based on their experience on loan processing and it advisable be in a continuous basis.
- The bank advisable give more emphasize on its implementation on credit policy and procedure, in order to have a better approach that will meet the objective of the bank.
- The bank advisable frequently follow-up by visiting borrowers business to create long-lasting relationship and assure future payment.
- In today's competitive world the bank must try to develop a sound policy in line with the existing situation of the market.
- The banks advisable develop different types of credit facilities to the borrower.
- The banks advisable assesses borrowers past financial history, credit worthiness and perform detail financial analysis before extending loans to avoid non-performing loans.

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APPENDIX

ST. MARY'S UNIVERSITY

Department of Accounting

Questionnaires: Prepared to collect data from Credit Department of Dashen Bank.

This questionnaire prepared by Graduate degree student in order to collect data for the research entitled "Credit Management policy and practice" a case

study on Dashen Bank S.c All information you give is valuable for the academic purpose and kept confidential. The validity as of your response will highly contributes for the success of this research paper.

PART I: GENERAL INFORMATION

1) Educational Background

- | Diploma
- | 1st degree
- | Above 1st Degree
- | Other. Please specify _____

2) Your Status

- | Top Management
- | Senior Management
- | Middle Management
- | Line Managemet
- | Other Clerical
- | Non Clerical

3) How long have you been working in Dashen Bank?

- | Below five years
- | 5-10 years
- | Above 10 years

PART II: Questions on Credit Management & Practice

4) How long will it take to process a given loan application?

- | Below 7 days | 22 -28/30 days
- | 8 - 14 days | Above one month
- | 15 - 21 days

5) Are there loans, which are granted without taking collaterals?

Yes

No

6) If your answer to Q. 5 is **Yes**, would you explain it?

7) Do you believe the procedure followed for loan approval by the bank is satisfactory?

Yes

No

8) If your answer to Q. 7 is **No**, what are the possible reasons?

9) Are there problems associated with implementing policy manual of the bank as desired?

Yes

No

10) Could you describe factors and reasons for the answer of Q. 9?

11) Does the bank assess borrowers past financial history, credit worthiness and perform detailed financial analysis before extending the loans?

Yes definitely

Not at all

Yes to some extent

I am not quite aware of it

12) From the total loans and advances granted to the customers in which sector does the bank usually focus? (Please would you rank them)

Agricultural Sector

Transportation

Manufacturing

Domestic Trade & Services

Export

Building & Construction

Import

Others_____

13) Can you justify the reason for your answer of Q. 12?

14) Is there any credit follow up techniques and procedures designed and implemented by the bank?

Yes

No

• If **Yes** explain about it briefly?

• If **No** what is the reason for this?

15) Do you have any follow up mechanism of your customers after granting the loan?

Yes

No

16) If your answer for Q. 15 is **Yes** how often?

Monthly

Annually

Quarterly

Suddenly

Semi annually

Others _____

17) Can you justify the reason for your answer of Q. 16?

18) What are the reasons for the borrower not to get the requested loan?

19) When the borrowers face a certain problem and unable to pay the loan, what mechanism do you apply in order to collect the loan?

- Extension of the life of the loan
- Injection of additional loans
- Rearrangement of loan repayment structure
- Others _____

20) Do you think the level of provision for NPL held by Dashen Bank is sufficient in relation to its NPL?

- Yes No

• Justify your answer for Q. 20.

21) What are the major causes of non performing loans **at Borrower Level?**
(Please rank them)

	Lack of proper business plan	
	Contingencies at borrowers e.g. death, sick	
	Diversion of the borrower fund to other purpose	
	Insufficient credit awareness	
	Unwilling customer to disclose the information required	
	Willful default/unwillingness to pay	

Other

22) What are the major causes of non performing loans **at Bank Level?**
(Please rank them)

	Lack of continuous follow up and proper risk assessment	
	Lack of consultation and communication with defaulter	
	Lack of sufficient credit information from other commercial banks	
	Mistake on estimation of collateral and evaluating the borrowers' Financial reports.	
	Problems associated with loan eligibility criteria	

Other

23) What are the major causes of non performing loans **at Economic Level?**

(Please rank them)

	Unstable political Situation	
	Excessive government intervention	
	Political power of the borrower	
	Weak economic plan and strategy implementation	
	Change in fiscal and monetary policies	

Other _____

24) If you have any problem that you considered in credit management & practice of Dashen Bank. Please mention.

25) If you have any additional comment or suggestions about the credit management & practice of Dashen Bank. Please mention?

St Mary University
Department of Accounting
Interview Questions

The interview questions is designed to Employee of Dashen Bank

1) What are the loan disbursement procedures in DB?

- 2) What are the reasons for loans to turn sick?
- 3) What are the remedial practices in DB to prevent happening of sick loans?
- 4) What measures did Dashen Bank take in the past to control or minimize the bank's NPL?
- 5) What are the effects of NPL on the bank?
- 6) How the bank management evaluates and ensures profitability and protect it's depositors against bank's lending risks?
- 7) General Comments & Suggestions.

DECLARATION

We, the undersigned, declare this essay project is our original work; prepared under the guidance of Ato Getahun Guta. All sources of materials are used for the manuscript have been duly acknowledged.

Name

Signature

Emebet Alemarga

Hanna Tekalign

Natnael Abera

Date of Submission:

June 2014

Advisor's Declaration

The paper has been submitted for examination with my approval as the University advisor.

Name:

Signature:

Date:



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