ST.MARY'S UNIVERSITY

FACULTY OF BUSINESS

DEPARTMENT OF ACCOUNTING

AN ASSESSMENT ON THE PROBLEM OF CREDIT PROCESSING AND ANALYSIS IN THE CASE OF CONSTRUCTION AND BUSINESS BANK

BY

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JUNE, 2014

SMU

ADDIS ABABA

AN ASSESSMENT ON THE PROBLEM OF CREDIT PROCESSING AND ANALYSIS IN THE CASE OF CONSTRUCTION AND BUSINESS BANK

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BY

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TABLE OF CONTENTS

List of Tables

DECLARATION

We, The Undersigned, Declare that this senior essay/project our original work, prepared under the guidance of Mr. Ahmed M. All source of materials used for the manuscript have been dully acknowledged.

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SUBMISSION APPROVAL SHEET

This paper has been submitted for examination with my approval as an advisor.

NAME: ______________________________

SIGNATURE: ______________________

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CHAPTER ONE

INTRODUCTION

1.1. General Background of the Study

Today, it is realized that commerce has come to be backbone 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 without a well-developed and financially strong banking system. Commercial banks are institutions specifically designed to further the capital formation process through the attraction of deposits and the extension of credit.

Among the depository institutions, banks are the most important financial institutions in the economy. They are the principal source of credit for many households, for most local units of government and for businessmen. The principal economic function of banks is to make loan. For most banks, loan accounts for half or more of their total assets and about two thirds of their revenue. (Rose 1990 P. 16)

In Ethiopia the institutional sources of credit includes the state and private owned commercial banks. The essential function of these banking systems is to act as an intermediary between savers and borrowers. However, practically some of these bank credits in Ethiopia have inherent problems and risks. Analyzing and assessing the loan before dispersed and following after disbursement are a major activity that requires due consideration in order to protect the bank from risk of loss. In order to prevent the bank from risk of loss, the bank's credit activities will be properly assessed and analyzed.

One of the state owned commercial banks in Ethiopia namely construction and Business Bank (CBB) has been involving in the provision of credit to almost all sectors of the economy (such as public enterprise, cooperatives and private firms).The source of those loan-able funds in demand deposit and saving deposits made by the customers. The bank provides various types of loans to customers mainly construction loan, personal loan, and loan against deposit. It also provides business loans to meet the working capital requirements of commercial and industrial activities within a limited ceiling. Construction and Business Bank S.C. is required to function efficiently to meet the growing demand of credit so as to induce development. So this study tries to assess the activity of the bank regarding credit assessment and analyzing and examining the credit operation of the bank.

1.2. Historical Background of the Bank

Before 1974, there were two financial institutions namely, the savings and mortgage Corporation of Ethiopia (SMCE) and the imperial savings and Home Ownership Public Association (ISHOPA) that were engaged in housing development finance.

The institutions were operating in Addis Ababa and Asmara only. However, the accessibility of these institutions for credit was mainly open to the middle and upper income groups.

Subsequent to the Urban Land and Extra houses proclamation, the Housing and savings bank (HSB) was established under proclamation No. 60/1975 by the merger of the two financial institutions mentioned above and with redefined objectives.

The main reason for the establishment of HSB was the need to encourage and further accelerate the rate of housing construction for the improvement of the living standards and conditions of Ethiopians. HSB went on fulfilling its objectives until the introduction of the free market economy.

HSB was given a broader responsibility to undertaken other commercial, foreign, and local banking services and thus, reestablished under proclamation NO 203/94 with this broader mission to the society and was renamed as Construction and Business Bank (CBB) since September 22,1987.

1.3 Statement of the Problem

Globalization has resulted in a stiff competition specially in banking activities. Hence delivering loan to the customer is fundamental and crucial so as to attract potential customer and as well as to be profitable and competitor in the market.

Lending is the back bone of any commercial banks. Hence, lending decisions are made with deep credit risk analysis/appraisal with regard to assessing credit worthiness of borrowers in line with the benefits of the bank.But,sometimes granting a loango bad due many reasons such as;

- ✓ The failure of the borrower in meeting his/her obligation as per the term and condition of the loan contract,
- ✓ Difficulty to fully disclose all the necessary requirements behalf of borrowers which results from poor credit processing and analysis;
- ✓ Lack of follow up after loan is granted can cause significantly higher non-performing loans that poses additional problem on both the bank and borrowers side.

1.4 Basic Research Questions

In view of the above problem aims at providing solutions/answers for the following research questions

- ➢ What are the challenges CBB faces in its credit appraisal and analysis?
- ➢ To what extent does the bank use appropriate credit policies and procedures?
- ➢ What kinds of methods are applied for improvement of a loan processing problem and credit analysis?

1.5. Objective of the Study

1.5.1 General Objective

The general objective of this study was:-

- ➢ To assess the determinant factors that pose problem in the credit process and analysis in CBB.

1.5.2. Specific Objectives

The study would have the following specific objectives:-

- To identify factors that cause problem in the process and analysis of credit practice of the bank.
- To identify the credibility of the bank in assessing loan.
- To evaluate the bank's lending strategy and procedural manual so as to improve loan processing and analysis problem.

1.6. Scope of the study

The study wasdelimited to CBB's head office since most of the loans are disbursed in Addis Ababa. Time and financial constraint might be reasons to limit the scope of the study only in Addis Ababa. The study focused on the credibility of credit assessments in CBB and the problem of credit processing. The study took secondary data of the bank from 2007-2012.Loan assessment is the major function for granting loans to borrowers. Deficiencies in this regard may result in the enhancement of the accumulation of non-performing loans. In return, the bank's profitability is eroded, additional administrative costs are imposed and the bank's growth rate has been hampered. The student researchers also tried to understand the operational application of theories, it helps to differentiate the most sensitive parts of the analysis which affects the bank negatively and the other thing is increases the operational efficiency of the researchers.

1.7. Significance of the study

Identifying the problem area of the loan assessment can help for the bank's decision makers and the concerned body to take corrective measures so as to reduce these non-performance loans. Therefore, a study in this area is obviously played a vital role. The study can also be used for other similar research as a reference and it were also useful for the researcher to gain experience and exposure to the industry of banking.

1.8.Research Methodology

1.8.1. Research Design

In order to answer the above basic research questions, the student researchers used descriptive research design. Descriptive research method help to describe the research setting as it is and also allow the use of both quantitative and qualitative approach. Descriptive research primarily aims at gathering knowledge about description and explanation of the objectives of the study. The student researchers simply described the things, events, and data which were collected through questionnaires and interviews.

1.8.2 Types of Data Collected

The student researchers used both primary and secondary data for the study. Primary data were obtained through interview and questionnaires from Construction and Business Banks' Officials and borrowers.On the other hand, Secondary data were captured through files used for credit processing and analysis in Construction & business bank's officials and borrowers. In addition to this the sources for the secondary data were CBB reports, manual, internet service and related books.

1.8.3. Methods of data collection

Primary data were obtained using questionnaires and interview. Both open and close ended questionnaires were distributed to the employees and customers of the bank. Furthermore, semi-structured interview were used to get information from the credit department officers of the head office. Secondary data source such as the banks' annual reports, the bank credit management policy, manuals, articles, journals and other documents relevant to the study were reviewed and observed.

