

**ST.MARY'S UNIVERSITY
BUSINESS FACULTY
DEPARTEMENT OF ACCOUNTING**

**AN ASSESSMENT OF LOAN
PROCESSING SYSTEM OF
NIB INTERNATIONAL BANK
SPECIFIC BRANCH IN TANA
AREA**

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JUNE 2014

SMU

ADDIS ABABA

**AN ASSESSMENT OF LOAN
PROCESSING SYSTEM OF
NIB INTERNATIONAL BANK
SPECIFIC BRANCH IN TANA
AREA**

**A SENIOR ESSEY SUBMITTED
TO THE DEPARTMENT OF ACCOUNTING
BUSINESS FACULTY
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**IN PARTIAL FULFILLMENT OF
THE REQUIREMENTS FOR
THE DEGREE OF BACHELOR
OF ARTS IN ACCOUNTING**

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CHAPTER ONE

1. INTRODUCTION

1.1. Back ground of the study

Commercial banks are the most important financial institutions for the economic development of a state. They render domestic and international banking service. Domestic banking includes deposit mobilization, such as saving accounts, current account/demand deposit, local money transfer, lending and issuance of local guarantees and international banking service includes facilitation of foreign trade such as import and export, L/C, Foreign exchange services, facilitation of international payment and international money transfers.

Commercial banks has owned by stockholders or share holders. They specialize in loan to individuals, commercial and industrial business.

The role of Commercial Bank in the nation are mobilizing savings for capital formation, financing industry by providing short-term, medium-term and long term loans to the industry and financing both internal and external trade by helping the movement of goods from one place to another by providing all types of facilities such as discounting and accepting bills of exchange, providing overdraft facilities, issuing drafts, etc.

In addition, it helps in monetary policy by faithfully following the monetary policy. Thus the commercial banks contributes much to the growth of a developing economy by granting loans to agriculture, trade and industry by helping the physical and human capital formation following the monetary policy of the country.

1.2. Background of the company

NIB Bank S.C is one of the private banks established 1999 in accordance with the licensing and supervision of banking business proclamation No. 84/1994 of Ethiopia to undertake commercial bank activities. It obtained its license from National Bank of Ethiopia on May 26, 1999 and started normal business activities in the month of October 1999. NIB bank was established with an authorized and subscribed capital of birr 50 million, which presently has grown to Birr 1.8 billion capitals. NIB bank operates through its head office in Addis Ababa and 87 branches, 3 agency offices for foreign exchange transactions in and outside Addis Ababa.

1.3. Statement of the problem

Banking industry from its nature; is a bit wide and modern which has various functions within its structure. Therefore, the profitability of

banks is affected, among other things in their loan processing system. Prepare, the reason to undertake this study is to assess the practical aspect of loan processing system of Nib bank and see how they are processed, the paper seeks to answer the following research questions are:-

- ❖ What are the types of loan and advance Nib Bank give?
- ❖ What are the problems faced by the bank and borrowers with loan and advance?
- ❖ What are the loan and advance evaluation processes Nib Bank follows?
- ❖ To what extent is the loan and advance management system contribute to the non performing loan (NPL)?

1.4. Objective of the study

The general objective of the study is to assess the loan management system of Nib Bank specifically in Tana branch.

The specific objectives of the research are: -

- ❖ To assess the type of loan and advance systems of Tana Nib Bank.
- ❖ To see the loan and advance evaluation system of Tana Nib Bank.
- ❖ To examine the problem will face by the bank and borrowers in loan and advance.
- ❖ To see the loan and advance management system contributes to non performing loan (NPL)

1.5. Significance of the study

To determined that the study clearly reflect most of the difficulties observed in the loan processing by Tana Area Nib Bank and gives possible solutions as to how credit officers should process potential healthy loans and undertake proper follow up measures when problem occur. And for other researchers it can be used as an additional reference for their findings. It is also hoped that this study gives guideline to the concerned managers of banks with regard to how they properly address the credit need of their customers and at the same time monitor and ensure collecting ability of their loans. Furthermore, it insures the compliance of staff with the rules and regulations of the banks regarding credit.

1.6. Scope and Limitation of the study

The research intends to address different issues regarding the strength and weakness on the practice and presentation of loan processing system in the banking industry. The research has taken specifically in Tana area Nib Bank as a model for practical considerations. Since, it is difficult to obtain information regarding loans from competing banks; the

scope of the study limited to discussing the process and implementation of loans in Tana area Nib Bank.

In the process of conducting this research study, various problems and constraints have been encountered.

The study has needed to address person to have sufficient and relevant information's but this study is prepared during limited time period due to a lot of factors that affect the smooth running of the paper work.

The capital requirement to complete this paper is avoid to high. During the time of conducting this study, various costs are incurred to make ready the paper for submission, like incurring costs for computer writing and other related costs to prepare the draft of the paper. Thus, this constraint forced us to limited size of the paper to certain areas on top of this some of the credit customers of the bank were not willing to provide certain relevant information's by assuming that information requested is very confidential.

1.7. Research Methodology

As most other researchers do, the study under consideration attempts to apply the research design and data Collection methods which are suitable for the successful accomplishment of the research.

1.7.1. Research Design

The research design is planned in such a way that could provide for the proper performance of the research. It helps for analyzing the data that has been collected by using various methods of collecting data. Based on the data which are relevant for the study, the research design is supposed to be flexible enough to avoid unnecessary delay.

The design includes qualitative and quantitative data which have to be simple for analyzing and interpretation.

1.7.2. Population and area of the study

The population from which representative samples has been taken comprises of: Tana area branch manager, credit analyst , loan officer and credit customers of the branch who have more experience. The study covers the employees and customers of Tana Area Nib Bank.

1.7.3. Sampling Method

The respondents have been selected by judgmental sampling in order to simplify the data collection process as it is a lower cost method of sampling.

Judgmental (Purposive) sampling: is one type of non random sampling that conforms to certain criteria. In other words, it occurs when the researcher selects sample members of respondents to conform to some criterion.

