

ST. MARY'S UNIVERSITY
BUSINESS FACULTY
DEPARTMENT OF ACCOUNTING

AN ASSESSMENT OF LOAN AND CREDIT IN THE
CASE
OF ABYSSINIA BANK

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JUNE 2014

SMU

Addis Ababa

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IN THE CASE OF ABYSSINIA BANK**

**A SENIOR ESSAY SUBMITTED TO THE DEPARTMENT OF
ACCOUNTING**

BUSINESS FACULTY

ST. MARY'S UNIVERSITY

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DEGREE OF BACHELOR OF ART IN ACCOUNTING**

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CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

Clearly, today it is realized that commerce has become to be the back bone for economic development of a nation. To develop their trade, countries have laid different facilities that could support the smooth flow of commerce. Among these, the service of banking has a paramount importance. No- market based economy is capable of functioning successfully with- out a well developed and financially strong banking system. (Rose: 2002:127).

Bank of Abyssinia is the most important financial institutions in the countries economy. It is the principal sources of credit (loan- able funds) for millions of individuals, families and for many units of government. Moreover, for small local business ranging from groceries stores to automobile dealers, these institutions are often the major sources of credit for large scale and small scale industries, micro finances, co-operatives and the banks. And also it provides other financial product and services to the society, such as financial information planning, counseling and management. (ibid)

In Ethiopia, the institutional sources of credit include the state and private owned commercial banks. The essential function of these banking systems is to act as an intermediary between savers and borrowers. Credit will be considered the heart of the commercial bank's business. Almost every commercial bank holds the majority of its asset in the form of loans, and the majorities of assets are collected from the public, that is the idle fund from the general public, and extend credit to those individuals who in turn use their funds to invest in different lines of business. However, practically some of these bank credits in Ethiopia have inherent problems and risks. Analyzing and assessing the loan before disbursed and following after disbursement is a major activity that requires due consideration in order to protect the banks from any risk of loss. So, considering these problems and risks, the bank's credit activities should be properly assessed and analyzed.

Currently there are more than twenty banks operating in Ethiopia, and the structure of the Ethiopian banking is not unique in comparison with other banking systems around the globe, except the numbers and sizes of each banks operating in different local communities across the country. Regarding the numbers, in Ethiopia most commercial banks are owned by private individuals and business enterprise. (Abyssinia Bank Annual Report)

Abyssinia Bank is one of the financial intermediaries that is engaged in banking activity which serves as a channel for loan-able funds from savers to borrowers. The source of these loan-able funds is demand deposit, saving deposit, and other types, which are made by the customers of the bank. The ability of increasing loan-able fund is a function of saving mobilization. The higher deposit mobilization implies a higher amount of credit to be granted. Hence, allocating higher amount of credit to different sectors bring about development in different sectors and induces economic growth of the country. (ibid)

Among these, our study focuses mainly on construction loan, personal loan, loan against deposit and business loan. So this study tries to assess the activity of bank regarding to, especially, credit (loans and advances) operation of the bank (ibid)

1.2. Background of the Organization

1.3. 1.2.1. Operational and Financial performance of the bank

On 15 February 1996 G.C, a new private owned bank of this historic name, but otherwise not connected with the older bank, came into existence. The subscribed capital of the new bank of Abyssinia was birr 25 million and its authorized capital birr 50 million. When we come to the highlights of major performance of the bank of Abyssinia, during the fiscal year that ended on June 30, 2013, the operational performance of the bank, i.e. the deposit mobilization effort of the bank showed an encouraging result and the total deposit mobilized by the bank by the end of June 30, 2013 reached birr 8.5 billion out of the types of Demand, Saving, and Time deposits which are rendered by the bank. The total out-standing loans and advances of the bank in the fiscal year 2012/13 stood at birr 4.7 billion exceeding the preceding year balance by birr 805 million(i.e. 20.6%). The growth in total out-standing loans from preceding year is mainly from Advances 171.6% and Term loans 26.8% as per their respective proportion. The total income earned from International banking operation in the fiscal year 2012/13 is birr 234.15 million. The income

attributed to the foreign banking operations accounted for 26.1% of the total income in the fiscal year under consideration. On the other hand; when we look at the Financial Performance of the bank, the total income earned by the bank at the end of June 2013 was birr 864.5 million which exceeds the total income earned in the previous fiscal year by birr 141.4 million or 19.6. The percentage share of interest income, service charge, and gain on fluctuation of exchange rates took the highest proportion with 67.5%, 13.4%, and 12.2% respectively. The bank registered an all time high profit before tax of birr 351.5 million at the end of June, 2013. The amount exceeded last year same period figure of birr 288.58 million by birr 62.9 million or 21.8%. The profit level recorded during 2012/13 was due to the concerted efforts made by all stakeholders as well as the improvement in asset quality and operational efficiency of the bank. The Equity of the bank of Abyssinia at the end of the fiscal year-i.e 2012/13 reached birr 1,107.6 million registering absolute growth of birr 201 million (22.2%) from the fiscal year 2011/12. Likewise, paid up capital reached birr 577 million with an absolute growth of birr 98 million (20.5%) from the preceding fiscal year balance. Also, in the just ended fiscal year the legal reserve and retained earnings of the bank have increased in their order or respectively by 27.9% and 22.8% from the previous fiscal year to reach birr 303.7 million and birr 198.1 million. (Abyssinia Bank Annual Report)

1.2.2. Loans provided by bank of Abyssinia

Abyssinia Bank provides different types of loans. Classifying loans in to various groups depends on the type of parameters used to categorize the loans. The parameters could be the time frame a given loan is bounded to; the function the loan is intended for; the type of collateral held for the loan, etc... accordingly the following types of loans have been identified and described here under:

- 2.3.1. **Over Draft Loan:** - is a renewable loan agreement in which the borrowers are allowed to draw fund from their current account over and above what they maintained in their account up to a certain pre-determined limit.
- 2.3.2. **Term Loan:** - is a loan granted for specified period of time with a periodic term repayments or installments, or in lump-sum at maturity with interest. The applicant of term loan should have a deposit or open a deposit account at the lending branch. These are:

Short term loan- maturity from 1 up to 3 years

Medium-term loan-i.e. maturity longer than 3 years but not exceeding a maximum period of 7 years.

Long term loan - i.e. maturity longer than seven years.

2.3.3. Agricultural Term Loan

2.3.4. Syndicate Loan: - is a form of term loan that is provided by and shared between the Abyssinia bank and other banks due to the volume of the fund and the magnitude of the risk involved. The term of the loan is often medium to long-run in nature.

1.3. Statement of the Problem

Lending is the essence of commercial banking: consequently the formation and implementation of sound lending policies and procedures are among the most important responsibilities of bank directors and management. Well conceived lending policies and careful lending practices are essential if, the bank is to perform kits credit-creating function effectively and minimize the risk inherent in any extension of credit.

Through preliminary study the researchers came up with the following problems. The bank faces some problems in its loan assessment, collateral assessment and also a problem of handling non-performing loans (NPL).

Therefore; the intention of this study is to answer the following basic research question.

1.4. Research Question

Based on the above problems, the entire effort of this study tried to answer the following basic question:

- A. How effectively does the bank implement policies and procedures in loan and credit assessment?
- B. How does the bank provide loan for its debtors?
- C. How does the bank follow up delay of payment?

These are the most and valuable issues that are addressed properly in this study.

1.5. Objectives of the Study

Financial institutions are the most important sectors in a country's economy. From this point of view,

1.5.1 The General Objective of the study focuses on credit operation and performance, specifically, assessment of loan and advances in Bank of Abyssinia.

1.5.2 The Specific Objectives

A, To examine the existing policies and procedures in loan and credit in BOA.

B, To evaluate how the bank provides loan for its debtors.

C, To assess how the bank deals with delay of payment.

1.6. Significance of the Study/Importance of the study

Though, some researches were made by the students on the bank regarding to the problems that faces in assessment of loans and advances, this study had further elaborate and help the students and others who inspire to have a refined research regarding this bank.

And also the importance of this study is to correlate (employ) the theoretical knowledge of the students to practical application, to provide suggestions on how to improve the existing activities of an organization and give detail information about loans and advances in general for external users.

In addition, this study would add to the existing knowledge and serve as a ground for further studies to be carried out on this area.