1.8.4 Population size & Sampling technique

The student researchers used probability sampling approach, particularly simple random sampling technique were used to gather data from the customers and employees of the bank. The primary data used for this study were collected from two types of respondents, from CBB staff working on loan and from bank borrowers. These two groups were selected because surveying and presenting the opinion of these groups believed to be relevant and can give meaningful information to the problems stated earlier.

The student researchers interviewed 6 personnel include Managers, Loan Officers, Loan Clerks and other operational staffs. 25 questionnaires were prepared and distributed and filled by different borrowers.

1.8.5 Methods of Data Analysis

The researchers used quantitative and qualitative data analysis technique.The responses collected from questionnaires were analyzed by quantitative approach; tabulation and percentage were used. Responses obtained through interview were narrated qualitatively and presented in paragraph.

1.9. Limitation of the Study

Because of time, place and cost constraint the study were conducted on Main Branch, on Credit analysis and problem of credit processing in CBB.

Since the research was financed by the researcher there were financial constraints. So the researchers made use of the available data under these limitations.

1.10. Organization of the Paper

This research study has four chapters. The first chapter deals with introduction, statement of the problem, objective of the study, significant of the study, methodology of the study, scope of the study and limitation of the study. The second chapter contained literature review. The third chapter contained data analysis and finding and finally the fourth chapter includes Summary, Conclusions and Recommendations.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1 Marketing Objective of Mortgage Lending Institutions

No two lenders have exactly the same new business development problems or objectives variations occur largely as a consequence of different in the nature and extent of the area served and differences in the amount and character of loan that make up the portfolio. There is relatively little uniformity in lending policy among lenders. Nor is there uniformity is permissible ratios and mortgage loans to assets or time deposits generally speaking, these ratios are restricted by federal regulations in the case of federally character lending institutions and by state laws and companies policies in the case of federally character lending institutions and by state laws and companies policies in the case of life insurance companies state banks, mutual saving banks, state supervised savings loan associations. A few states impose no limitations. New business developments activities vary widely even among companies with similar operations. These varying or dissimilar considerations, the major objective of every prudent lender is to obtain as much sound business as desired in the different types of loans, which it is willing to make (Willis R. Bryant 1956 P.221).

2.2.**Loan Documentation**

Loan documentation is a critical aspect of the lending process. It includes written analysis of the credit request; appropriate instruments which communicate (i.e. notes, security agreements and loan agreements), and documentation of actions.

As stated by Linder (1993 P.167) documenting proper compliance is a primary focus of regulators. They seek documentation of timely compliance with disclosure requirements of the variations consumer regulations. Compliance examinations are being enforced with much stricter penalties. This environment has been created due to class-action lawsuits, which could cause depletion of a bank’s capital position and a loss of public confidence in the bank. Both of these conditions can destroy the financial soundness of the bank.

The loan officers are front line troops of the lending operation. They are charged with the challenging responsibility of dealing with the bank’s borrowing customers on a day-by day basis; helping the borrower determine his credit needs; obtaining assembling and analyzing the information required to make a sound decision on a loan application; and negotiating the terms of each loan with the borrower in such a manner that the loan is both satisfactory to the borrower and incompliance with the policies of the bank (Behren 1974 P11).

2.3.**Purposes of Documentation**

Effective loan documentation shall serve the following distinct purpose:it shall avoid misunderstandings between all parties involved to the loan i.e the branch, head office, borrower and the regulatory body; it shall establish the bank's rights versus the borrower in case something goes wrong with the loan; andit shall protect the bank's right against third parties i.e other creditors, if any Loan documentation shall also facilitate and efficient credit analysis, which in turn will assist to make prudent credit decision. In this regard, the whole package of documentation shall include all actions, which take place throughout the life of a loan i.e beginning from loan application up to final settlement of a loan (CBB Manual,2003).

2.4. **Phase of the lending Process**

The following phases occur in every lending situation. Each phase is equally important. The loan officer needs to document each phase. The phases of the lending process are: Interview and application phase, Information –gathering phase, Analysis phase, Recommendation for approval /counter-offer/ denial, Documentation preparing phase, Booking phase and Monitoring phase.

2.4.1. **Interview and application Phase**

The loan officer should be assumed that he/she will gather as much of the data necessary for the credit granting decision as possible. In order to gain efficiency and credibility, checklist should be developed and used .the type of worksheet will depend on the type of loan being requested. (Linder 1993 P.117)

Interview

The interview is the first contact with the would be borrower and provides an opportunity for the banker to explore about the applicant beyond the loan application (TeferaSeifu 2002 P.1)

It should be friendly discussion in which the banker tries to see through the loan request. He should touch on points like: The purpose of the loan, The applicant's commitments else where, The applicant's deposit account at other branches, The applicant's business experience and How he intends to pay off the loan etc.The interview should not be stricted to the borrower only. The personal guarantor, if proposed, should also be interviewed for a deeper insight to determine his credit worthiness and liabilities.

Applications

An application for credit should be completed for every loan request. While it is a requirement that banks have a complete, signed, and dated application for certain types of dwelling related loans, regulatory guidelines strongly suggest that an application be obtained in all situations. It becomes the document where the loan officer records the answers to the information discussed above. The application can also be used to document compliance with the timing criteria for adverse action requirement (Linder 1993 P .167).

Upon receipt of an application for a loan, essential information obtained and pertinent credit data developed. This is work of the credit department which, in performing its functions, conducts a through investigation, making use of all sources of information (Benjiamin 1959 P.63).

For every loan request the following information should be determined:Know precisely the purpose of the loan, Ascertain the source of repayment, Identify a secondary source of repayment, Determine the preferred repayment schedule, Define any available collateral and Be sure that the loan complies with bank loan policy.

Loan Purpose

As Linder mentioned (1993 P 117) knowing the purpose of the loan request is important for several reasons. By determining the purpose of the loan, the loan officer will know:What application form to use, What regulatory disclosures are required at the times of application and Information important to the structuring of the loan.

Loan Request

Every loan application should indicate whether the loan request is to be considered, individual credit or joint credit, the income and assets that can be used for determining credit worthiness and the loan amount the maturity and the interest rate requested.

Signature

The application should be signed by the individual applying for the loan. A financial institution may not require the signature of an applicant's spouse or other specific person, other than a joint applicant, on any loan, if the application qualifiers under the credit criteria established by the bank. If the bank requires a cosigner, it may not specify who that person is to be, unless the applicant resides in a community property state and the bank is relying on that property to satisfy the debt.

The financial institution may require the spouse or other person's signature only on the documents that they feel are necessary to make the property available to them in the case of delinquency or default (Liner 1993 P.11).

2.4.2. **Information gathering Phase**

The second phase of the lending process involve the gathering of additional information necessary to make an informed credit decision.

Among these the loan officers should raise the following question:-

- Has the proper determination of the business entity been performed?
- If multiple entities are involved, has the loan officer determined the relationship between those entities, including their ownership and the nature of their affiliation?
- Has the business correct legal name been determined?

Credit Report

The primary purpose of the 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 and technical ability of the borrowers(Linders 1993 P122)

Generally studying records of the business past basically in the form of analyzing annual financial statements, and by studying projections of future performance in the form of cash-flow projections, the loan officer will be in a better position to determine credit worthiness.