1.7.4. Target population

The target population is the employee of tana nib bank in loan (4 in number) and credit customer (50 in number)

1.7.5. Sample size

The samples who are being selected for this research are 4 employees and 5 customer of tana nib bank listed below:

Respondents	No of representatives
Branch manager	1
Assistance manager	1
Credit analysts	1
Loan officers	1
Credit customer	5
Total respondents	9

1.7.6. Data Collection method

Both primary and secondary data used to undertake the study. Primary data has been collected by interviews and questionnaires.

A. Interview

The interview part has been made through prepared questions, which has been conducted with credit analysts, some credit customers and managers.

B. Questionnaires

The questioners at most effort try to translate research objectives in to specific questions the respondent can answer and try to motivate the respondent to operate with the survey and to provide the information correctly.

Secondary data

Secondary data has been collected from internal reports such as credit manual, quarterly and annual reports of the bank, some different books, different website and nib bank official website.

1.7.7. Method of data analysis

The data collected through different methods has been analyzed using table and through appropriate explanation of the corresponding tables.

CHAPTER TWO

2. Review of Related Literatures

Banking and other financial service and available in Ethiopia which the national bank of Ethiopia (NBE) serves as the central bank. Commercial banking functions are performed by one state owned commercial bank and by a number of newly emerging private commercial bank and offer savings and checking accounts, extend short term loans, deal with foreign exchange transactions, provide mail and cable money transfer services, participate in equity investment, provide guarantee services and perform all other commercial banking activities (Addis Ababa Business Directory 2001)

2.2 Origin and growth of Banking

The origin of Commercial Banking can be traceable in the early times of human history. In the ancient Rome and Greece, the practice of storing precious metals and coins at safe places and loaning out money for public and private purpose on interest was prevalent. (K.C shechar, (1997P-3)

There are two specialized banks. The development bank of Ethiopia (DBE) and construction and business bank (CBB) DBE extend short, medium and long term loans for viable development project including industrial and agricultural projects. It also provides other banking services such as checking and saving accounts to its clients. The CABB provides long term loan for construction, acquisition or maintain of dwellings, community facility and real estate development. (Addis Ababa Business Directory 2001)

2.3 Meaning and functions of Banks

2.2.1. Meaning of Bank

A bank is an institution, which deals with money and credit; it accepts deposits from the public, makes the funds available to those who need them and helps in the remittance of money from one place to another. In fact, a modern bank performs such a variety of functions that it is difficult to give a precise general definition of it.

In general, the term bank in the modern times refers to an institution having the following features:

- ✓ It deals with money; it accepts and advances loans
- ✓ It also deals with credit; it has the ability to create credit i.e. the ability to expand its liabilities as a multiple of its reserve.
- ✓ It is a commercial institution it aims at earning profit.
- ✓ It is a unique financial institution that creates demand deposits, which serve as a medium of exchange and as a result the banks manage the payment system of the country (Holders Milne's 1994 P⁴)

2.2.2. Major Duties of National Bank of Ethiopia (NBE)

As per the proclamation number 206/1955 National Bank of Ethiopia (NBE) and Commercial Bank of Ethiopia (CBE) were institutionalized in 1994. Main role of NBE currency notes and coins, control and administer foreign exchange of the country, supervise the financial institutions, issue monetary policy issue license to financial institutions, dissolve and merge financial institutions, determine the duties and

responsibilities of financial institutions and determining interest rates and loan limits on credit and other payments. (Belay Gidey 1993 E.C page 92, 93, 94).

2.2.3. Functions of commercial banks

In the modern world, banks perform such a variety of functions that it is not possible to make an all inclusive list of their function and services however, some basic functions performed by the banks are (k.e Shekhar, 1997 p5)

2.2.3.1 Accepting deposits:-

Deposit is the money kept in a bank & it is the lifeblood of commercial banks. As with out deposit they can not perform the rest of their activities such as lending and investment and in turn they can not make money and also they can not sustain in business.

The first important function of a bank is to accept deposits from those who can save but can not utilize this saving for profit them. People consider it more relational to deposit their savings in a bank because by doing so they, on the one hand, earn interests, and on the other, avoid the danger of theft. To attract saving from all sorts of individuals the banks maintain different types of account.

I, Fixed / time / deposit account:-

Fixed deposit is one, which is repayable after the expiry of predetermined period fixed by the customer it self. Normally the money on fixed deposit is not repayable before the expiry of a fixed period. That is they are not repayable on demand but they are withdrawable subject to a period of notice. The rate of interest is so attractive which will be fixed by negotiation depending on the amount to be deposited and the period. (NIB domestic Training Manual, January 2010)

Money in these accounts is deposited for fixed period of time and can be withdrawn before the expiry of that period. The rate of interest on this

account is higher than on other types of deposits (k.e. shekhar, 1997p5)

II, Saving deposit accounts: -

Whenever people consumes less than what they earn, then the unconsumed part of the earning is called saving.

Money is not spent or used for consumption and they also believe that it is the backbone to investment as it is the root for the building up on real capital. Saving deposit a deposit for unlimited period of time. That is it has no specific maturity date on which the funds need to be withdrawn the bank required to pay interest to the depositor based on the deposit amount. (NIB domestic training manual, January 2010)

The aim of these accounts is to encourage and mobilize the public. Rate of interest paid on these deposits is low as compared to that on fixed deposits (k.e shekhar, 1997 p5)

III,Current/Demand deposit accounts:-

Current deposit account is a non-interest bearing account in which money can be deposited and withdrawn on demand without restriction

It is an account, which is generally opened by business people for their convenience.