1.7. Scope of the Study

This study had focused on an assessment of loan and advances in bank of Abyssinia, Addis-Ababa area, at piazza branch and also uses data for 2012/13 specific periods and covers only the evaluation of loans and advances.

1.8. Limitation of the Study

The finding of the research would be more fruitful if it was conducted in all branches of Bank of Abyssinia. However, due to time and resource constraints the research was conducted only in piazza branch.

1.9. Research Methodology

1.9.1 Research Design (Approach of the Study)

The research design is a structural frame work for the study. The purpose of this proposal or study would be in order to evaluate the assessment of loan and advances in Bank of Abyssinia. The study is a descriptive type of research. There fore, the research approach is mixed type of research that is both quantitative and qualitative type of data had been employed and also this is because the study had include survey and fact findings of different aspects with respect to the loan and advance, and the students had to use information or facts on that is already available and analyzed these facts.

1.9.2 Sources and Types of Data

For the achievement of the objective of this study, both primary and secondary types of data or input had been used to perform the study. The primary source of data had been gathered from workers and staff members of the bank of Abyssinia through interviewing and questionnaires, who are working on loan area and credit customers of the bank. The secondary source of data had been gathered from different documents, written materials and other related literatures.

1.9.3. Method of Sampling Techniques

The total number of employees working in piazza branch are 32 but for our study we chose 10 workers working on loan area that is the total number of staffs working on loan and credit, and therefore, due to a relatively lower number of targeted population and relatively homogenous group, Census sampling techniques are used depending on the objective of this study and this is because of getting a reliable information from the respondents.

1.9.4. Population and sampling techniques

The study used both primary and secondary sources of data collection method or instrument for achieving the intended objectives of the study. Primary data had been gathered through interviewing and questionnaires, to the contrary; secondary data had been gathered though different published documents and other related literatures. Furthermore: the researchers had

used two types of questionnaires that are to be filled by employees (in English language) and to be filled by customers (i.e. Amharic Language) format.

1.9.5 Method of Data Processing, Analysis and Presentation

After processing and classifying the data or information, the study would use both qualitative and quantitative method of data analysis, which means the study would use both questionnaires and personal (face-to-face) interview to achieve the intended objectives.

Interview: structured type of interview had been used to collect information from loan and credit department as well as the credit customers and this would help the researchers to acquire supplementary information in accessible way.

Questionnaires: an open and a close ended questionnaires had been used to gather the required information and these types of questionnaires are objective and subjective in their nature and had their own choice and personal justification to the respondents that may require answering those type of questions by selecting or putting tick-mark on the option and describe their own justification on the listed out data's and satisfying his/her replay. For this descriptive type of study or analysis the statistical tool like percentage and tables had been employed or used. The data's had been presented by using table and percentage which would be more suitable according to the data to be collected. And by far, for this descriptive type of data analysis or research design, the data would be presented through narrative method of data presentation in order to be more suitable.

1.10. Organization of the paper

This study would have different parts which are organized in to four chapters including work plan and cost budget, of which the first two chapters are considered to be a research proposal part and the rest two chapters would be included under a research project study. When we look at the detailed information regarding to the organization of the study, the first chapter is introductory part that explains briefly about the back-ground of the study, statement of the problem, research questions or hypothesis, objective of the study, significant of the study, delimitation or scope of the study, limitation or problems of the study and organization of the study including the materials and methodology of the study, such as design or approach of the study, the source of data, method of sampling techniques, method of data collecting instruments, and the method of data processing and analysis of the study. The second chapter deals with a literature survey or review-i.e. surveys those are discussed some issues relating to loans and advance under various books and other related written documents. The third chapter will discuss about the assessment of credit operation of the bank, Analysis, data presentation, and interpretation. And by far, the last fourth chapter would present the conclusion, summary, and recommendation of the study with respect to loan and advance of the bank of Abyssinia.

CHAPTER TWO

Literature Review

2.1 History of Bank and credit Concepts

There is no single and universal truth among the writers about the origin of the word “banking” some say it is derived from the Italian word “banco” means a counter desk which is the first thing anybody see when gets in to the bank others contend that it is derived from Greek word “banque” means bench and still other claim that is originated from the German word “banch” which means joint stock firm in its naive form .

Banking is an ancient business. There were banks already in ancient Babylon and classical civilizations particularly in Rome. But modern banking started in Renaissance of Italy where bankers, apart from buying and selling foreign currencies, also took demand and time deposit.

In England banking news grew out of the custom of gold smiths, who took gold and silver from their customers for safe keeping. They then discovered that they could lend such coins out, keeping just a certain proportion as a reserve, since not all customers would come in for repayment at the same time. Moreover they gave their depositors interest bearing receipts, which these depositor could pass on to other people, instead of paying with coins.

In colonial American the first bank in the modern fines of the term was the bank of North America in 1782.

(Thomas Mayer, James S. Duesen berry, Robert Z . Aliber, 1881, 358)

It may be said that banking in its most simple form, is an old as authentic history. As early 2000 B. C Babylonians had develop a system of bank. In ancient Greece and Rome’s the practice of granting credit was widely prevalent. Traces of credit by compensation and by transfer orders are found in Assyria, Phoenicia and Egypt before the system Attains full development in Greece and Rome. As early as 1349, the business of banking carried on by the drapes of Barcelona. During 1401, a public bank was established in Barcelona it used to exchange money, received deposits and discount bills of exchange. During 1407 the bank of Genoa was established in 1609 to meet the need of merchants of the city (Shokhar, 1993, 547).

Generally, the early development of banking and credit was closely associated with three elements; Merchant, money Lenders and goldsmiths (Ayalew Fikru, 2002, 87)

a) Merchants

Primitive merchants were pioneers of modern commercial banking. They used to trade over extensive areas with the objects to get a means of earning for their survival. They were the first people who have introduced cross-country trade.

Primitive merchants first by chance and then by intent began to generate a profit from what they trade. As their trade expanded massively, they began to borrow money from their neighbors or friends to finance their trade. These and other practices immediately gave way for the emergence of village money lenders.

b) Money Lender

Those village people called usurers started to lend their excess money with interest rate which was quite rapacious. This practice transcends itself the activities of banking.

With the passage of time, there came the activity of borrowing cheap and lending which represent the main objectives of modern banking. The main distinction between money lenders and banking is: Banking is said to take place when there exists deposit mobilization and lending simultaneously which as money under give loan from their own financial resources as opposed to money lenders.

a) Gold smith

Modern banking was begun by the gold smiths. It was underlined in many banking books that they were founders of modern bank during the middle age (1100 - 1500 AD).The gold smith began to accept valuables and gold coins from the society for safe custody and issue receipts as acknowledging the same. The gold smiths were the only people with boxes and rooms strong enough to guarantee safety from depositors. Depositors can redeem their receipts in gold coins up on presentation. The receipts in course of time begun to another person in payment for goods and services, the receipts in effect, act as a paper money. This became basis for modern banking.

Having noticed the circulation of their receipts as easy as gold coins, the gold smiths begin to make loans in the form of their receipt. They charge certain amount of interest rate on where they have loan. As a result the gold smith made a lucrative profit by issuing more and more receipts than what was actually in the safe vault with the assumption that:- New depositors offset the decline from the value due to redemption and depositors may not frequently come to withdraw their debt with the gold receipts.

It was only in the nineteenth century that modern commercial banking system development in the lending countries of the world.

2.2 Lending procedures

The principal reason bank is character by state and a federal authority is to make loan to their customers. How well a bank performs its lending functions has a great deal to do with the economic health of its region, because bank support the growth of new businesses and jobs within the bank territory and promote economic vitality. (Peter S. Rose, 2002)

Before the bank lends the money, the bank may consider the following procedures.

a. Interview

The loan officer should assume that he/she will gather as much of the data necessary for credit granting decision as possible. In order to gain efficiency and credibility, check list should be developed and used. The type of work sheet will depend on the type of loan being requested (Linder, 1993).