2.4.3. **Analysis Phase**

This is the critical phase of the 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. In addition to the areas already mentioned, document the analysis of the five Cs of Credit i.e character, capital, collateral and condition (Linder 1993 P167).

2.4.4. **Recommendation for Approval, Counter-offer, or denial**

Once the previous steps have been completed, the loan officer should be ready to make a decision on whether to recommend approval of the loan as requested; to propose a counter-offer to the customer, which if accepted by the customer, would be approved by the bank; or deny the loan request.

2.4.5. **Documentation Preparation Phase**

The proper completion of all required documents is critical to the loan. If the borrower experience problems, the financial institution must have strong documentation in order to minimize the risk of financial loss (Linder 1993 P.139).

Security Agreements

"A security agreement is a written agreement between the debtor and the secured party which creates a security interest in personal property or fixture " (Linder 1993 P160)

The requirements for a valid security agreement are as follows:

- It must be in writing and must be signed by the debtor, except in situations where the collateral is in the possession of the secured party
- It must contain a "Granting " clause in which the debtor gives to the secured party a security interest in the collateral to secure payment or performance of an obligation.
- It must contain a description of the collateral
- It must contain a recital of the obligation secured by the collateral

Credit file Documentation

Credit files will be examined by the examiners to determine if the loan officer has properly analyzed the credit in relation to the Cs of credit. The loan officer needs to document his/her analysis of human /management factors (character): the borrower's financial position(Capital); the borrower's ability to repay the loan as it has been structured (Capacity); the establishment of security pledged for the loan including identification, valuation, and the method for determining the value of the security (Collateral); and the economic conditions existing which could affect the collectability of the loan, both currently or in the known future (conditions) (LINDER 1993 P160).

2.4.6. Booking Phase

While this task is normally the duty of clerical personnel in lending, it is the responsibility of the loan officer to be assured that the loan has been booked on a timely basis and that the customer has received proper credit for the proceeds of the loan.

Credit files

Credit or loan files should be established for each borrowing customer. The files need to be maintained through out the term of any outstanding credit with the bank. A "file Format" should be established for each type of credit file.

2.4.7. Monitoring Phase

It is the responsibility of the loan officer to obtain all required documents. A system should be established for this purpose. In addition, the system should allow for continual monitoring and follow-up for current financial information, updated appraisal etc.A lender who negotiates a firm, specific, workable repayment program with the borrower at the time the loan is made, and who then follows up on the borrower's repayment performance has taken a major step toward the successful collection of the loan (CBB manual :P 60).

2.5. **Credit Analysis**

Credit Analysis is the method by which one calculates the creditworthiness of a business or organization. The audited financial statements of a large company might be analyzed when it issues or has issued bonds. Or, a bank may analyze the financial statements of a small business before making or renewing a commercial loan. The term refers to either case, whether the business is large or small.

The numerous and varied risks in lending stem from the many factors that can lead to the nonpayment of obligations when they come due. Losses something result from “acts of god” such as storms, droughts, fires, earthquake, and floods. Changes in consumer demand or in the technology of an industry may alter drastically the fortunes of a business firm and place a once profitable borrower in a loss position. A prolonged strike, competitive price-cutting, or loss of key management personnel can seriously impair a borrower’s ability to make loan payments. The swings of the business cycle affect the profits of many who borrow from banks and influence the optimism and pessimism of business people as well as consumers. Some risks arise from personal factors that are difficult to explain. In determining whether or not to grant a loan a banker must attempt to measure the risk of nonpayment. This risk is estimated through a process referred to as credit analysis (Edward W.Reed 1985 P216).

2.6. **OBJECTIVES OF CREDIT ANALYSIS**

The principal purpose of credit analysis is to determine the ability and willingness of a borrower to repay a request loan in accordance with the terms of the loan contact. A bank must determine the degree of risk it is willing to assume in each case and the amount of credit that can be prudently extended in view of the risks involved. Moreover, if a loan is to made, it is necessary to determine the conditions and terms under which it will be granted. Some of the factors that affect the ability of a borrower to repay a loan are very difficult to evaluate, but they must be dealt with as realistically as possible in preparing financial projections. This involves looking into the past record of the borrower as well as engaging in economic forecasting.

Thus, the bank-lending officer attempts to project the borrower and the environment, including all possible hazards that may affect them, into the future to determine whether the loan will be repaid in the ordinary course of business. Loans should not be based entirely on a borrower's history and reputation-they may be contracted today, but they are paid in the future.

The work of credit analysis is basically the same in all banks, but certain functions may be emphasized to a greater extent in some banks than in others. In general, they include the collection of information that will have a bearing on credit evaluation, the preparation and analysis of the information collected, and the assembling and retention of information for future use. In some banks the credit department may make recommendations regarding a credit application, but the final decision regarding a loan is left to the lending officer and/or the loan committee. In addition to these important functions, the credit department serves as a training ground for future loan officers. In small banks the loan officers typically perform their own credit analysis.

2.7.**FACTORS CONSIDERED IN CREDIT ANALYSIS**

Bank credit people in analyzing a loan request consider many factors. They are the ingredients that determine the lending officer's faith in the debtor's ability and willingness to pay the obligation in accordance with the terms of the loan agreement. For years credit people referred to the three C's of credit –capacity, character, and capital. Over the years numerous other credit analysis factors have been specified as worthy of consideration, and, with a little imagination, each of these can be labeled with a word beginning with "C" the most important of these are collateral and conditions. For purposes of discussion, we shall classify the essential factors in credit analysis as capacity, character, ability to create income, ownership of assets, and economic condition (Edward W.Reed 1985 P.217).

2.7.1. **Capacity to Borrow**

Banks are interested not only in the borrower's ability to repay but also in his or her legal capacity to borrow. Banks made few loans to minors, since they can disaffirm at a later date unless the proceeds of the loan are used for essential purposes. When a loan is made to a minor, a parent, guardian, or other person of legal age is usually asked to cosign the note.

In lending to a partnership, it may be advisable to require that all members of the partnership sign for the loan. If that is not feasible, the lending officer should determine whether the signing partners have authority to borrow for the partnership. A verified copy of the partnership agreement or power of attorney may be used for this purpose. When such evidence of authority is not received, the lender may find it difficult to collect from non-signing partners if they establish that the borrowed funds were not used to further the business of the partnership. In general, every partner has authority to execute instruments for the partnership, but if the non signing partners can show that the partner(s) who purportedly acted on behalf of the partnership did not have such authority and that the lender knew this or, in some cases, should have known it, they may avoid any responsibility for the loan.

In lending to a corporation, it is advisable to examine the charter and by laws to ascertain who has authority to borrow in its behalf. In many cases, banks also follow the practice of requiring a corporate resolution signed by the members of the board of directors setting forth the borrowing authority and designating the person or persons who have the authority to negotiate for loans and to execute borrowing instruments. Banks may also require a resolution to borrow from cooperatives and other organizations such as churches and other nonprofit associations.