As they are operated by cheques, they are sometimes known as checking account. (Nib domestic training manual, January 2010)

2.2.3.2 Advancing of loans:-

The second important function of a bank is advancing of loans to the public. After keeping certain cash reserve, the banks lend their deposits to the needy borrowers. Before advancing loans, the banks satisfy themselves about the credit worthiness of the borrowers. The common types of loan granted by the banks are term loan, overdraft facility and others. (k.e. Shekhar, 1997 p6)

Supply and demand at the market level determine the market interest rate on loans. A purely competitive bank must take this loan rate as given and determine how many loans to issue at this rate. The bank's goal is to maximize its profit. (Baye, Jansen, 1997p 134) .

2.3 Sectorial Classification

Products categorization in economic sectors enables the bank to direct the composition of its loan portfolio to achieve strategic objectives rather than deferring to the demands of its market. nib may indulge in any sector of the economy upon assessment of performance/potential of the sector and related government policies to this effect. The bank presently extends credit facilities for the following economic sector: Agricultural, building and construction, domestic trade and service (DTS), import, export Manufacturing or industry, hotel and tourism, transport, financial Institution, mines, power and water and staff benefit facilities (Nib Bank Credit Manual March 2012 P.5).

2.4 Credit Product

Nib provides the following two types of credit products: Loans and advances and guarantee products.

2.4.1 Loans and Advance

Loan & advances include over drafts, overdrawal, merchandise loans, term loans, advance on export and import etc. Loan and advance and advances are further classified into:

1. Short term facilities that include over draft facilities, temporary over draft facilities, overdrawals, and merchandise loans, all types of import and export advances and term loans with maturities of less than two years.
2. Medium term facilities that are term loans with maturities greater than two years and up to five years.
3. Long term facilities that are term loans with maturities greater than five years. (Nib Bank Credit Manual March 2012 P.5-6)

A number of problems faced by borrowers also are in regard to deposits, remittances and collections. Basically the problems peculiar for borrowers arise due to difficulties in attitudinal adjustment of bank staff to the new client and new environments and inadequate job knowledge coupled with inexperience. It will obviously take some time to overcome these problems in their entirety. (K.e. shekhar, 1997p 84)

A. meaning of credit

The word "credit" is derived from the Latin word creditor which means to believe of trust. In economics, the term credit refers to a promise by one party to pay another form one your goods on demand at some future date. R.P kent, 2002, Credit defines "as the right to receive payments or the obligation to make payment on demand at some future time on account of the immediate transfer of goods. (ML Jhingan, 2004 p165).

B. Source of credit

The major source of profit for banking business is interest from loans and advances. And again the major source of loan able fund is deposit collected from customers in the form of saving deposit , current deposit and fixed deposit .(Nib Bank loan Training Manual January,2010)

The fundamental credit administration principles for corporate services are no different than those for lending – the key being "knows your customers". Knowing your customer, however, may require unprecedented cooperation in many institutions. Knowledge of the customer's service usage – including transaction volumes and dollar flows is found in the business unit of operations are responsible for sales and deliver, but knowledge of the customer's creditworthiness lies with the account officer or credit administration (Paul F. May land 1993, p13)

C. Loan

Loan is the thing that is lent, specially a sum of money. The action of lending something or the state of being lent "for each lender a loan is an investment comparable to bonds, stocks or other assets. On the other hand for each borrower a loan is a debt and obligation to repay the borrowed money plus interest." (Thomson's Dictionary of banking)

Large, well-known companies either issue bond or borrow from banks.

Small and medium-size firms, in contrast, find it difficult and expensive to issue bonds. Without access to the bond market, they rely on local banks and other financial institution for loans. Individuals, have little alternative to borrow from a bank or other financial intermediary in order to finance the purchase of houses, automobiles, and vacations.

Some commercial loans are long term and are used to buy machinery, land, and buildings. Many business loans are short-term, providing the working capital needed to plug gaps between income and expense by financing the purchase of labor, materials, and unfinished goods used production. There are time lags between employing in puts and producing output, between production and sales, and between sales and receipt of payment. Loans help business bridge these gaps. Some delays are almost continual, some are seasonal, and some vary with business cycle. In economic slumps, firms accumulate unsold products. In credit crunches, they accumulate unpaid bills. In both cases- slumps and crunches- firms need extra cash. (gary smith, 1991, p 153)

D. Advances

Advances are credit facilities in the form of written promises that should not necessarily be given noon physical money as in loans.

2.4.1.1 Type of Loans and Advance

The major categories of bank loans are: commercial and industrial loans, real estate's loans, loans to individuals (mainly personal loans and installment loans for consumer goods), loans to units of state and local government, security loans, loans to financial institutions, agricultural loans, lease financing receivables, and loans to foreign banks and officials institutions. This classification is based on the uses of the funds, not on the types of collateral, (Campbell dolanp, 1984 p152)

2.4.1.1.1 Term loan

"Term loan are credit facilities with structured repayments to be effected with in a certain period of time. Repayments of a term loan shall be in line with the cash flow program of the customer and nature of business. A term loan's repayment can accordingly be monthly, quarterly, semi annually, annually or at lump sum payment. Term loans can be short term, medium term or long term. Truck loans, Automobile loans, Machinery purchase loans etc are also type of term loans but their specific requirements may differ.

Generally, term loans are available for various sectors with specific requirements detailed in the credit processing under writing procedure of the bank. (Nib bank credit manual).

Term lending is based on the "anticipated income theory" of commercial banks assets. Neither the traditional concept of liquidity nor the criterion of shift ability can be applied to term loans. Generally, these loans are given for long periods ranging from one to ten years. They are intended for meeting the fixed capital requirements of industry such as the expansion in plant capacity; the strengthening of the working capital of an excising industrial unit, etc. the loan is repaid over a period of years,

out of the income of industrial unit concerned. Therefore, the liquidity of these loans depends upon the anticipated income of the borrowing concerns. (Varsheny P.N.1974 p.74)

2.4.1.1.2 Overdraft Facilities

It is facility where by customer is allowed to utilize a found up to certain limit set by the bank for a limited or unlimited time (commercial code of Ethiopia 1960)

An overdraft is a form of short term credit facility by which a customer may be allowed to draw beyond his/her/its current account up to a prescribed limit. The facility is usually used to bridge short term working capital constraints arising in business between receipt of funds and disbursement of funds. Overdraft facilities are availed for the various sectors described under categorization of products here above.