The interview is particularly important because it provides an opportunity for the bank's loan officer to assess the customer's character and sincerity of purpose. (Peter S. Rose, 2002, 625)

It should be a friendly discussion in which the banker tries to see through the loan request. It should point out points like: - The purpose of the loan the application's commitment elsewhere, the application's business experience, how it is interview for a deeper insight to determine his credit worthiness and liabilities.

b. Application

An application for credit should be computed for every loan requested. While it is the requirement that a bank has a compiled signed and dated application for certain type of dwelling related loans, regularly guidelines strongly suggests that an application should be obtained in all situations. It becomes a document when the loan officer records the answer to the information discussed above. It can also be used to document compliance with timing criteria for advised action requirement (Linder, 1993, 547)

When the banks accept an application for a loan, essential information above it is obtained and pertinent credit data developed.

This is the work of credit department which in performing its function conducts a thorough investigation making use of all services of information. (Benjamin, 1959, 322)

The loan application should state details of the requests loan , the collateral offered , the duration of the loan in which the borrower intend to pay off the debt and the installment if monthly , quarterly , in one lump sum etc .

The application as well as the mortgage or personal guarantor should sign on the application. The consent to mortgage his/ her clearly stated to stand as a guarantor for the requested loan should be clearly stated and signed for by the mortgage or personal guarantor.

C. Loan Documentation

Crucial documents are needed in order to fully evaluate the loan request, including complete financial statement and in the case of a corporation, board of director is resolutions authorizing the negotiation of a loan with the bank. Once all documents are on file, the credit analysis division of the bank conducts a thorough financial analysis of them aimed at determining whether the customer has sufficient cash flow and back up assets to repay the loan. (Rose, 2002, 116).

Loan documentation is a criteria aspect of the lending process. It includes the written analysis of the credit request appropriate instruments which communicate and documentation of actions.

In the case of business organization the memorandum and articles of association should be obtained and refined by the legal department for review and comment as to who is authorized to conclude loan contract on the behalf of the enterprise and also who can mortgage the property of the company.

Moreover, the following documents should be submitted by the loan customers:

A- Renewed trade license for current year

B - Power of attorney if applicable

C- Feasibility study, in case of new project.

D-Origin security certificates that of land holding care booklet.

E- Financial statement audited of provisional.

F- Manufacturing and Performa invoice, receipt, sales or purchase agreements, work order etc. These all will help the bank to examine the genuinely for the Requests.

D. Financial Statement and property Estimation

The financial statement, like Balance sheet, income statement and cash flow statement should be carefully analyzed to determine the financial soundness of the applicant and assess the repayment capacity.

After analyzing the financial statement, the credit analysis division then prepares a brief summary and recommendation which goes to the loan committee for approval. On larger loans members of the credit analysis division give and oral presentation and the loan committee over the strong and weak points of a loan request.

If the loan committee approves the customary request, the loan officer of the credit committee will usually check on the property or other assets to be pledged as collateral in order to insure that the bank has immediate access to the collateral or can acquire title to the property involved if the loan agreement is defaulted.

This is often referred to as perfecting the bank's claim to collateral. Once the loan officer and bank's loan committee are satisfied that both the loan and proposed collateral are sound, the note and other documents that make up loan agreement are prepared and are signed by all parties to the agreement. (Peter S. Rose, 2002, 321)

Ratio and percentages to measure the liquidity and profitability of the business need to be reviewed carefully to assist in the decision making of the amount and the type of loan to be granted.

The Bank's or council engineers should estimate property issued as a security. Otherwise, if it is complex and yet the bank's engineer is not available, the estimation will be left to the municipality engineer. In case of building re-estimation should be made every three years or after renovation or extension

Made, other collaterals such as vehicles will be estimated at lesser interval due to the rapid depreciation.

e. Site or Business visit

It helps to assess the customer's location and the condition of the property and to ask clarifying questions. The loan officer may contact other creditors who have previously lent money to this customer to what their experience has been. A previous payment record often reveals much about the customer's character sincerity of purpose, and sense of responsibility in making use of bank credit.

The credit investigator or branch managers will go and visit the working place of the applicant and the personal guarantor. Among the other things the purpose of business visit helps to:-

1. Verify the declares financial position of the applicant and checking physically the amount of cash on hand, goods in stock, receivable documents, vehicles, buildings and merchandises etc.
2. Assess whether the applicant and guarantor are actually operating a business that they are licensed to.

3. Have an overall view of the applicant or guarantor by the observing the locality as regard to the demand of the area. The number of employees and machineries.
4. Determine the addresses of the borrower or his guarantor for subsequent visits and also identify the security pledged.

F. Credit Analysis

This is the critical point in credit granting process .It is an area where the loan officer needs to document that he / she has actually performed proper analysis of the various risks involved with the particular credit request.

The primary purpose of credit investigation is to determine the personal and business reputation and responsibility of the borrower. Prompt and complete repayment of the loan with interest depends to a large extent on the honesty and managerial / financial technical ability of the borrower. (Linder's, 1993, 63)

The question that must be deal with before any other is whether or not the customer can service the loan. It is to mean that the borrower can payout the credit when due, with a comfortable margin for error. This usually involves the following six aspects of the loan applications.

- **Character:** - The loan officer must be convinced that the customer has a well defined purpose for requesting bank credit and a serious intention to repay. Once the purpose is know, the loan officer must determine if it is consistence with the bank's current loan policy. If the bank's loan officer feels the customer is insincere in promising to use borrowed funds as planned and in repaying as agreed, the loan should not be made , for it will almost certainly become a problem credit for the bank.
- **Capacity:** - the loan officer must be sure that the customer requesting credit has the authority to request a loan and the legal standing to sign a binding loan agreement. This customer character sticks is known as the capacity to borrow money. A loan agreement signed by unauthorized losses for the bank.
- **Cash:** - the flow of liquid funds that is normally principal means a borrower uses to repay his or her loan. Moreover, short falls in cash flow are common indicators of failing business and troubled loan relationships.

- **Collateral:** - In assessing the collateral aspect of a loan request the borrower position of adequate net worth or own enough quality assets provide adequate support for the loan. Technology plays a paramount important. If the borrower's assets are technologically obsolete, they will have limited value as collateral because of the difficulty of finding a buyer for those assets should be borrower's income falter.

Many banks require borrowers to put up collateral to obtain a loan. It is a property or other assets pledged as security against default on a loan. If default occurs, the lender gets the collateral; otherwise, the bank releases the hostage (Baye. Jansen, 2006)

- **Conditions:** - The loan and credit analyst must be aware of recent trend in the borrower's line of work or industry and how changing economic condition might the loan.
- **Control:-** the last factor in assessing a borrower's credits worthily states is control which center on such question as whether changes in law and regulation could a diversely affect the borrower and whether the loan request meets the bank's and the regulatory authorities standard for loan quality. (Peter S. Rose, 2002, 74).

G. Collateral

Collateral refers to assets pledged to secure repayment of a loan. It can be the borrower's or third party's property and can be a real estate (building). Motor vehicle , machinery , business mortgage or lease land that can be registered with a competent registrar; or can be merchandise , cash deposit, life insurance policy surrender value , share, guarantee, or securities (T-bill or bonds) that may not be registered .

Collateral should be readily marketable, accessible, stable in value, easily transferable (where applicable). Second degree mortgage may be accepted to strengthen collateral positional (of already extend loan, for example)

I. Type of collateral

- I. Buildings –can be private, public, etc used for residence, office, store, factory operation, and soon. If under construction, should be at least 40% complete.

- II. Motor vehicles- trucks, trailers, tractors, buses, automobiles , etc
 - III. Construction machinery
 - IV. Bank Guarantee
 - V. Cash deposit in bank-savings, demand and time deposits. If it is from S/A or C/A it should be blocked.
 - VI. Negotiable instrument
- **Cash surrender value of life insurance** -cash value (amount of saving) of a non-term life insurance policy.
 - **Treasury Bills (T-bills)** –Short-term financial papers/ instruments commonly issued at defined denominations (Birr 5000 for example) by Government Treasuries. They are normally issued at discount and will be redeemed at par value.
 - **Government Bonds** – long –term debit – instrument issued by a Government body. The issuing body pays interest at regular intervals and the principal is redeemed at a specified maturity date.
- VII. **Merchandise**– for merchandise loan. The merchandise should be exportable or imported item and should not be perishable.
 - VIII. **Federal Government Guarantee**
 - IX. **Business Mortgage**
 - X. **(clean basis)**
 - XI. **Letter of comfort**
 - XII. **Corporate or personal Guarantee**-is legally binding written commitment issued by legal entity stating that the guarantor will cover any outstanding loan repayment in case of default by the borrower. Such collateral is acceptable for clean loans (approved by authorized committees).