Banks sometimes find it inadvisable to lend unless certain other creditors of the borrower agree to subordinate their claims to that of the bank. This occurs frequently in lending to small corporations, where the corporation has borrowed sizable amounts from its major stockholders. In such cases the bank may be willing to lend to the corporation only on the condition that the lending stockholders and perhaps other creditors as well, agree to permit the corporation to pay the bank first in the event of liquidation of the business. Through this process of subordination, the bank becomes a preferred creditor and is assured a prior claim on the assets of the business over those who have agreed to subordinate their claims. (Edward W.Reed 1985 P. 218)

2.7.2. **Character**

The concept of character, as it relates to credit transactions, means not only the willingness to repay debts but also a strong desire to settle all obligations within the terms of the contract. A person of character usually possesses attributes such as honesty, integrity, industry and morality, but character is a difficult thing to evaluate. It is entirely possible for a person not to have all of these qualities but to still which to repay financial obligations. The Mississippi River gambler may have paid his debts as agreed even though he was unacceptable as a whole to society because of certain socially undesirable traits. Character worthy of credit is largely a function of a person's honesty and integrity, and is just as important in lending to business firms as to individuals. The past record of a borrower in meeting his or her obligations is usually weighed heavily in evaluating his or her character for credit purposes. Sometimes, however, assessment of character is largely a matter of judgment, unsupported by extensive factual information.

2.7.3. **Ability to Create Income**

If a loan is to be repaid from earnings, it is essential to evaluate the borrower's ability to earn a sufficient amount to repay the loan. Some loans are made with the expectation that repayment will come from the sale of assets, from other borrowings, or from the issuance of common stock in the case of corporations. The primary source of repayment of most loans, however, is the revenue-generating capacity of the borrowers.

An individual's power to generate income depends on such factors as education, health and ENERGY, SKIL, AGE, STABILITY OF EMPLOYMENT, AND resourcefulness. for a business firm, generating income depends on all factors that affect sales volume, selling prices, costs, and expenses. These include the location of the firm, the quality of its goods and services, the effectiveness of its advertising, the amount of competition, the quality and morale of its labor force, the availability and cost of raw materials, and the quality of its management. Many credit people rank the quality of management as the chief factor in deciding whether to extend credit. They refer to it as the management factor—the ability of a firm's managers to assemble personnel, raw materials, and capital assets to produce a satisfactory flow of goods, services, and profits. Some businesses rise while others fall, and the difference is often attributable to management. Effective management sees and takes advantage of new opportunities, makes timely adjustments in production in response to changes in demand for the firm's products, replaces inefficiency with efficiently, and provides products and services with strong customer appeal because of their quality and/or pricing. It is difficult to evaluate the managers of a firm, particularly when they have not been on the job very long, but it is nevertheless important.

2.7.4. **Ownership of Assets**

Ownership of assets is similar to capital and collateral in the C's of credit. Manufactures must have modern machinery and equipment if they are to be competitive producers. Retailers must have a stock of merchandise and attractive buildings and fixtures if they are to attract customers. Credit will not be supplied to business concerns unless the owners to support the debt have supplied capital. The net worth of a firm (the capital supplied by the owners) is one measure of its financial strength. It is often one of the principal determinants of the amount of credit a bank is willing to made available to a business borrower. The amount and quality of the assets held by a firm reflect the prudence and resourcefulness of its management. Some or all of these assets may service as security for a loan and thus as insurance that the loan will be repaid should the borrower's ability to create income not be sufficient to retire the loan. It should be emphasized, however, that while security does reduce the risk, banks prefer that borrowed funds be repaid out of income.

Assets of the borrower frequently secure consumer loans. Most cars, for example, are purchased on credit, and the automobile services as collateral for the loan. The same is true for houses and, to a lesser extents, for household furnishings and appliances. If the value of the pledged assets has not depreciated below the unpaid balance of the loan, the borrower has a strong incentive to continue the payments. (Edward W.Reed 1985 P. 218-220)

2.7.5. **Economic Conditions**

Economic conditions affect the ability of the borrower to repay financial obligations but are beyond the control of the borrower and the lender. Economic conditions made up the environment within which business units and individuals operate. Borrowers may have good character, an apparent ability to create income, and sufficient assets, but economic conditions may render the extension of credit unwise. It is here that the loan officer must become an economic forecaster. The longer the maturity of the loan, the more important economic forecasting becomes, since there is a greater possibility of an economic downturn before the loan has been fully repaid. The economy is subject to short- and long-run fluctuations that vary in intensity and duration. These movements are never the same, conform to no definite pattern, and may affect different industries and areas of the country differently.

Many borrowers fare well in periods of prosperity, but in periods of recession capital may be dissipated, income may decline, and even character may diminish. These factors give rise to the nonpayment of debts. A bank-lending officer must, therefore, keep informed as to the economic pulse of the nation, the community, and the industry or industries in which he or she makes loans.

In extending credit to business borrowers, a bank is interested in the economic function performed by the business and its importance in the industry. A knowledge of what is happening in the industry is very important—changes in competitive conditions, technology, the demand for products, and distribution methods, if a loan applicant is not performing a function basic to the operation of the economy, the lender will be less likely to act favorably on the credit application than if the opposite situation prevails(Edward W. Reed 1985).

2.7.6. **Relative Importance of the Credit Factors**

Although all the factors mentioned earlier are important in credit analysis, most bankers agree that the collateral available for a loan is generally the least important. Credit is granted with the expectation that the funds will be repaid as agreed, not that the pledged assets will have to be sold to provide the funds needed for repayment. Security is taken in most instances to strengthen a weakness found in one or more of the credit factors, such as the ability to create income.

Every loan application is unique. One credit factor may be most important in one situation while another one is in a second situation. Over the entire spectrum of credit analysis, however, character emerges as the most important factor, If a borrower is of poor character, the probability is high that at some time he or she will not comply with the terms of a loan agreement. (Edward W.Reed 1985 P. 220-221)

2.8. **Loan Problems**

The problem loan can be defined as one in which there is a major breakdown in the repayment agreement resulting in an undue delay in collection, or in which it appears legal action may be required to effect collection, or in which there appears to be a potential loss. (H.B 1974 P. 19)

It would be impossible to enumerate all sources and causes of problem loans. They cover a multitude of mistakes a bank may permit a borrower to make, as well as mistakes directly attributable to weaknesses in the bank's credit administration and management. Some well constructed loans may develop problems due to unforeseen circumstances on the part of the borrower; however, bank management must endeavor to protect a loan by every means possible. One or more of the items in the following list is often basic to the development of loan problems. Many of these items may also be indicative of potential bank fraud and/or insider abuse.(WWW.FDIC.Jov)

2.8.1. **Poor Selection of Risks**

Problems in this area may reflect the absence of sound lending policies, and /or management's lack of sound credit judgment in advancing certain loans. The following are general types of loans which may fall within the category of poor risk selection. It should be kept in mind that these examples are generalizations, and the examiner must weigh all relevant factors in determining whether a given loan is indeed a poor risk.

2.8.2. **Over Lending**

It is almost as serious, from the standpoint of ultimate losses, to lend a sound financial risk too much money as it is to lend to an unsound risk. Loans beyond the reasonable capacity of the borrower to repay invariably lead to the development of problem loans.

2.8.3. **Fraudulent Information**

It is not unusual for un-audited financial statements submitted by borrowers to omit or contain erroneous information. As a rule, this results either from oversight or a lack of understanding of what should go into a statement. In some instances the misrepresentation is deliberate and constitutes an attempt to induce the creditor to make a loan which otherwise he would not make. Fraudulent information is extremely hard to defect. Discrepancies in a financial statement may come to light either by comparing the current statement to prior status given by borrower, or by verifying this information from other sources.