The overdraft account should show a credit balance at least once during the last 180 days preceding the date of renewal.

Executive management credit committee of the bank may approve administrative renewals of overdraft facilities for a maximum period of three months, if timely renewal of over draft facility is not possible for some reasons.

Overdraft loan shall be secured by tangible collateral in the form of building, cash and cash substitute except export facilities.

NIB shall maintain that the total overdraft loans of the bank are within the limit set by the national bank of Ethiopia (NBE). (Nib bank, credit manual 2012).

The NBE's directive no.sbb/43/2008 stipulates that the share of overdraft loans (excluding those secured by cash collateral) in total loans and advances portfolio of a bank shall not exceed twenty five (25) percents at any time starting from June 30, 2009.

2.3.1.1.3 Over drawl Facility

An overdrawal is a temporary facility that allows a deserving customer to draw a specified amount of fund over and above the overdraft limit in order to meet unexpected seasonal cash shortage. The bank does not encourage an overdrawal facility.

The facility will not have a revolving nature. Any proceed credited to the overdrawn account shall settle the facility and no subsequent overdrawal shall be allowed.

The maximum amount of overdrawal shall be Birr 2 million or 50% of overdraft limit whichever is lower.

The tenure of the overdrawal shall not exceed 90days.

Registration of collateral may not be required but sufficient collateral margin shall be ensured.

Overdrawal shall be approved for existing customer only.

Overlapping overdrawals shall not be allowed

Due to the inherent urgency of facility, overdrawals shall be approved by emcc irrespective of the discretionary lending limit.

2.4.1.1.4 Advance on import bills

It is a provisional account opened to record value of L/C documents received less margin paid until such time that the import settles the bill and collects document to clear the goods from customs/port. The document should be cleared by the customer upon arrival. Failure to clear the document with in one month will result in higher interest rate change.

This system is designed to accommodate the non-withdrawal of import documents by the importer. For acceptance L/C the import document will be released to the customer who signs the draft payable at a latter date as specified therein. For sight L/C customer must be advised to collect the import document after payment of 100% of the document value.

2.4.1.1.5 Advances against Export bills

This is a post shipment finance granted to well known exporters as a percentage(%) of export receivable against export documents with the exception of clean on board ocean bill of lading. The credit is anticipated to be settled against the proceeds of the export made.

2.4.1.1.6 Merchandise Loan

A merchandise loan is a short term credit facility provided by the bank against physical pledge of merchandise goods, or documentary evidence (L/C, export documents, warehouse receipt...) as collateral for the loan. Merchandise loans shall be vailed for a period of six months but depending on the nature of the business, revolving merchandise loans can be availed which are renewable every six months. Merchandise should be valued at lower of cost or net realizable value. (NIB Bank credit manual).

2.4.2 Letter of guarantees

A letter of guarantee is written promise by NIB to compensate (pay a sum of money) to the beneficiary (local or foreign) in the event that the obligor fails to honor its obligation in accordance with the terms and conditions of the guarantee agreement/contract. Guarantees issued by the bank can be conditional/unconditional and revocable/irrevocable.

The guarantee may be of limited period and sometimes open ended. Guarantee products are contingent liabilities which include all types of guarantees such as advance payment guarantees, bid bond guarantees, Performance guarantees, advance payment guarantees, customs bond etc (nib credit manual march 2012)

2.5 Classification of Loans and Advances

In line with the characters issued by NBE, loans and advances should be

regularly reviewed and classified in a manner consistent with regulatory standards. Generally the directive classifies loans and advances into the following five categories

pass - loans in this category are fully protected by the current financial and paying capacity of the borrower & are not subject to criticism. **Special mention** - loans or advances with pre-established repayment programs past due 30(thirty) days or more but less than 90(ninety). **Substandard**- loans or advances with pre-establish repayment programs past due 90(ninety) days or more but less than 180(one hundred eighty) days.

Doubtful/ loans or advances with pre-established repayment programs: past due 180(one hundred eighty) days or more but less than 360(three hundred sixty) days and

loss / Non performing loans or advances with pre-establish repayment program past due 360 (three hundred sixty) days or more.(NIB credit manual 2010)

Secured verses unsecured loans

In order to receive loans , banks often required that borrowers assign them legal claims to real estates corporation stock , savings deposits, life insurance policies or automobiles and other consumer durables purchased on the installment plan . If the borrower defaults, the banks have the right to sell this collateral to recoup the amount owed ...collateral reduces the risk and enables banks to lend at lower interest rates than they otherwise could. If a borrower puts up collateral to obtain the loan, it is said to be secured, (Campbell Dolan 1984p 150) .

2.6 Loan categories by type of sectors

According to the (NIB bank credit manual)

Agricultural production loan – the agricultural sector is the mainstay of the Ethiopian economy. It provides employment opportunity for the

overwhelming majority of the population, it supplies raw materials to the textile, food, beverage and other industries, it is the major source of exports, and, what is more significant is, it provides food for the ever growing population. Its contribution to the gross national product is above 50%. Agricultural loans are usually meant for covering costs of harvesting, purchase of agricultural inputs like selected seed, fertilizers and improved seeds, purchase of machinery such as combine harvesters, tractors, and construction of storage facilities etc. As in other case, loans can be extended to individuals, companies or cooperatives.

Consumer loan- consumer loan is an interest bearing loan which all permanent staff members are entitled to borrow up to one year gross monthly salary at prevailing ordinary saving interest rate with monthly repayment up to 1/3 of the salary and repayable within 36 months. Personal or other form of acceptable collateral should be presented to secure the loan. If the employee resigns on his/her own accord or his/her employment contract is terminated by the bank, he/she shall be charged the market interest rate.