XIII. Combination of any or all of the above

2. Estimation of Collateral

Building, lease land, motor vehicles, merchandises financial papers and business mortgage shall be estimated in line with the bank's estimation procedure. Where estimation is to be performed by entities outside of the branch, the branch shall collect the necessary documents per the credit manual and forward it to the estimator or invite the estimator to estimate the property.

Building –shall be estimated by bank engineers. The manager or his delegate and the owner of the building will be witnesses for presence of the building and physical estimation activities performed.

Lease Land - If no construction is started, at least 40% of the lease amount paid or floor price of lease office or of the location value, whichever is the lowest, will be taken.

Motor Vehicle – will be estimated in accordance with the bank's guideline put in place vehicles of different ages, brands, and current replacement cost (market price) etc.

Merchandise - **cost** or market value, whichever is lower.

Imported items =purchase price + insurance + freight / transport + customer clearance. Good source of information for CIF and custom clearance is custom declaration.

Locally Manufactured Goods =market price of the products. Information can be obtained from the Bank's research unit.

Financial Documents/ Assets

- Domestic Bank Guarantee – $(100+i)$ = lending interest rate, and should not be more than 25% of capital and reserve of the bank.
- Foreign Bank guarantee - $(102+I)$ %, i = landing interest rate.
- Share Certificates – par value or book value, whichever is lower.
- Others - (SA, CA, T-Bill, etc) $\geq (100+i)$ %, i = lending interest rate.

Business Mortgage

- Incorporeal (Intangible) –no value as it will be considered as additional collateral for clean loan.
- Corporeal (tangible)- estimates will be made per the guideline for merchandise , building , etc .stated above .

h. Insurance

All type of insurable securities offered by a borrower should be insured for full value stating in the bank as a co- beneficiary (for first, second or third degree collateral). The cost of insurance policy shall be borne by the borrower and the policy should not be cancelled before full settlement of the loan. The lending branch should ensure that the policy is signed by authorized signatories (keep their specimen signature) and that all relevant risks to which the collateral is exposed are covered.

I, Disbursement and Loan Administration

Loan disbursement is the final step in responding to borrower’s request for credit. However, there are some per- disbursement and post- disbursement activities include signing of contract, registering the contract with the authorities concerned for the pledged properties, insurance of the pledged properties, fulfillment of other terms and conditions, if any, etc. once the loan is disbursed, it has to be seriously followed – up for proper repayment, utilization, etc ..And the loan file should be properly administered.

2.4 Type of Loans

Abyssinia Bank provides different types of loans. Classifying loans in to various groups depends on the type of parameters used to categorize the loans. The parameter could be the time frame a give loan bounded to; the function the loan is intended for; the type of collateral held for the loan; etc. accordingly the following type of loans have been identified and described here under.

2.4.1 Overdraft loan

Overdraft loan is renewable loan arrangement in which the borrower is allowed to draw fund from her / his maintains in her / his account up to certain per- determined limit.

2.4.2 Term loan

Term loan can be defined as loan granted for a specified period of time with a periodic term repayment of installments, or in lump-sum at maturity with interest. The application of term loan should have a deposit account (saving or current account) or open a deposit account at the lending branch.

- ❖ **Short-term loan** – Term loan are extended by the bank to finance working capital or other short- term financial constraints of the business. The maximum term of single maturity loan three years.
- ❖ **Medium- term loan** – A term loan which has maturity period longer than three years but not exceeding a maximum period seven years.
- ❖ **Long term loan-** A term loan which has a maturity period longer than seven years but exceeding a maximum period of time of fifteen years.
- ❖ **The bank will extend medium –or long term loan** for project / business whose nature Justifies, or requires such period of time for implementation and repayment of the loan. Medium and long term loans are intended for the partial financing of the acquisition and / or leasing of fixed business assets (leas- land buildings, machinery, equipment, public transport vehicle, trucks and trailers, etc). The establishment of new project and expansion of an existing business – all of which must be justified by a project feasibility study and / or business plan. The loan may embody a working capital finance need.
- ❖ **Agricultural term loan** – is a loan granted to alleviate the financial constraints of the agricultural sector in the form of an agricultural input loan for the purchase of agricultural machinery , working capital finance and investment finance to large and modern commercial farms.
- ❖ **Syndicate loans** – it is a form of Term loan that is provided by and shared between the Abyssinia bank and other banks due to the volume of the fund and the magnitude of the risk

involved. The term of the loan is often medium to long in nature. The loan can be extended from three to fifteen years.

- ❖ **Loan for the privatization of public enterprise** –it is a form of term loan that is provided by the bank to partially cover the cost of the acquisition of a public enterprise to be privatized. The term loan is generally medium to long in nature and can be extended from three to fifteen years. The minimum contribution of the borrower should not be less than 40% of the Ethiopian privatization Agency’s or the Bank’s estimation of the privatization enterprise assets- whichever is higher. Current asset and obsolete fixed asset must be excluded from the estimation.
- ❖ **Loan for small – scale Enterprise** –it is a loan provided to small- scale enterprises mainly in the form of short-to medium, term with interest. Small- scale enterprises are those businesses with a paid up capital more than birr 20,000 and up to 500,000, but excluding high- tech consultancy firm and other high-tech establishments. These enterprises employ 11-49 workers.
- ❖ **Loans for Micro- financing Institution** –it is a loan availed to the Micro- finance – institution mainly in the form of Term Loans that are repayable within a specific period of time with a negotiable interest rate. Micro – finance – institution (MFIs) are organization that are engaged in providing services such as credit and savings to the low-income (active poor) segments of the society.
- ❖ **Mortgage Loans** – It is a loan extended to alleviate the financial constraint of the housing construction sector in the form of medium and long – term loans for purchase / construction of residential and business buildings.
- ❖ **Motor vehicle Loans** – It is loan extended for the purchase of trucks, buses and automobiles. The minimum contribution of the borrower should not be less than 30% of the cost of vehicles.

2.4.3. Merchandise Loan

Merchandise loan (ML) is a short – term credit facility granted against merchandise pledged as collateral or against agreement of regular submission of a stock list. The merchandise to be held

as collateral will be counted and stored in a warehouse with a dual locker, the keys of which will be one in the borrower and one at the lending Bank. The merchandise against which such loans are secured should not be perishable or subject to significant price fluctuation. There are three type of merchandize loans incorporated in the Bank's credit manual. These are

- ❖ One time (regular) merchandise Loan (ML-) for which the contract remains in the force up to the maturity period of the loan, usually 90 days.
- ❖ Revolving Merchandise Loan (ML-) is similar to one time but can be renewed periodically prior to maturity.
- ❖ Loans against railway receipts of merchandise that is in transit (in a course of shipment) supported by Railway Receipt, Truck way or Airway Bills. Legal opinion will be sought to establish the authenticity of the documents.
- ❖ Loans against the pledge of a certified warehouse receipt-It are granted against the pledge of a certified warehouse receipt. Merchandise loan against warehouse receipts is extended as per the "proclamation provide for a ware house Receipts System, No 372 / 2003

2.4.4 Letter of Credit (Import)

Letter of credit (L/C) is a credit instrument issued by a Bank at the request of an importer through which the bank commits itself to a payment undertaking to an applicant (importer) to pay a seller (exporter) a given amount of money upon presentation of specified documents representing the supply of goods within specific time limits, the documents confirming to the terms and condition agreed by the importer and exporter.

In simple terms it is a means of payment in international trade, where by banks undertaking to effect payment on behalf of the importer upon presentation of documents confirming to the terms and conditions agreed by the importer and exporter.

- ❖ **Import Letter of Credit facility (L/C)** –it is one type of credits facility extended to importers for opening of Letter of credit facility. The facility is given for partial financing of the amount of L /C b setting a limit to the amount of the L /C opened for a limited period of time.

2.4.5 Revolving Export Credit Facility – is an advance extended to exporter upon presentation of acceptable export documents, except bill of landing. The documents must confirm that the goods are in transit or shipment. Revolving export credit should be advanced on clean basis after receiving the following documents. Irrevocable letter of credit, Waybills (such as truck way, rail way) insurance contract, certificate of cleanliness from appropriate organ and other documents as specified in the letter of credit. Note that contract should be made for each advance to be made to the customer.