2.8.4. **Disappearance of depreciation of collateral**

Banking generally consider secured loans to be of higher quality than unsecured loan since, at least in theory, the bank holds security which can be converted into cash to pay the loan.

2.8.5. **Failure to Establish or Enforce Liquidation Agreements**

Loans granted without a well-defined repayment program violate a fundamental principle of sound lending. Regardless of what appears to be adequate collateral protection, failure to establish at inception or thereafter enforce a program of repayment almost invariably leads to troublesome and awkward servicing problems, and in many instances in responsible for seriousloan problems including eventual losses. This axiom of sound lending is important not only from the lender's standpoint, but also the borrower's (WWW.FDIC.Jov)

2.8.6. **Incomplete Credit Information**

Lending errors frequently result because of management's failure to obtain and properly evaluate credit information. Adequate and comparative financial statements, income statements, cash flow statements and other pertinent statistical support should be available. Other essential information, such as the purpose of the borrowing and intended plan or sources of repayment, progress reports, inspections, memoranda of outside information and loan conferences, correspondence, etc., should be contained in the bank's credit files. Failure of a bank's management to give proper attention to credit files makes sound credit judgment difficult if not impossible. (WWW.FDIC.Jov)

2.8.7. **Overemphasis on Income**

Misplaced emphasis upon loan income, rather than soundness, almost always leads to the granting of loans possessing undue risk. In the long run, unsound loans usually are far more expensive than the amount of revenue they may initially produce. (WWW.FDIC.Jov)

2.8.8. **Self-dealing**

Pronounced self-dealing practices are almost always present in serious problem bank situations and in banks, which fail. Such practices with regard to loans are found in the form of overextensions of credit on an unsound basis to insiders, or their interests, who have improperly used their positions to obtain unjustified loans. Active officers, who serve at the pleasure of the ownership interests, are often subjected to pressures, which make it difficult to objectively evaluate such loans. Loans made for the benefit of ownership interests which may be actually carried in the name of the seemingly unrelated party are sometimes used to conceal self-dealing loans (WWW.FDIC.Jov)

2.8.9. **Technical Incompetence**

Technical incompetence usually manifested in management's inability to obtain and evaluate credit information and put together a well-conceived loan package. Management weaknesses in this area are almost certain to lead to eventual loan losses. Problems can also develop when of credit in which it lacks expertise and experience.

2.8.10. **Lack of Supervision**

Loan problems encountered in this area normally arise for one of two reasons:

1. Absence of effective active management supervision of loans which possessed reasonable soundness at the inception. Ineffective supervision almost invariably results from lack of knowledge of a borrower’s affairs over the life of the loan. It may well be coupled with one or more of the causes and sources of loan problems previously mentioned.

2. Failure of the board and/or senior management to properly oversee subordinates to determine that sound policies are being carries out. (www. FDIC.Jov)

2.8.11. **Lack of Attention to Changing Economic Conditions**

Economic conditions, both national and local, are continuously changing, and a bank's lending policies should be in a constant state of flux, or does it suggest that management should be able to forecast totally the results of economic changes. It does mean, however, that bankers should realistically evaluate lending polices and individual loans in light of changing conditions.

Economic downturns can adversely affect borrowers' repayment potential and can lessen a bank's collateral protection. Reliance on previously existing conditions as well as optimistic hopes for economic improvement can, particularly when coupled with one or more of the causes and sources of loan problems previously mentioned, lead to serious loan portfolio deterioration.(WWW.FDIC.Jov)

2.8.12. **Competition**

Competition among financial institutions for growth, profitability, and community influence sometimes results in the compromise of sound credit principles and acquisition of unsound loans. The ultimate cost of unsound loans outweighs temporary gains in growth income and influence.(WWW.FDIC.Jov)

2.9. **Financial Statement Analysis**

Financial statement analysis is not being adequately performed in order to determine the

Financial strength (or weakness) of the borrower. As a loan administrator, it is essential that

Financial statement analysis procedures be developed and implemented. It is a critical element of asset quality. The purpose of financial statement analysis, as done by a financial institution, is to determine the ability of the borrower to meet the credit underwriting standards of the institution in regard to the loan request.(Linder 1993 P. 173)

Financial Statement basically consists of three documents:Balance Sheet, Income Statement and Cash flow Statement

2.9.1. **Financial Statement**

There are three major concerns that the loan officer must address when analyzing financial statements:The quality of the information, The relationship between items, andThe timing of the statement. Financial statement includes balance sheet, income statement and cash flow statement. Balance sheet contains asset, liability and equity. Income statement relates the sales of a given period to the manufacturing or production costs incurred in producing the goods that were sold and to the other expenses incurred in that period. Cash flow statement includes trend analysis and ratios.

Organizational Structure of the bank

The supervisory authority of CBB is the Board of management delegated by the government. The General Manager, the Deputy General Manager and nine department rune the Bank. The lowest structure in the organization is a section. The list of the department and other organs of the bank are as follows:- Control Department, Administration Department, Business Development Department, Credit Department, Engineering Department, Legal Service Department, Accounts and Investment Department, Information and Computer Service Department, International Banking Department, Branch Operations and System Improvement and Customer Service.

SOME FACTS ABOUT LOANS, RESOURCES AND BRNACH NETWORK

1.Duration of Loans: - Loans are granted to borrowers for various repayment periods (schedules) based on monthly income, age, and the type of loan. Based on their duration loans could be generally classified as short-term, medium-term and long-term. The time period for short-term loans is twelve months and for medium term it is above one year but less than five years, for long term it is above five years.

2. Interest Rates on Loans: - The maximum interest rate limits shall be in accordance with the directives issued, from time to time, by the National Bank of Ethiopia. The bank has the discretion to lend below the maximum rate set by National Bank of Ethiopia but the Board of Directors of the bank shall determine this from time to time.

3.Own Contribution and Collateral: - Private organizations for construction of a hotel, shop, garage, etc... Must contribute a given percent of the cost of the project. Similarly for purchase of residential and commercial buildings the borrower should raise from own source. The extent of own investment varies with the type and purpose of loan extended.

Collateral is essential in lending process of the Bank. The collateral act as a buffer in case of unforeseen eventualities. The collateral ratio to be used for ending varies depending on the type and term of loan.

<u>4.Financial Resources</u>: - The financial resources of CBB constitute the deposits of individuals and organizations, borrowing from domestic as well as foreign sources. In CBB three types of deposits are accepted, i.e. saving deposits, time deposits and current accounts.

Savins Deposits: - These are interest-bearing accounts that have no defined maturity date. The saving account of any depositor attracts interest at a given rate, which is subject to change from time to time.

Time Deposits:- This is another means of attracting financial resources and here the depositor can deposit funds of any amount for a fixed period of time but not less than three months. The interest rate applied on time deposits is subject to change from time to time.

Current Account: - This is a demand deposit and is transacted only by cheque and standing instruction and does not bear interest to the depositor.