Emergency staff loan- this is an interest free loan, which all permanent staff members are entitled to borrow in the following manner:

-Two months' salary for employees with less than one year of service which is repayable within 24 months.

-Four months salary for employees with more than one year of service which is repayable with in 24 months.

-In both cases, personal guarantee of two staff members with at least equivalent salaries is required.

Limitations on the creation of credit

The power of commercial bankers to create credit is limited mainly by cash reserves which they have to hold against their deposit and the total

amount of legal tender currency issued by the center bank. Every bank has to meet the demands of its customers to pay cash over the country so a working reserve of liquid cash is always necessary for banker of course if the people are highly banking minded a lower cash reserve will suffice. But in the case of a community where the banking habits are not well developed a higher cash reserve is essential in either case a cause reserve is necessary and this acts as a brake on the power of the banks to create credit / kc shekbar 1997 .18 19/

2.6. Loan eligibility criteria

It is a criterion the bank establishes for the customer to fulfill to apply for a loan and advances in order to qualify for a loan:-

1. The applicant should submit the basic documentary requirements which should include: application letter valid business license article and memorandum of association audited financial statements for all share companies power of attorney perform invoice sales agreements concluded contracts land holding certificate and vehicle ownership booklet. Testimonial letters, banks statements.
2. The purpose of the request should be clearly stated.
3. Evidence should be submitted that would show the profitability of the business which is sufficient to provide the owner with adequate returns while meeting loan obligations within a reasonable period of time
4. In the investment of projects , financial and economic rates of returns should be set and tested against national parameters for their accept ability
5. The business should have at least one year of operational experience. Unless treated exceptionally , sufficient collateral acceptable to banks is offered(Tilhum Hailu, 2005)

2.7.1 Loan Evaluation

Personal and business loans are initiated with an application and an interview with a loan officer, who sometimes given a more congenial title, such as "relationship." The loans officers' responsibility is to acquire information about the customer, the purpose of the loan and the likelihood of its repayment. Those who have a long standing relationship with the bank involving deposits previous loans and other services naturally expect to have their loans approved more readily than applications from strangers presumably continuing close relationship with customer gives bank information about the borrower that is not easily available to others. The cost of obtaining and verifying such information makes it impractical for little known firms to make public security offerings and makes it economical to maintain on going relationships with banks.

The evaluation of a personal loan involves an investigation of the applicant employment and credit history the loan office looks for a record of stable employment at a wage adequate to repay the loan and meet other financial obligations and for evidence of the repayment of earlier credit obligations including a home mortgage car and education loans and credit worthiness using a credit scoring system based on the economic and demographic characteristics and default on loans solon applicants are given points for job stability .

2.8 Steps of be follow on loan processing

Loan processing which needs exertion of maximum effort in order to avoid faulty loans has to follow the following steps according to the training manual prepared for credit staffs.

2.8.1 Credit Analysis

The purpose of credit analysis is to asses the likelihood that the

customer will repay the loan in accordance with the stipulated terms. In determining whether or not to grant the requested credit, the loan officer must strictly evaluate the loan request in line with the customer's ability and desire to repay the loan. The time honored the 5(five) "C"s of credit (Capital, character, capacity, conditions, and collateral) are used as a basis for approving credit.

Capital: the level of capital, (which involves analysis of the customer's net worth) is important in establishing the customer's ability to repay the loan by falling back on other assets that can be used to generate cash to repay the loan. If the value of assets substantially exceeds liabilities, the credit is less risky.

Character –involves determining the customer's willingness and assessing. Character is the customer's credit history.

Capacity: involves determining the ability to repay and involves analysis of the level and sustainability of the income that can be used to meet the required loan repayment. The larger the income after payments, the greater the capacity.

Collateral: if the loan is secured by collateral and the customer fails to repay the loan as promised, the bank has the right to the assets used to secure the loan. To provide an alternative source of repayment the collateral must be marketable and the value of collateral must exceed the balance of the loan at the time of default. Collaterals should serve only as last alternative source of repayment and in most cases should not be a major consideration in granting credit.

Condition: refers to general economic conditions and the impact these conditions will have on capacity and to a lesser extent on the remaining characteristics. Considering the potential impact of general economic conditions on the ability of the customer to repay the loan is particularly important during recession times.

The environment surrounding theme affects borrowers for instance

climate disaster is one factor that affects the agricultural sector. All condition that can affect the borrower in the future should be assessed before the loan is granted

2.8.2 Approval

This is the loan processing stage where decision is made on the loans requested based on outcomes of the evaluation and analysis conducted.

2.8.3 Disbursement of Loan

After having ascertained completion of formalities required to be met prior to disbursement the branch will disburse the loan. Receipt of written instruction of the borrower to effect the disbursement is important, and conditions set at time of approval regarding the mode of disbursement have to be strictly observed.

2.9. Risks faced in lending

As the magnitude of loans disbursed in the banking sector become greater and greater and the risk associated with uncollectibility of its becomes higher and higher above signal digit ratio of nonperforming loans to total loan is a symptom of poor credit analysis and follow up in order to minimize the risk associated with credit (National bank of Ethiopia memorandum ref.. No SD/290/04, dated October 26, 2004).

According to ML Jhingan /2004/ there are causes where banks sometimes given too much or too little credit may lead to inflation that causes direct and immediate damage to creditors and consumer on the contrary too little credit leads to deflation that brings down the level of output employment and income such as credit leading to hyperinflation creates political instability.

2.9 Factors that Affect Loan Processing and Collection

Corporate planning and development department of bank on its October

2005 issue classified the causes in two broad groups.