2.4.6 Pre-shipment Export Credit

It is a loan extended to non-coffee exporters against 80% guarantee of NBE for purchase of raw material, processing them and converting them into finished goods, transporting them, warehousing of goods and packing them until such time as the goods are shipped.

2.4.7 Advances on Export Bills

Advance on export bill is a post-shipment export credit facility extended to an exporter upon presentation of all relevant documents, for a period of 15 days, to bridge the gap between the shipment of goods and realization of proceeds. The loan will be settled from the proceeds of the export.

2.4.8 Letter of Guarantee

Letter of Guarantee (L/G), as defined in the credit manual, is a written promise by the Bank to compensate (pay a sum of money) in the event that the obligor fails to honor its obligations in accordance with the terms and conditions of the guarantee agreement/contract. Examples of L/G include bid Bond, performance Bond, Advance payment guarantee, Retention Guarantee, etc. L/G is usually unconditional, i.e. the Bank pays upon written request of the beneficiary reporting that the obligor fails to fulfill its commitment.

L/G is provided on behalf of a customer against adequate collateral and will be processed in the same way as any other loan except in the case of issuing counter guarantee to a local beneficiary on behalf of a correspondent or international bank. In this case the guarantee will be issued by international bank department (IBD) or any other foreign banking unit empowered to do so and may need National Bank of Ethiopia's (NBE's) consent. If any payment is made to the

beneficiary, interest will be calculated starting from date of payment. Otherwise only a commission, for issuing the guarantee, will be collected every three month or the whole period at the time of issuing the guarantee as the case may be.

Loan can also be categorized based on the purpose the loans are provided. Same examples include

- Agricultural loan
- Manufacturing Industry loan
- Building and construction loan
- Domestic Trade and services loan includes truck loan
- Import loan
- Export loan
- Furniture loan, etc

Loan are also classified into Non-performing Loans (NPL), Advances in Legal Department (ALD) and Loan in Realization (LIR) to assist in reporting status of credit facilities in a given unit , a branch for example. (CBE, 1999)

2.5 Credit Risk

Bank security investments are closely regulated due to the credit test risk displays by many securities, especially those issued by Private Corporation and some local governments.

Credit risk is the danger that a bank's extension of credit will not pay out as promised reducing the bank's profitability and threatening its survival. (Peter S. Rose, 2002, 98)

The Lending activities of the bankers play a key role in the location of credit among various possible uses. Credit is wasted if business firm lack the ability to pay back with interest amount they borrow because they failed to spend the funds productivity. Loan turns bad either because of ill planned spending of funds or because of contingencies that could not have been foreseen.

Bankers proposed uses of loan. They can do little to prevent losses resulting unforeseeable contingencies. (Collin D. Campbell, Rosemary G. Campbell and Edwin G. Dolan, 1988)

The principal business of commercial banks is to make loan to qualified borrowers loans are among the highest yielding assets a bank can add to its portfolio, and they provide the largest portfolio of operating revenue. Because the long term loans carry greater risk due to unexpected changes in interest rates, banks have also required a much greater proportion of new loans to carry variable interest rates that can be changes to shifting market conditions. (Peter S. Rose, 1992, 224)

Prudent management and administration of the overall loan account including establishment of sound lending and collection policies are of all vital important if the bank is to be continuously cooperated in an acceptable manner.

Loans do not deteriorate suddenly and without warning. One or more of the times in the following list is often basic to the development of loan problems.

A. Delinquency

Delinquency is generally considered an indicator of potential loan problem. However, the mere fact that a loan is delinquent in form little about the problem that may exist. In order to identify the magnitude of the problem, the cause of delinquency must be determined. If it is an indication of the borrower's unwillingness to pay, the loan is very likely in serious trouble and may be past salvaging.

It should be recognized that an unanticipated request for an extension or renewal prior to or at maturity may be an indication of a breakdown of the payment agreement as serious as a delinquency. The reason for any request of this nature should be examined very carefully to insure it is justified by a change in circumstance and that it is that is not merely an attempt by the borrower to obscure that fact that he has not complied with his agreement to repay the loan.

B. Fraudulent Information

Every bank credit is to some extent based on the financial status of the borrower. It is not unusual for unaudited financial statement submitted by borrowers to contain erroneous information. As a rule this either forms over sight or a lack of understanding of what should go

in a statement. In some instance of this representation is deliberate and constitutes an attempt to induce the creditor to make a loan which otherwise be not made. It may also represent a calculated attempt to defraud the bank, so the banks must make immediate and aggressive corrective action if it to avoid loss.

C. over lending of banks

This is a most serious one, from the stand point of ultimate losses, to lend or sound financial risk too much money as it is to land to unsound risk. Loan in excess of the reasonable capacity of the borrower to repay in variable leads to the development of problem to the loan disbursed.

D. Disappearance or Depreciation Agreement Setup

Basically banks consider secured loans to be of higher quality than unsecured loans since to convert the securities so that to pay the unsecured loans. Thus disappearance or depreciation of collateral can create. A serious problem even though the loan is considered as secured loan. Within the period till the settlement the bank should periodically as certain the location of the collateral be make periodic physical inspection.

E. Unenforceable Liquidation Agreement Setup

Loans disbursed without a well defined repayment program violate a fundamental principle of sound lending. Regardless of what appears to adequate collateral protection, failure to establish at in caption there after enforce a program of repayment almost in available leads to troublesome and awkward servicing problems and in many instances is response for serious loan problems including eventuation losses. This axiom of sound landing is important not only from under bland point, but also the borrowers.

F. Inefficient (Incomplete) Credit Information

Lending errors frequently result from management's failure to obtain and properly evaluate credit information adequate and comparative financial statement, cash flow statement and other pertinent statistical support should be available. Other essential information such as the purpose of the borrowing and intended plan & source of repayment progress report, inspection, Memoranda of outside information and loan continence, correspondence etc should be contained

in the bank Credit files. Failure of the management of the bank to give proper due care to credit filed makers sound credit Judgment difficult if not impossible.

G. Lack of Supervision

In relation to this credit default may arise from either one of the two reasons

- 1- Absence of effective activity management supervision of loan which possessed reasonable soundness at the inception. Ineffective supervision almost invariably results from lack of knowledge of the borrower's affairs over the life of the loan.
- 2- Failure of the board and or senior management to property over see subordinates to determine that sound polices are being carried out.

H. Lack of Attention to Changing Economic Conditions

Not only the national but also the local economic condition are changing continuously as a result the bank's lending policies should be updated to accommodate the changes in the economy. It is to man that the banks should realistically evaluate lending policies of individual's loans in light of changing condition. Reliance on previously existing conditions as well as optimistic hopes for economic improvement can, particularly when cooped with one or more of the cases and sources of loan problems previously mentioned lead to serious loan portfolio deterioration.

Chapter Three

3-1 Credit Analysis, data Presentation and Interpretation

The primary data used for this study is collected from two types of respondents from bank of Abyssinia staffs working on loans area and from loan customers (borrowers). These two groups are selected because presenting and analyzing the option of these groups is believed to be relevant and meaningful to study the problem properly.

In addition to this, we have the chance to observe the flow of credit application in certain selected branches, to sense and analysis the trial problem of the bank. Analysis and explanation in the table is only for most frequented and extreme figures, which are the most fruitful for our study.

3.1.1 PRESENTATION AND ANALYSIS OF BANK STAFF RESPONSE.

We prepared 30 questionnaires and distributed to bank of Abyssinia staff, and borrowers, and out of which who are involved in the process of credit area, and out of which 20 were properly filled out and returned back.

Table 1 response on the credit policy of the bank of Abyssinia

Response	No. of respondent	percentage
Yes	15	75
No	5	25
Total	20	100

Source-Interview and questionnaire

➤ **Do you think that the credit policies of bank of Abyssinia are tight?**

This question is the most important and basis for the study and it simplify the works in smooth way. As indicated in table (1) 75%of respondents believed that the credit policy of the bank is strongly tight and 25 %respondents believed that it is not tight. Generally the basis for any credit for any commercial banks is their loan polices. What the researchers observed is that a number of

responses indicated that the lending policies of bank of Abyssinia are more or less stringent, i.e. the lending policies are tight ones. So, this may leads the borrowers to shift in to the other competitive banks, which have a flexible credit policy, and this leads to the bank out of competition and not to retain in the market.