CHAPTER THREE

PRESENTATATION, ANALYSIS AND INTERPRETATION OF DATA

3.1. Presentation and Analysis of Data

3.1.1 Presentation and Analysis of Primary Data

The primary data used for this study was collected from two types of respondents, from CBB staff working on loan and from bank borrowers. These two groups are selected because surveying and presenting the opinion of these groups is believed to be relevant and it gives meaningful information to the problem we stated earlier. Questionnaires and Interviews were prepared and gathered the necessary information. Analysis and explanations for numbers in the table and graphs are given only for most frequented and extreme figures.

3.1.2 Presentation and Analysis of interviews with bank officials

Interviews were prepared and the researcher asked and gathered the information from the bank officials and presented as follows:

1. **Experience in the bank and position of interviewee**

The researcher interviewed 6 personnel include Branch Managers, Loan Officers, Loan Clerks and other operational staffs. Most of them served the bank above 4years and have diploma and degree regarding to their educational status.

2. **Responses on time taken with new applicants in interviewing, document collection and credit analysis**

As we obtained from the information collected, the loan staffs will not give much time in interviewing, document collection and credit analysis. This is because of inefficiency of loan staffs, lack of confidence and lack of initiatives.

3. **Response on financial analysis of borrowers financial statement**

This question tries to get the necessary information about the financial statement quantitative analysis because the decision or recommendation becomes difficult for credit managers. The gathered information shows the 4 of the interviewee responded that the branch conducted financial analysis while 2 of the replies the branch do not conduct financial statements analysis some of the borrowers are not in a position to present financial statements.

4. **Response on why the bank could not approve all loan requested by borrowers**

At attempt was made to see if loan requested by borrowers were approved or not. For our 6 interviewee 1 of the interviewee replied high number of loans are approved, 3 of them replied medium number of loans are approved and 2 believed that the loan requested by the borrowers get minimum approval for different reasons such as credit policy of the bank, repayment capacity of the borrowers, inadequacy of collateral and inefficiency of good track records.

5. **Opinion on the consequence of depreciation or disappearance of collateral**

As per the opinion of the interviewees the non-performing of loans arises because of the disappearance or depreciation of collateral and delays in legal decisions for non-performing loan. As collaterals depreciate, their market value declines and the possibility of collecting cash that is enough to cover the loan & interest will be lower.

6. **Reasons for shifting of borrowers from bank to bank**

Sometimes borrowers shift from bank to bank for many reasons. As we get from out interview most of the interviewee raised different opinions for the shifting of borrowers. Among the 6 respondents 2 of them believed that it happened due to delays in processing loan request 4 of them believed that it happens due to under estimation of collateral, 6 of them believed that lack of sufficient credit facilities and the rest 4 answered due to searching of more amount of loan.

7. **Lending authority of each loan officers.**

As we investigated CBB loans are approved by loan committee. Even the President 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, on the other side it can delay loan processing activities.

8. **Responses on proper estimation of collateral and valuing of building construction**

When a bank evaluates credit request estimation of collateral and valuing of building construction is vital. From our 6 respondents 2 of respondents believed that there is proper estimation of collateral, 4 of the respondents feel there is no proper estimation of collateral.

9. **Responses on adequacy and details of credit information exchanged between banks**

As we stated before in processing loans exchange of credit information is an important aspect. Banks should exchange detailed and relevant credit information among themselves. The opinion of the interviewee 5 believed that there adequate and detailed credit information exchange while 1 feel as there is no adequate exchange of credit information.

10. **Reasons for Existence of Non-performing Loans**

As per the interviewees reply the bank faced problems on collecting loans. Some of the reasons are inappropriate credit analysis, over lending, disappearance or depreciation of collateral, lack of proper follow up and delays in legal decision.

11. **Response on credit policy of the bank with current situation inline with borrowers interest**

The last interview question presented to the bank officials tried to check if the credit policies of the banks are in line with the need of the borrowers. The basis of any credit analysis for any commercial banks is their loan policies. The lending policies of CBB more or less are stagnant, i.e. the lending policies are a tight one. Timely revision and updating the lending policies andlending strategies are not formulated depending on the market situation. From the 28 interviewee 9 of them believed that credit policies of the bank are matched with current situation the rest 19 have negative opinion on credit policy of the bank.

3.2.3 Presentation and Analysis of Borrowers' Response

25 questionnaires were prepared and distributed and filled by different borrowers. However, as borrowers especially defaulters do not come frequently and the total numbers of questionnaires used in this analysis are limited to 15.

Table 1: Level of Education of Borrowers and Type of Occupation

Item	Alternatives	Frequency	Percentage(%)
Educational background	Certificate	6	40
	Diploma	6	40
	Degree	3	20
	Masters degree		
	Total	15	100

Source; primary data

According to table no. 1 above, Out of 15 respondents, the educational levels of 6(40%) borrowers are certificate level, 6(40%) and 3(20%) of them are Diploma and degree holders. Based on the data majority of the respondents are degree holders. This implies that the respondents can clearly understand and give a reliable answer for the study.

Table 2: Number Of Years The Borrower Uses Bank Loan

Item	Alternatives	Frequency	Percentage
how long have you been using bank loan?	1-5 years 6-10 years 10-15 years Above 15 years	13 2 -	87 13 -
	Total	15	100

Source; primary data

According to table no. 2 above which shows that majority 13(87%) of the respondents have an experiences of using bank loans for about l-5yrs while the rest 2(13%) of them have an experience of 6-10 years. This shows that the businesses are young to have business experience and credit repayment ability.

Table 3: Purpose of the Loan The Borrower Requested

Item	Alternatives	Frequency	percentage
Why do you need the bank loan?	business construction residential construction Business Expansion Other purpose	4 8 2 1	27 53 13 7
	Total	15	100

Source; primary data

There are different reasons that borrower use loan such as construction of residential house, commercial building and others. Development in business and political environment in which the borrowers operate the need for bank loan is vital. According to the respondents; 4(27%) of borrowers use the bank loan for business construction purpose; 8(53%) of the borrowers used the loan for residential construction, 2(13%) of the rest used it for Expansion of Business. The other 1(7%) use for different purposes. Based on the data majority of the respondents implied that the need for loan are for residential construction purposes most of the time. This implies that the bank provide loan for those borrowers who are borrowing for residential construction purposes among the many services offered by the bank which shows that the bank didn't take into account other loan services well.

Table 4: Opinion on Time Taken from Date of Application to Date of Approval

Item	Alternatives	Frequency	percentage
How do you see the time taken to get your loan approved?	It take longer time	12	80
	Reasonable time	3	20
	Total	15	100

Source; primary data

As can be seen from table 4 above, Even if recently the management of the bank studying the way of shortening the time taken for loan processing there is a practice in the bank to process one loan file up to two months. The reason for this is the decision is made by different level of the credit committee, the lengthy process in sub city and board of directors. Due to this the bank loses many customers. According to the respondents which shows 12(80%) of the respondents believe that it takes longer time; 20% of the respondents replied it takes reasonable time. This implies that the time taken to file application of loan, if it is made to take reasonable time, it can enhance the service giving capacity of the bank.

Table 5: Opinion Collected if Borrowers Have Ever Used Banks Consultation

Item	Alternatives	Frequency	Percentage
Have you ever used the bank's advice?	Yes No	9 6	60 40
	Total	15	100

Source: own survey

According to table 5 which shows that out of 15 valid responses, 9(60%) of the respondent have used banks' advice and 6(40%) responded they do not use bank advice. Based on the data majority of the respondents have used the bank advice while and after loan request. This implies that the advice obtained from the bank could significantly improve the effective use the fund and to repay their loan as per the term and contract of loan.