1. Internal factors are lack of continuous follow up of repayment due to manpower shortage lack of consultation and communication with defaulter overstating the collateral value at the time of estimation lack of credit information to be gathered from other commercial banks and agency problem /i.e branch managers focus merely on increasing their loan portfolio accepting loaners without making due analysis/.
2. External factors are: - diversion of the borrowed fund to other purposes unavailability of demand and price fluctuation on both local and international market country economic and political.
3. condition impact of change in fiscal and monetary policy insufficient credit awareness unwilling customers to disclose the information required , unethical competition make between banks and willful default

Consequence :- providing loan over the total capital of the firms or business entitles providing loan without sufficient back up adequate safety of collateral or security providing loan without sound credit principal and appraisals , providing loan to unfamiliar borrowers and without adequate information about the borrower , providing loans with the quality and dependability of personal guarantee providing loans / large sum / without audited financial system of borrower firm company providing additional loan without additional collateral providing loans without the expertise of engineering appraisal and without additional collateral providing loans without the expertise of engineering appraisal and without consideration of depreciation and current fair value of the property of the borrower , providing with non-existent merchandise and if there is its marketability that is not fast moving items providing loans with collateral which has no legal documents or registration

With municipality providing loans with collateral which has no legal documents or registration with the municipality providing loans without sufficient credit history or information of the borrower providing loans without viable project business proposals and the damage of nonperforming loans on commercial banks occurred due to the above causes aggravated because of the way that the banks try to recover sick loans .

2.11 The Role of Commercial Banks to the Economy

Besides performing the usual commercial banking functions banks in developing countries play an effective role in their economic development. The majorities of people in such countries are poor unemployed and engaged in traditional agriculture. There is acute shortage of capital people lack initiative and enterprise means of transport are undeveloped industry is depressed the commercial banks help in overcoming these obstacles and promoting economic development. The roles of commercial bank in a developing country are the following

It is well known that the lifeblood of the private sector is capital which is an input that increases productivity and creates wealth unless there is sufficient capital there will be outgrowth it is because of lack of capital that Ethiopians productive forces are categorized as the least developed in the world capital is not something that can be scooped off from the land one means of obtaining capital is through bank credit. The prime task of banks concentrates on the process of lending money that involves collection of funds from different sources by way of accepting deposits and deployment of demobilized funds in the form of credit areas where it is needed to support commercial activities that have economic importance commercial banks avail credits for the purpose of working capital and to finance investment bank credit can be defined as money provided by banks for eligible activities that have economic importance

with an agreement to payback the principal with interest within the period specified in loan contract (opining surveyor Majorcans of NPL by NIB Bank 1997 E.C)

Literatures reviewed so far emphasize the importance of loan and advance management system.

The next chapter evaluates the loan and advance management system of NIB banks

As those different scholars stressed, focused and points out that how banks loans and advances are vital and essential to the existence bank hence constantly and persistently revising checking and enhancing the loans and advance management system of the bank unquestionable and advisable in line with the Scio- economic and technological development of the nation.

Chapter Three

Data presentation and Analysis

This chapter deals with a tabular data presentations along with their immediate interpretations. The data were collected through questionnaires that were distributed to some selected staffs and customers of the tana area NIB bank. All questionnaires which are distributed for credit customers and staffs are filled and returned.

3.1 Respondents Biographic data

The selected staffs have played a great role in the finalization of this paper by answering the asked questions in the form of questionnaire and interview. Their responses for the respective question are analyzed as follows.

Table.3.1 Respondent's General Information

Position	No	Percentage
Manger	1	25%
Assistant manager	1	25%
Credit analysis	1	25%
Loan officer	1	25%
Total	4	100
Time stayed	No	Percentage
Less than 1 year	0	0%
From 1 to 3 year	1	25%
From 3-5 years	1	25%
Above 5 years	2	50%
Total	4	100

(Source: Primary Data, 2006E.C)

As can be seen above the research has tried to cover all areas of position that are available in the loan processing. 25% of the respondent was working on managerial level. 25% of the respondent was working as assistance manager. 25% of the respondent was working as loan officer and 25% of the respondents was credit analysis. Of the respondents 0% have less than 1 year credit experience, 25% has from 1-3 years of credit experience, 25% has from 3-5 years of credit experience and 50% of them have above five years experience. This shows that almost all staff of credit has gained much knowledge through good experience and are capable of doing on the credit area.

3.2 Requirements for Loan Application

According to the interview made with loan officer the basic requirements expected from the applicant to get loan from the bank are mentioned as follows:

3.2.1. Application Letter

Its includes Financial statements, Trade license, Investment certificate and TIN (Tax Identification Number), Article and memorandum of association, Ownership certificate of the collateral offered, Bill of quantity and blue print and marriage certificate of the mortgagers.

In addition to what the loan officer mention above, the following documents are described necessary depending on the type of loan and collateral required on the banks credit manual: power of attorney, pro-forma invoice, concluded contracts, land holding certificate and vehicle ownership booklet, bank Statement and testimonial letter.

3.2.2. Credit Worthiness Evaluation

The credit analysis has also indicated as to how they evaluate the credit worthiness of the customer.

By evaluating the capital strength and capacity of the company, by evaluating the strength of the collateral and characteristics of the company.

The credit manual indicates the 6'Cs

(Character, capital, collateral, condition, capacity, and consultancy)

of credit is the basis for analyzing the credit worthiness of the customer. The respondents also describe their evaluation method according to the manual.

3.2.3. Collateral Requirements

The commonly accepted collaterals by the bank are listed by the respondents as follows

- Buildings
- Vehicles
- Machineries
- Merchandise

The above listed types of collaterals are standard all over the world. However, buildings hold the biggest portion from the rest in our country to be accepted as collateral according to the interview made with the respondent.

3.2.4 Credit Processing Procedures

The procedure followed by the bank in extending loan is listed under by the respondents.

1. Consultation with the customer.
2. Document received as per requirement.
3. Analysis made at the branch and sends to head office for approval.
4. Loan contract preparation and send to government municipalities for registration.
5. Loan credited to their account for the same purpose (for details refer literature review part).

3.3 Personnel involved in Loan Approval

As per the credit manual the following staff of the bank participates in the approval of loan.