Table 2, Response on credit policy of the bank with current situation and in line with borrower’s interest.

Responses	No of respondents	percentage
Yes	11	55
No	9	45
Total	20	100

Source-Interview and questionnaire

- **Is there proper credit policy with a current situation in line with the borrower’s interest?**

As shown in the above table (2), credits policies of the bank are matched with current situation are answered by 11 respondents. The other 9 have negative opinion on the policy. And the researchers tried to check the credit policies of the bank in line with need of the borrowers. As the researchers mentioned before, the basis of any credit is the policies which are seated and implemented by the organization .What the researchers observed that there is no timely revision and policies updating for credit policies.

Table (3) Respondent’s response regarding to taking adequate trainings, especially in credit area.

Responses	No of respondent	percentage
Very high	13	65
Moderate	3	15
Low	4	20
Total	20	100

Source-Interview and questionnaire

➤ **How is the adequacy of the training in credit area?**

As shown in the above table (4), 65% of the respondents believed that very adequately trained in credit area. The other 20% are not well trained. The researchers also made observation and interview to see if the loan staffs are well trained to handle credit. Training is necessary because technical skills and competencies are advantageous in the competitive banking business. Training affects not only credit activity but also over all the organization. Therefore, bank of Abyssinia should handle training policy with a hand to hand credit area for its employees effectively.

Table (4) Lending authority of each loan officers

Responses	No of respondent	Percentage
Yes	-	-
No	20	100
Total	20	100

Source-Interview and questionnaire

➤ **Does each loan officer approve loan independently?**

As shown in table (4) all loan officers have no authority to approve loans individually: this indicate that all bank of Abyssinia loans and advances are not approved by one individual rather all loans are approved by a loan committee even the general manager has no authority to approve loan individually. Although it has its own advantage in terms of revising the work of an individual or a group, it can delay loan processing and as a result, the customers are forced to go to the other competitive banks.

Table (5) Responses on why bank of Abyssinia could not approve all requested amount of loans by borrowers

Responses	No of respondent	Percentage
Credit policy of the bank	2	5
Repayment capacity	15	65
Lack of adequate collateral	3	30
Total	20	100

Source-Interview and questionnaire

- Why all amounts of loans requested by borrowers are approved As shown in table (5) the highest percentage is the repayment capacity of the borrowers, is the cause for not accepted the total amount of loan requested by the borrowers. According to our observation and the respondents the requested amount of loans are not approved totally (exactly) because the lack of sufficient loan able fund and this push the bank to stick to rigid and conservative credit policy.

Table (6) Responses on financial analysis.

Response	No of respondents	Percentage
Done properly	10	50
Not done	5	25
Done sometimes	5	25
Total	20	100

Source-Interview and questionnaire

➤ **Does the bank made financial analysis properly?**

The responses of the staff as shown in the above table (6) indicates that 50% of the respondent respond that the bank conducts financial analysis, while 25% of them respond that the bank doesn't conduct sufficient financial analysis and the rest of 25% respond that it can be done sometimes .This question was included in the questionnaires, because upon receipt of loan financial statement is properly made and analyzed in a detailed manner, otherwise the decision or recommendation will not be effective.

Even if the problem of analyzing financial statements comes from external factor ,such as lack of reliable data ,absence of true information from borrowers ,and others, the bank also had a failure in assessing and analyzing the data forwarded by the borrowers to grant its loan and estimate the profitability of the project and loan repayment capacity before disbursement . Therefore, because of these the branch holds a greater amount of uncollectible loans and advances, so that it requires upgrading the analytical skills of credit staff through intensive training.

Table (7) Responses on lack of proper collection of loan and advances

Responses	No of respondent	Percentage
Yes	8	40
No	12	60
Total	20	100

Source-Interview and questionnaire

➤ **Is there a proper pay- back period of the loan?**

As indicated in table (7),60% of respondents believed that there is no proper collection of loan and advances and 40% believed that there is moderate collection period of loan .Even if the bank presently shows strong effort to clear the long outstanding arrears, which developed Over successive year, the huge amount of arrears had not been covered. These indicate that the bank faces more problems on proper collection period credit analysis. Over lending, process, collateral evaluation, proper follow-up and others.

Table (8) Response on proper estimation of collateral and valuing of building construction

Responses	No of respondents	Percentage
Yes	5	25
No	15	75
total	20	100

Source-Interview and questionnaire

➤ **Is there a proper estimation of collateral?**

The summarized response of respondent in table(8) indicate that 25 % of respondent believed that there is proper estimation of collateral and 75% of the respondents feel there is no proper estimation of collateral .As indicated in table (8) and in our observation there is no uniform collateral estimation for the bank of Abyssinia with regard to the loan amount. The practice of

the bank still shows a routine estimation processes for collateral, by demanding or requiring the clients to raise high valued collaterals. Because of this, the bank loses its prominent customers. The engineering method is not market oriented. The bank applied a highly conservative method of collateral estimation.

Table (9) Response on the type of loan rendered by the Bank

Responses	No of respondent	Percentage
Term loan	1	10
Business and residential contraction loan	1	10
Personal consumption loan	7	70
Truck loan	1	10
other	-	-
Total	10	100

Source-Interview and questionnaire

➤ **What type of loan facilities has been made by the bank?**

As shown in the above table (9) loans requested by customers are different in type, amount and terms (period).According to our observation and customers’ response ,most of the time, the practice of diversification of loan type and huge amounts of loanable funds used for personal consumption in which the borrowers operate the need for bank loan is very important .

Thus, most of the times, customer’s need various types of loans for the various purposes to fulfill the market need in condition.

3.1.2 PRESENTATION AND ANALYSIS OF BORROWER'S RESPONSE

We prepared 15 questionnaires and distributed to at the bank of Abyssinia, pizza branches' borrowers, and out of which ten questionnaires were properly filled out and returned.

Table (1) Borrowers opinions on time taking from date of application to date of approval.

Responses	No of respondent	Percentage
Long time	8	80
Short	2	20
Total	10	100

Source-Interview and questionnaire

➤ **How do you measure the time gap taken in to loan processing?**

As shown in the table (1) 80% of the respondent believed that it takes longer time and 20% of the respondent replied it take short time. Even if recently the management of the bank studying the way for shortening the time taken for loan processing ,the practice is still in problem, for example to process a single loan file it takes up to six months. The cause for this is the decision was made by different level of the committee, lack of professionals, and lack of efficiency. Due to these, the bank loses a number of customers.

Table (2) opinions collected for a reason that is not getting the loan amount requested by the borrowers.

Responses	No of respondent	percentage
Lack of sufficient collateral	6	60
Bank's maximum limit	2	20
Others	2	20
Total	10	100

Source-Interview and questionnaire

- **Do you know why is the reason that the bank decreases the amount of loans requested?**

The reason for not getting the exact amount of loan to the borrowers request are given as in the above table (2) 60% lack of sufficient collateral, and 20% of the respondents believed that the bank consideration is limited and 20% of the respondent respond that other reasons including the bank did not trust them and cannot consider the managerial capability in relation with the loan. In addition to this, the researchers also observed that the bank still require high valued collateral irrespective of the difference in risk follow in each loan case.

Table (3) Responses of borrowers on inability to repay the loan

Responses	No of respondent	Percentage
Increase in interest rate	3	30
Borrowing over capacity	4	40
Market problem	3	30
Total	10	100

Source –Interview and questionnaire

➤ **Why do customers delay in the repayments of loan on timely bases?**

There are different reasons for the failure of borrowers to repay debt. As shown in the table (3), 30% of respondent's faces market problem 40% of respondents' face borrowing of over capacity and other 30% are because of an increase rate.

As we understand from the respondents and from bank of Abyssinia banking practice, the major problems to repay the loans on timely basis are political, economical and environmental conditions. One of the main outcomes of credit analysis is cash flow forecast, which depends on the ability to a reasonable estimate in the future economic situation and others. The future forecast also relies on past trend analysis. This is not easy to do as the future involves uncertainties .Therefore, forecasting about future performance of loan applicants (customers) in our country is the most difficult task because of lack of reliable past information and relatively higher variability observed in the economic ,political ,and environmental performance of the country. Because of this, the bank of Abyssinia successive reports show the amount f loans held under ALD (Advances Under Legal Department) and LIR (Loans In Realization) shows increasing from time to time.