Table 6: Reason for Not Getting the Loan Amount That the Borrower Requested

Item	Alternatives	Frequency	Percentage
Is the loan you get equal with what you requested?	Yes No If no why?	- 15	- 100
	Total	15	100

Source; primary data

According to table 6 which shows whether the loan request were equal with loan approved; 15(100%) of the respondents replied that it is not equal by saying no. The reasons for not getting the exact amount of loan the borrowers requested are given as lack of collateral, because the bank considered as it is enough, and 'other reasons' take. Other reasons include banks did not trust them and bank did not consider their managerial capability and their short time relation with the bank.

Table 7: Reason for Inability to Repay Loan

Item	Factors	Frequency	percentage
Why do you think borrowers fail to repay their loan?	Economic problem	9	60
	Borrowing over capacity	3	20
	Because of interest rate	3	20
	Total	15	100

Source; primary data

As can be seen from table 7, there are different reasons for the failure of borrowers to repay debt. 9(60%) of borrowers face some problems to repay debt because of political, economical and environmental problems that lead to business failure. The other 3(20%) of the respondents said because of borrowing over capacity and diversion of loan proceeds and the rest of 3(20%) said it is because of an increased in interest rate.

Table 8: Reason for Shifting to Other Banks

Item	Alternatives	Frequency	percentage
In your opinion why do borrowers shift from bank to bank for loan?	Ease of getting loan	2	13
	Lower collateral requirement	11	74
	Accessability	-	-
	Other reason	2	13
	Total	15	100

Source; primary data

According to our respondents 11(74%) of borrowers have chosen other banks because of lower collateral requirement and 2(13%) preferred them for ease of getting loan while the rest 2(13%) respondents fall under 'other reasons' have chosen for the vicinity of the banks and for being close relationship with some employees. Based on the data majority 11(74%) of the respondents implied that the collateral requirement of CBB is more strong than other banks. This implies collateral requirement play a major role in making borrower’s shift from bank to bank.

3.3. Presentation and Analysis of Secondary Data

The most important factor for a bank to be profitable and stay in the business is to maintain the quality of its credit or loan portfolio.In financial sector maximizing profit is limited by many factors, which in turn affect the loan quality of the bank.

Table 9: Disbursement of Loan by Economic Sector for Year 2007/8-2011/12

Year	**Construction Sector**		**Business Sector**		**Total In million**
	Residential Construction	**Non Residential construction**	**Short term loan**	**Medium term loan**	
2007/8	16.7	41.3	4.4	2.1	64.5
2008/9	33.6	60.4	3.6	2.6	100.2
2009/10	53.5	137.9	18.2	8.6	218.2
2010/11	101.5	249.1	18.4	51.8	420.8
2011/12	132.1	145.0	8.6	59	344.7

Source-CBB Annual Report

As we trying to see loan disbursed to different economic sectors show a decline. This was because of the revision of the bank credit policy, the increment of construction cost, and in recent time collection of loan become a critical problem for banks cause of different political, economic & environmental reasons.

According to table 9 which shows disbursement of loan by construction and business sector for year 2007/8-2011/12: with regard to construction sector, most of the bank disbursement of loan comprises to Non-residentialconstruction purpose and the loan disbursement of the bank have significantly increased from 2007/8-2011/12. Based on the data obtained from CBB's annual report, most of the loan were disbursed to non-residential construction sector. This implies that the amount of loan disbursement of the bank were comprised mostly by non-residential sector which shows the bank approval loan considerably gave emphasis on tis sector.

With regard to disbursement of loan to the business sector; medium term loan have increased with an increasing rate from time to time even if short term loans disbursement were significant.

The total amount of loan disbursement have increased from time to time for both economic economic sectors. The construction sector took the lion share out of the total disbursement, non-residential construction sector being the leading sub-sector. Therefore, based on the data, most of the loans are disbursed to the construction sector than business sector and it has increased in a considerable amount. This implies that the construction sector are the major emphasis which the bank mostly disbursed the loan.

Table 10: Saving Mobilization of Construction and Business Bank

Year	Saving Deposit		Time deposit		Demand Deposit		Total Deposit	
	Amount In mill	Growth rate	Amount	Growth rate	Amount	Growth rate	Amount	Growth rate
2007/8	387.1	0.09	143.2	-0.22	84.6	0.32	614.9	0.19
2008/9	399.8	0.03	168.6	0.17	115.7	0.37	684.1	0.57
2009/10	524.4	0.31	203.1	0.20	329.4	1.85	1056.9	2.36
2010/11	626.1	0.19	188.1	-0.07	161.8	-0.51	976	-0.39
2011/12	722.3	0.15	231.4	0.23	182.6	0.13	1136	0.51

Source-CBB Annual Report

Construction and business bank has around 106 branches that are engaged in various banking activities among which deposit mobilization is the main one. The bank mobilizes three types of deposits saving, time and demand deposit and we are trying to show the last four year saving mobilization here under:

As per the annual report of CBB; the bank mobilize deposit from saving, time and demand deposit. As can be seen from table 10; the trend shows that deposits are mobilized from saving deposits with an increasing growth rate from from 2007/8-2011/12 when compared with time and demand deposit. Based on the data most of loans disbursed are mobilized from saving deposits.

Table 11: Trends of Non-Performing Loans in CBB

	2007/8	2008/9	2009/10	2010/11	2011/12
Pass	332900.12	379837.68	556387.26	853039.96	995801.46
Special mention	17231.09	27583.73	14381.51	11212.33	65183.88
Substandard	25244.16	16698.69	8776.51	2803.59	29050.71
Doubtful	10627.00	16401.71	13754.60	6675.71	16029.01
Loss	244716.98	227189.82	212724.11	218476.21	180819.07
Total NPL	280588.14	260290.22	235255.22	227955.51	225898.79
Total portfolio	630719.35	667711.63	806023.99	1092207.80	1286884.13
Ratio(Total NPL Total portfolio)	0.44	0.39	0.29	0.21	0.18

Source: CBB's yearly annual reports

Definition of the above terms:

- Pass - Healthy loan
- Special mention -Loans which are outstanding for not more than 30-89 days
- Substandard - Loans which are outstanding for not more than 90-179 days
- Doubtful - Loans which are outstanding for not more than 180-360 days

- Loss - Loans which are outstanding for 365 and above day

The non-performing loans in CBB is declining from time to time, it is still beyond the acceptable level of the NBE requirements. With regard to the NBE requirements, the acceptable level of non-performing loans is 15% of the bank's total outstanding loan portfolios (NBE directive number SBB/32/2002).

As can be seen on table 11, on the year 2007/8 from the total portofolio, loans outstanding for less than a year, 44% of it was NPL, on the year 2008/9 it was 29%, on year 2010/11 it was 21% and 2011/12 it was 18%. Based on the data the amount of loan from the portofolio decreasing by decreasing rate. This implies that the performance of the bank on the collection of outstanding short-term loans improved and the profit margin was improved as well.

CHAPTER FOUR

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter deals with summary, conclusion based on primary and secondary findings and finally to recommend to construction and business bank's management and concerned parties.