1. Branch credit committee include Credit analyst in the branch, assistant manager and branch manager, accountant, loan officer participate in the approval of loan up to birr 150,000.00 grade I out lying branch, approval of loan up to birr 150,000.00 grade I city branch, approval of loan up to birr 250,000.00 grade II, approval of loan up to birr350, 000.00 grade III and approval of loan up to birr 500,000.00 grade IV.
2. Credit department credit committee include credit manager, branch operation manager, head credit analysis, presenting credit analyst approval of loan up to birr2,000,000.00.
3. Management credit committee v/p credit &branch operations credit department manager, head credit analyst at head office , accounts & finance manager of the bank participate in the approval of loans up to birr 5 million.
4. Executive Management credit committee for loan request which is more than 15 million will be approved by the board of directors and board members with president of the bank.

3.4 Non-Performing Loan in NIB Bank

Respondents were also asked to indicate in which form of business ownership the rate of NPL is high and most of them agree that it is in plc (Private Limited Companies) and state their reasons as follows:-

NPL any defects or violation of agree contract terms as to payment of loan, time of payment, amount of payment, interest payment by the loan despite the forward reasons.

- Frequent disagreement between shareholders, conflict of interest and lack of independent management and ownership.
- Diversion of the approved loan to unwanted business line.
- When the collateral offered is less in value than the loan given. When loan is granted collateral free i.e. clean basis

3.4.1. Status of non performance loan(NPL) loans

sector	no	Amount granted	Date granted	Due date	Repayment amount	Principal (out standing bal.)	interest	Total indebtedness	Arrear amount	days
Constructio n T/L	1	307,437.07	31/05/13	31/05/14	27,750.00	239,307.74	23,790.23	263,097.97	241,901.04	274
	2	1,000,000.00	02/09/13	01/09/14	268,625.00	708,571.14	40,392.74	748,963.88	464,875.00	122
DTS T/L	3	800,000.00	16/11/12	15/11/16	21,462.00	568,449.57	6,666.52	575,116.09	85,848.00	123
	4	200,000.00	17/03/12	18/03/15	17,750.00	200,000.00	6,695.89	206,695.89	88,750.00	150
Manufactur ing	5	850,000.00	13/12/12	12/12/15	28,640.00	530,087.86	16,562.01	546,649.87	114,560.00	120
	6	700,000.00	02/05/12	03/05/15	22,577.00	436,675.88	5,016.50	441,692.38	112,885.00	119
Mining power water	7	1,200,000.00	01/08/13	31/07/14	324,281.00	464,161.78	38,939.68	466,579.46	464,161.78	232
	8	1,153,485.00	24/09/11	23/09/15	98,082.00	591,081.60	30,196.87	621,278.47	166,164.00	100
	9	1,000,000.00	21/07/12	20/07/16	85,031.00	654,056.46	23,748.58	677,805.04	94,200.00	95
Import	10	900,000.00	27/12/13	26/12/15	79,900.00	529,733.21	693.68	530,426.89	239,700.00	93
Hotel & tourism	11	2,059,313.93	31/10/11	31/10/17	48,452.00	1,123,935.87	1,827.50	1,125,763.37	37,786.20	32
	12	4,000,000.00	24/02/12	23/02/17	94,112.00	2,615,970.42	24,228.13	2,640,198.55	189,320.00	97
	13	4500,000.00	28/12/13	27/12/15	176,000.00	2,980,000.00	38,200.00	3,018,200.00	528,000.00	94
Advance	14	4,800,000.00	30/12/13	29/06/14	-	2,295,661.77	19,120.03	2,314,781.80	2,313,586.00	2

3.5. The Role of Legal Department in Loan Recovery

The role of legal department is stated as follows by the respondents.

The main function of legal department is to protect and assess the bank property against any fraud activities of from customers and any legal related activities.

- To access the nature of the documents from legal point of view. For example, to check whether the individual (manager of the company) authorization enables him to mortgage a property of the company or third party and can conclude a contract.
- To check on the validity of the documents presented.
- Following court cases to settle the defaulted payments.
- To advice the bank and update against issuance of new laws

3.6. Problem faced by Credit Line Staffs during Loan Processing

Table 3.2. Problems in Loans Processing

Have you ever come across any kind of problems regarding loan processing?		
Answer	No	Percentage
Yes	2	50%
No	2	50%
Total	4	100%

(Source: Primary Data, 2006E.C)

50% of the total respondents have come across problems and they have explained the problem they faced as follows.

- "Initially matching generalized credit policy and procedures to specific loan request was a problem"
- "Some customers are reluctant to disclose necessary information specially their financial statements which is unavoidable and vital to know the financial position of the prospect borrower".
- "Objective sect oral evaluation is impossible in the country in account of absence of any responsible body that provides the required data."
- "Lack of information in evaluation new projects.50% of the total respondents say that no problem stem from

credit lines staffs themselves. This depicts that staffs are co-operative enough in informing and requesting the need procedure of the bank.

3.7. Causes for NPL at Tana Area NIB bank

Credit staffs were also requested to list the causes for the loans to be non-performing or doubtful and their answer is organized as follows.

Table 3.3. Reasons for NPL

	Type of reason	Number	Perecentage
1	Lack of continuous follow up of repayment due to manpower shortage	3	21.42%
2	Lack of pre and pose Disbursement consultancy to loan	3	21.42%
3	Use of loan granted for unintended purpose	3	21.42%
4	Incapability of management in leading the business	2	14.28%
5	Overstating the collateral value at the time of estimation	2	14.28%
6	Unavailability of demand and price fluctuation on both local and international market and willful default	1	7.14%
	Total	14	100%

(Source: Primary Data, 2006E.C)

21.42% of the total respondents replied that the main cause of NPL is lack of continuous and tight follow-up, lack of before and after loan approval consultancy and other 21.42% of the respondents replied that due to diversion of funds for un intended purposes. This clearly indicates that the major sources of default are controllable and determinable in nature and calls for reinforcement of the stated reasons.

3.7.1. Information Disclosure by Applicants

Respondents were also asked customers are willing to disclose every information the bank needs for loan processing and their response is organized as follows.