Table (4) Reasons for shifting of borrowers from the bank

Responses	No of respondents	Percentage
Lack of different credit facilities	6	30
Under estimation of their collateral	5	25
Inefficient and delay in processing loan	7	35
Others	2	10
Total	20	100

Source-Interview and questionnaire

➤ **Why bank of Abyssinians loan customers shift to other banks?**

The last question presented to the respondents tried to check and summarize the reasons of the respondents on customer's loyalty to the bank .As shown in the above table(4),most of the respondents raised different opinion for the question .Even if bank of Abyssinia in its lending policies aiming to give loans to different sectors and for different periods, the practice of the bank still shows a simple and common type of loan for residential construction loan for salaried persons and business construction loans for business men. Nowadays the lending Policies of the bank more or less stringent that is the lending policies are tight and inactive in diversification of loan type. Due to the reasons mentioned in the table (9) and other external and internal problems the bank lose many customers.

Table (5) - Response on time taken with the new applicants

Responses	No of respondents	Percentage
Poor	10	50
Moderate	7	35
Good	3	15
Total	20	100

Source- Interview and questionnaire

➤ **How long does it take to process a loan?**

As shown in the above table (5) 50% of responses contains poor communication, the other 35% contains moderate and 15%is good. Most of the loan staffs will not give much time in preliminary screening interviewing, document collection and credit analysis. This is because of inefficiency of the loan staff, lack of confidence, lack training and lack of initiation. The reason is that the bank did not pay competitive salary as compared to other commercial banks .so that, well experienced personnel is going to be resigned from their job.

Table (6) outstanding balances of NPL and Loans Portfolio of bank of Abyssinian from 2002-2006

Years	Loans &advances outstanding bal	NPL Outstanding balance	Percentage
2008	513373213.00	20540580.00	4
2009	500458810.00	100588140.00	20
2010	490069188.00	90290220.00	18
2011	550520584.00	115255220.00	21
2012	600746805.00	150955510.00	25

Source-Interview and questionnaire

Finally, as we collect the data from bank of Abyssinia Annual reports, in table (6) the balance of non-performing loans decreased while the total outstanding loan increased .unfortunately, still the bank has a significant percentage of non –performing loans in relation to the total outstanding loans. And the outstanding loans and advances are not increasing at a constant rate of growth.

CHAPTER FOUR

4 .SUMMARY, CONCLUSION AND RECOMMENDATIONS

Analyzing and assessing the loans and advances before disbursement and following after disbursement is a serious problem which requires a solution in order to protect the bank from risk of loss. So, in order to prevent these problems, the bank's credit activities should be properly assessed and analyzed, In order to accomplish the objectives of the study, the researchers made a through analysis of the loans and advances in bank of Abyssinia S.CO. Taking the statement of problem in to account .And also the researchers made all necessary efforts to get reliable and sufficient data. Accordingly, through out the research paper the following conclusions and recommendations are drawn.

SUMMARY

The points below are the summary of major findings derived from the data gathered and analyzed.

- ✓ The credit policy of the bank is strongly tight, 75 % of the respondents said that its tight and the remaining 25% said it's not tight. So as a result this may lead the borrowers to shift to other competitive banks that have a flexible credit policy.
- ✓ The reason for delay of payments is borrowing over capacity.65% of the respondents pointed that repayment capacity is the reason,30% lack of adequate collateral and the remaining 5% said that it's because of the credit policy of the bank.
- ✓ All the designated loan officers have no authority to approve loans by themselves .100 % of the population said no to this question. Decisions are made in a committee meeting which takes a long time and very time consuming to the borrowers. As a result this led the customers to move to other banks where the loan processing doesn't take long.
- ✓ Proper financial analysis is almost a 50/50 answer in which the staff doesn't take proper care in reviewing them properly. Lack of reliable data and absence of true information by the borrowers is of this reasons the branch holds a greater amount of uncollectible loans and advances.

- ✓ There is no strong, reliable and proper estimation of collateral. 60% of respondents said that there is no proper estimation of collateral and 40% disagreed. The practice of the bank still shows a routine estimation process for collateral by demanding high valued collateral because of this, the bank may tend to lose its prominent customers.
- ✓ The bank's successive reports show the amount of loans held under advance legal department (ALD) and loans in realization (LIR) are increasing from time to time. Analyzing and assessing the loans and advances before disbursement and following up after disbursement is a serious problem which requires a solution in order to prevent this problem.

4.1 CONCLUSION

This research paper tried to investigate the overall credit operation of the Bank of Abyssinia. As indicated in chapter three based on the interview conducted and questionnaire distributed and filled, both customers and staff tried to indicate there are some problems that BOA faced. Firstly when customers come to the bank to apply for loan, they encounter with different kinds of problems. Some of the problems originate from the customers themselves that affect the duties of the banker and others are created by the bank itself. Out of the problems discussed in chapter three we can spot out the major ones that highly affect the loan process.

Most of the time customers are not willing to disclose every information that the loan requires. This brings a serious problem that highly affects the process and the duration of time taken to process the loan.

In general, customers expressed the problems they faced in getting loan service because of different reasons. For example, the bank requires high value collateral; the customers do not get the amount he/she requested and lack of flexibility in handling different types of loan.

- Lack of proper attention to customers at the time of interviewing, document collection, site visit and credit analysis leads to lose its prominent customers of the bank.
- Lack of a well experienced professionals in credit area leads to risk of collection of loans and advances

- Weak credit follow up and collection leads the bank to extra costs (expenses) to clear the long outstanding
- Delay in loan processing, lack of diversification of loan type, lack of timely loan processing ,lack of timely decision on loan processing and under estimation of collateral makes customer to shift to other banks, This also means that the bank losses its prominent customers.
- Bank of Abyssinia credit policy is not based on the current situation of the banking market. This will leads the borrowers to shift other banks which have a flexible credit policy.
- The loan able fund of the bank is not well trading. This will lead the bank to extra interest expenses by paying high interest rate for NBE (National Bank of Ethiopia).
- The lending policy of bank of Abyssinia is more or less stagnant, i.e., the lending policies are tight ones. Because of this and other problems like, lack of adequate collateral evaluation, limited borrowing capacity and in efficiency of good track record leads borrowers to insufficient amount of loanable fund. This may affect the business relation of the borrowers and the banks.

4.2 RECOMMENDATIONS

By taking in to consideration the finding, which are identified in the study the researchers wish to provide the following recommendations.

- It's advisable to develop a strong credit assessment and follow up in order to facilitate the quality control of loan portfolio and pay –back period.
- To increase credit quality of the bank ,it must or give an intensive training in order to equip employees with adequate knowledge of customer handling, report writing, loan processing and others .And this training should be based on their experience and need in continuous basis.
- It will be better if the bank pays a competitive and attractive salary to the bank staff or employees of the bank in order to retain and secure its well skilled and experienced personnel.
- Approving loan by committee has to be revised and decentralized. And also the delegation of the authority could be practiced.

- It's advisable for each loan officer, branch manager, division manager and general manager to have a certain limited authority to approve loans with specific time .This reduces the time of dalliance in processing of loans.
- The bank must apply different types of interest rate on loans based on amount, risk, time and type of loan based on the market interest rate.
- To minimize losing of borrowers for various reasons, its better to advise and convince borrowers. By applying all necessary facilities like effective and timely loan processing follow up supervision, and making an advisory service.
- The bank could develop different types of credit facilities to the borrowers in accordance with the society and market needs and interest.
- It's better if the banks decreases its long term loan portfolio and increase other types of loan portfolio in order to alleviate maturity mismatch and non-performing loan.
- Credit information's could be obtained from borrower's supplies, customer and creditor and this credit information should be exchanged between other banks.
- The bank must develop a strong departmental organization by upgrading capacity, human resources, financial resources and other assets.

APPENDIX

Appendix I

Questionnaire to be filled by Employees of Bank of Abyssinia

The questions is prepared only for academic purpose and any information that you provide us is confidential and do not have any impact to your organization. Hence, we cordially request you to fill/answer the questions genuinely.

Note: for the questions which have choices indicated by box's () you can be choose more than one by making right inside the box's () except "yes" or "no" questions.