4.1. Summary of the Major Findings

- 87% of the respondents have used the bank loan for 1-5 years. Among the respondents 53% of them used the bank loan for business construction purpose.
- It takes longer time to get loan approval from the application phase as indicated by 80% of the respondents. In addition, all (100%) of the respondents indicated that the loan request are not equal with what borrower's get.
- 60% of the respondents have used the bank's advice while applying and using the fund obtained from loan.
- 60% of the respondents believed that economic problems affect the borrower's ability to repay their loan along with borrowing over capacity and because of interest rate.
- 74% of the respondents have an opinion that borrower's shift from bank to bank for loan are because of lower collateral requirements. In addition, 71% of the respondents indicated that lack of proper estimation of collaterals.Most of the borrowers shift from bank to bank for various reasons. It includes delay in loan processing, lack of diversified credit facilities, underestimation of collateral and other reasons.
- 82% of the respondents indicated the existence of existence of adequate and detailed credit information exchange between CBB and other commercial banks.Banks are unable to analyze all financial statements submitted by borrowers because some borrowers who use residential loan are salaried people and the other business borrowers are not applying proper accounting system and do not hire professionals as replied by 86% of the respondents.

- 65% of the respondents implied that the bank approvals of loan from loan application are made.
- Borrowers do not get the exact amount of loan they applied for. Some of the reasons include credit policy of the bank is not in line with the existing situation, lack of adequate collateral, limited repayment capacity and inefficiency of good track record.
- The amount of loan approved is not enough when compared to what the borrowers are requested to their purpose.

4.2. Conclusion

- Even though most of the loan staffs are diploma and degree holders, CBB has not given adequate training in handling loan processing and loan collection effectively and efficiently.Loan staffs do not give much time in interviewing, document collection and credit analysis.in addition, the bank takes longer time to process loan application and approval.
- Most of the borrowers of the bank have used the bank's advice while applying and using the fund obtained from loan. Even though, the loan request are not equal with what borrower's get.
- Economic problems affect the borrower's ability to repay their loan along with borrowing over capacity and because of interest rate.
- Borrower's shift from bank to bank for loan because of lower collateral requirements. In addition, lack of proper estimation of collaterals and for various reasons. This includes delay in loan processing, lack of diversified credit facilities, underestimation of collateral and other reasons.
- Theexistence of adequate and detailed credit information exchange between CBB and other commercial banks. Banks are unable to analyze all financial statements submitted by borrowers because some borrowers who use residential loan are salaried people and the other business borrowers are not applying proper accounting system and do not hire professionals.
- Borrowers do not get the exact amount of loan they applied for. Some of the reasons include credit policy of the bank is not in line with the existing situation, lack of adequate collateral, limited repayment capacity and inefficiency of good track record.And also the amount of loan approved is not enough when compared to what the borrowers are requested to their purpose.

4.3. Recommendation

The following are some of the suggestions that the study tried to recommend to Construction andBusiness Bank's management and concerned parties.

- CBB should give adequate training for loan staffs with regard to interviewing, document collection and credit analysis so as to minimize the time to process loan application and approval
- economic problems affect the borrower's ability to repay their loan along with borrowing over capacity and because of interest rate.
- The bank should give due emphasis in attracting its borrower's and prospects to minimize the shifting of borrowers from bank to bank for loan appropriately determining and proper estimation of collaterals.
- The existence of adequate and detailed credit information exchange between CBB and other commercial banks can be a useful source of borrower's information. Therefore, theBank should be able to analyze all financial statements submitted by borrowers in order to enhance the service giving capacity of the bank..
- Some of the reasons borrowers do not get the exact amount of loan they applied for include credit policy of the bank is not in line with the existing situation of borrowers. Hence, the bank should take into account in properly handling collateral, repayment capacity and efficiency of good track record.

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APPENDEX

Appendix 1

St Mary University College

Faculty of Business

Department of Accounting

Questionnaire to be filled by employees of the bank

Dear respondent:-

Thank you very much for dedicating a few of minutes of you time to complete this questionnaire which is used for collecting data to conduct a survey on "**the problem of credit processing and analysis in CBB**" as partial fulfillment of the requirement to award BA degree in accounting from St. Mary University these findings will be used to show problem concerning credit processing and analysis of the bank please be ensure that your response are strictly confidential and used only for the research purpose

Instruction

Please indicate your response by making **"**"√" against your choose and if you need any clarification please feel free to contact us

1. Educational Back ground

   □ Certificate □ Diploma □ Degree □ Master degree □and above

2. Work experience in the bank

   □ 1-3years □ 4-6years □ 7-9years □ >10years

3. How long do you take to make interview, document collecting and credit analysis

   □ < One week □ One week □ Sometimes □ Two weeks

4. How often do you analyze the borrowers financial statement ?

   □ Always □ S sometime □ Not at all

5. Do you approve all loan request ?

   □ Yes □ No

   if your answer for Q. No. 4 is No Why ___________________

6. What cause the loan to became Non performing ?

   □ Disappearance of borrowers □ Depreciation of collateral □ Delay in legal decision □ Lack of follow up

7. Why do you think borrower shift from Bank to bank?

   □ Delay in loan process □ Underestimation of collateral

   □ Lack of sufficient credit facilities □ Search for more amount of money

8. How do you evaluate the loan approval procedure of the bank ?

   □ Centralized □ Decentralized

9. Do you think that there is proper estimation of the collateral and building construction?

   □ Yes □ No

10. Do you think that there is credit information exchange b/n banks.

    □ Yes there is □ No. there is no mechanism to get proper information

11. Why Non Performance Loan exist in the bank ?

□ In efficiency in credit analysis □ Over handling □ Lack of Proper follow up

□ Delay in legal decision

12. How do you evaluate the credit policy of the bank in line with borrower interest?

□ It is good for current situation

□ It is not good not bad

□ It needs amendment

Appendix 2

St Mary University College

Faculty of Business

Department of Accounting

Questionnaire to be filled by Customers of the bank

Dear respondent:-

Thank you very much for dedicating a few of minutes of you time to complete this questionnaire which is used for collecting data to conduct a survey on "**the problem of credit processing and analysis in CBB**" as partial fulfillment of the requirement BA degree in accounting from St. Mary University these findings will be used to show problem concerning credit processing and analysis of the bank please be ensure that your response are strictly confidential and used only for the research purpose

1. Educational Back ground

   ☐ Certificate ☐ Diploma ☐ Degree Master degree

2. How long have you been using the bank loan?

   ☐ 1-5years ☐ 6-10years ☐ 10-15years ☐. >15 years

3. Why do you need the bank loan?

   ☐ Business construction ☐ residential construction ☐ business expansion ☐ other purpose

4. How do you see the time taken to get your loan approved?

   ☐ If taken longer time ☐ reasonable time

5. Have you ever use the bank's advice?

☐ yes ☐ . No

6. Is the loan you get equal with what you requested?

☐ yes ☐. No ☐if No why________________________

7. Why do you think borrowers fail to repay their loan?

☐ Economic Problem ☐ Borrowing over capacity ☐ Because of High Interest rate ☐ using the money for other purpose

8. In your opinion why do borrower shift from bank to bank for loans?

☐ ease of getting loan ☐ lower collateral requirement ☐accessibility ☐. other reasons