Branch /Department _____ Job title _____

Questionnaires to be filled by employee of bank

Preliminary Information

1. Age:

20 and bellow 20

31-40

21-30

41 and above

2. Education Status:

Bellow grade 12

Grade 12 completed

Diploma

Certificate

First degree

MSC/MA and above

3. Work Experience in the bank

1-4 year

4-8 year

8-12 year

above 12 years

4. Category of job in the organization

Academic staffs'

Academic staffs

1. Is Bank of Abyssinia (BOA) your first bank as an employee?
 Yes No
If No, why you choose Bank of Abⁱⁱⁱ other banks?
 Since your earlier work environment was bad
 Since vacancy was available only as bank of Abyssinia
 To earn high salary
 Since bank of Abyssinia is a good bank in the banking sector
Others, please mention if possible _____

2. How do you evaluate the working environment wit in bank of Abyssinia?
A/ Excellent B/ Good C/ Satisfactory D/ Weak
3. How do you see the management of bank towards employees in motivating them and its capability for excellent performance of the bank?
4. Do you think that the polices of bank of Abyssinia are tight?
 Yes No
5. Is there proper credit policy with current situation and in line with borrower's interest?
 Yes No
6. How is the time gap taken to the new borrowers in bank of Abyssinia?
A/ Poor B/ Moderate C/ Good
7. How is the adequacy of the training in credit area?
A/ some training only B/ Not trained
8. Does each loan officer approve loan independently?
 Yes No
9. Why all amount of loan requested by borrowers are not approved?
A/ credit policy of the bank B/ Repayment capacity
C/ lack of adequate collateral
10. Does the bank make financial analysis properly?
A/ done always B/ not done C/ done sometimes
11. Is there proper payback period of loan?

- Yes No
12. Is their proper estimation of collateral?
Yes No
13. Why bank of Abyssinia loan customers shift to other banks?
A/ lack of different credit facilities
B/ under estimation of their collateral
C/ inefficient and delay in processing loan D/ Others
14. What types of loan facilities you utilize?
A/ Term loan B/ Business and residential, construction loan
C/ truck loan D/ Others
15. How do you measure the time taken in loan processing?
A/ Long time B/ short C/ Moderate
16. Do you know why the banks decrease the amount of loan you request?
A/ lack of sufficient fund B/ Borrowing over capacity
C/ Other
17. Why do you delay the repayment on timely bases?
A/ increase in interest rate B/ Borrowing over capacity
C/ Market problem
18. Does the bank project appraisal for loan provision?
Yes No
19. Does the branch take or is taking any measure to improve the competitive position?
Yes No
- If Yes, is it successful or not?
If No, what you plan to do? _____
20. How do you evaluate the directives of the national bank of Ethiopia towards the performance of banks (both private and public)?
A/ they are restrictive
B/ creating good enabling environment to the good performance of bank?
21. The interest rate for loan is A/ fixed B/ Floating
If it is fixed by whom? _____

If it floating on what bases _____

22. What is the maximum loan that your branch can approve by itself? _____

Is it small or not? _____

23. How do you see the credit processing speed of your branch and /or the bank? _____

24. Have you been encounters with a credit request In excess of the bank lending limit (Not the branch lending limit)?

Yes No

If yes, how do you manage it?

a/ by rejecting the excess credit request

b/ arranging cross pendant bank to handle the excess credit

25. What are the banks preferable collaterals for provision? Indicate by using number (A) being the most accepted collaterals, (B) the second accepted and so on.

_____ Real state _____ account receivable, _____ plant and equipment _____ negotiable bill of loading, _____ warehouse receipt, corporate and bonds.

26. What is the collateral that the bank requests for loan provisions?

27. How do you see the performance of bank of Abyssinia in comparison with other banks (both private and public)?

A/ Excellent B/ Good C/ Satisfactory D/ Good

28. Is here strong competition in banking sector, particularly from the huge public banks?

Yes No

If Yes, in what way? Please mention _____

If No, should competition be encouraged or not? Why? _____

29. What would you suggest to improve the efficiency or performance of the bank of Abyssinia from its current performance and be competent in the banking sector? Please explain. _____

Appendix II

Interview to be answered by the employee of the bank

Interview guide line questions

Your genuine and honest response is highly needed since it will grant the paper credibility .We strongly assure you of confidential treatment of your answers and would like to extend our deep-hearted thanks in advance for being a volunteer to devote your valuable time in explaining the question we raised bellow:

1. What is the general objective and goal of credit policy to be addressed by the bank?
2. What are the pre-condition or criteria to be expected from the borrowers for obtaining the loan?
3. Is there a conducive environment for the loan to be disbursed and paid back in the time duration?
4. Does the bank made effective control and monitoring the use of loan for the intended objective, and after a while, if not, made a corrective action?
5. If so, what corrective measures and actions do you take?
6. For which sector does the bank provide the loan in a high, medium and short degree of priority?

በደንበኞች የሚሞላ ቅጽ

ይህ ጥያቄ የተዘጋጀው ለትምህርት ማጠናቀቂያ የተዘጋጀ መጠይቅ ሲሆን ማንኛውንም የአርሶን መልስ በሚስጥር እንደምንይዘውና ምንም አይነት ጉዳት እንደሌለው ስንገልጽ ለተደረገ መልካም ትብብር ሁሉ ልናመስግንዎት እንወዳለን።

ለጥያቄው መልስ በሳጥኑ ውስጥ አስቀምጦልኝ ከአንድ በላይ ምርጫ ሲኖሮት በሳጥን ውስጥ ምልክት አድርጉልኝ ከአዎ ወይም ከአይደለም በስተቀር

ቅርንጫፍ _____ የስራ አይነት _____

1. በአቢ.ሲ.ኒያ ባንክ ተጠቃሚ ኖት?
 አዎ አይደለም
 አዎ ከሆነ ለምን አቢ.ሲ.ኒያ ባንክ ከሌሎች ባንክ ተቀዳሚ ምርጫ አደረጉት?
 አቢ.ሲ.ኒያ ባንክ የመጀመሪያ የባንክ ፍላጎቶች ነው
ሌሎችን ባንኮች ከቻሉ ግልጽልኝ
2. ከአቢ.ሲ.ኒያ ባንክ ጋር ያሉት ግንኙነት እንዴት ነው?
ሀ/ በተበዳሪነት ለ/ በአስቀማጭነት ሐ/ ተጠቃሚ አይደለሁም
3. የአቢ.ሲ.ኒያ ባንክ ብድር ተጠቃሚ ከሆነ የብድር አሰጣጡን እንዴት አዩት?
ሀ/ ደካማ ለ/ መካከለኛ ሐ/ ጥሩ
4. የባንኩ የብድር አሰጣጥ ደንብ ከወቅቱ ሁኔታ እና ከተበዳሪ ፍላጎት ጋር ያጣጣማል ወይ?
 አዎ አይደለም
5. እያንዳንዱን የብድር ክፍል ሠራተኞች በሚያነጋግሩበት ጊዜ ስለብድሩ አጥጋቢ መልስ ያገኛሉ ወይ?
 አዎ አይደለም
6. በብድር ዙሪያ ያጋጠሞት የሠራተኞች የብድር አሰጣጥ ግንዛቤያቸውን እንዴት አዩት?
ሀ/ ትንሽ ስልጠና ተሰጥቷቸዋል ለ/ ምንም ስልጠና አልተሰጣቸውም
7. ባንኩ ብድሮን እንዲከፍሉ ያስታውሶታል ወይ?
 አዎ አይደለም
8. የባንኩ የበላይ አስተዳዳሪዎች ለደንበኞቹ ያላቸውን አመለካከት እንዴት ያዩታል?
ሀ/ በጣም ጥሩ ለ/ ጥሩ ሐ/ አጥጋሚ ነው መ/ ደካማ ነው

9. ከአቢሲኒያ ባንክ ጋር ቀጣይ ግንኙነት ይኖረኛል ብለው ያስባሉ?

አዎ

አይደለም

10. አቢሲኒያ ባንክ ከሌሎች ባንክ የሚለየው በምንድን ነው?

ሀ/ በመስተንግዶ

ለ/ በብድር አሰጣጡ

ሐ/ በሁለቱም

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Declaration

We the under signed, declare that this senior Essay in our original work, prepared under the guidance of Ato GETAHUN GUTA. All resources of material used to the manuscript have been fully acknowledged.

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Submission Approval Sheet

This senior Essay has been submitted for examination with my approval as an Advisor

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