Table 3.4. Customers Disclosure Evaluated by the Bank

Are customers willing to disclose every information the bank needs for loan processing		
Answer	No	Percentage
Yes	1	25%
Some are willing and some are not	3	75%
Total	4	100%

(Source: Primary Data, 2006E.C)

As indicated on the above table 75% of the respondents agreed that there is a problem in disclosing information from customers. This is a serious barrier for loan processing. Only the remaining 25% of the respondents says that customers are willing to disclose every information which are required by the bank.

3.7.2. Effect follows up of Loan

The selected staffs were asked whether the bank made the necessary follow up after the loan is disbursed or not.

Table 3.5. Follow up Evaluated by Staffs

Does the bank make the necessary follow up after the loan is disbursed		
Answer	No	Percentage
Yes	2	50%
Yes but limited	2	50%
Total	4	100%

(Source: Primary Data, 2006E.C)

Follow up is the key for successful loan collection in every bank. Because, the borrowed fund may be converted to unintended business or illegal business purposes and leads the loan to be doubtful. But as indicated above even though the bank made follow up of loan 50% of the respondents agree that it is too limited and not enough compared to the number of loans disbursed and much effort is expected for effective loan processing

3.7.3. In addition to the above question, respondents were given the opportunity to add any additional information and opinion they have in mind and it is organized as follows

"Periodic evaluation of the overall economic situation of the country should be made to find out potential areas for credit expansion and to minimize concentration on relevant sectors in order to safeguard the bank from associated risks"

"To get required information for projects appraisal loan officer should get internet service from the bank"

"Training has to be given for the staff"

"The major weakness is the failure to bring to practice policies and procedures as they are on paper"

"Analysis should have most recent hard copies of business releases."

3.8. Attitude of the Credit Customers towards Credit Facility

Some selected credit customers of tana area NIB Bank have also been given the opportunity to express their attitude towards the credit facility that NIB Bank renders to its customers and their response is analyzed as follows.

3.8.1. The length of time that the business started operation

Table 3.6. Duration of the Business since it is Started.

Times stayed	No	Percentage
Less than 1 year	-	0%
From 1 to 4 years	2	40%
From 4 to 8 years	2	40%
More than 8 years	1	20%
Total	5	100%

(Source: Primary Data, 2006E.C)

From the finding it can be seen that the majority of the respondents have been in the business for more than 1 year. This shows that they are experienced in the business area and they have better know how on the process of loan in the business.

3.8.2. The Length of Time that Respondents Stay as Customers of

NIB Bank

Table 3.7. Years of Respondents Attachment to the Bank

Time stayed	No	Percentage
Less than 1 year	-	0%
From 1 to 3 years	1	20%
From 3 to 5 years	3	60%
From 5 to 8 years	1	20%
More than 8 years	-	0
Total	5	100%

(Source: Primary Data, 2006E.C)

From the findings it can be seen that the majority of respondents have been customers of Tana area NIB Bank for about 3 to 5 years. This shows that most of the company customers have gone a long way with the company and hence, the bank must put much thought and also make use of serious effort to satisfy its customers by producing a more effective credit service.

3.8.3. Problem on getting Loan Service

Table 3.8. Attitude of Customers towards the Bank Loan Service

Answer	No	Percentage
Very Good	3	60%
Good	2	40%
Fair	-	0%
Total	5	100

(Source: Primary Data, 2006E.C)

The above table shows that a relatively small proportion of the respondents, which is summed to be 40% who have come across difficulties in getting loan service. They specify their reasons to the difficulties they faced as follows

- "High value collaterals are needed"
- "Because the time wasted to process the loan is very long"
- "Limited amount of loan approved" and 40% of the respondents

Supported the raised question considers as better bank loan Service is in relation of the prevailing market competitors. This clearly indicates as bank loan service is in a better position Currently but it needs further consolidation by considering Socio-economic, technological advancement and actions of Market competitors.

3.8.4. Respondents Evaluation of the Speed, Courtesy and Cooperativeness of front Line Officers

The supplier customer relationship must be consistently good. Customers are very susceptible that can never be satisfied if they can not agree with the front desk workers whom they face directly no matter how careful the top managers area. In this regard, customers were also asked whether or not they observe problems on speed, courtesy and cooperativeness of front line officers of the loan section. Their responses are summarized in the following table.

Table3.9. Evaluation of Speed, Courtesy and Cooperativeness of Credit Officers.

Answer	No	Percentage
Yes	1	20%
No	4	80%
Total	5	100%

(Source: Primary Data, 2006E.C)

The data shows that there is no as such considerable problem of the front desk workers approach. However, the bank should work on this matter for the better improvement by showing a good tone of voice since the worker customer relationship is very important for the success of the Bank.

3.8.5 Loan Processing from Application to Approval

Table 3.10. Evaluation of the Loan Processing by the Customers

Answer	No	Percentage
Very good	1	20%
Good	1	20%
Satisfactory	1	20%
Need improvement	2	40%
Total	5	100%

(Source: Primary Data, 2006E.C)

As indicated on the above table (40%) of the respondents agree that the loan processing need improvement and they described their reasons as follows

Even though all the necessary document are listed on the credit manual the customers complain, "We are not told every necessary document that must be presented once they told us something and in then next day another"

20% of respondents responded that existing loan processing procedure is good enough

3.8.6. Advisory Service Given to Customer

Table 3.11. Advisory Services for Customer

Answer	No	Percentage
Yes	5	100%
No	-	-
Total	5	100%

(Source: Primary Data, 2006E.C)

Consultancy is one of the key factor, among other that is, the 'Cs' of credit, in analyzing credit and for the final success of loan processing that is collection of disbursed loans as indicated in the credit manual.

From the table we can understand that all the (100%) respondents agree that they are provided an advisory service from the bank. But some of the respondents reply that the advisory service provided by the bank is not satisfactory.

3.8.7 Training Given for Credit Customers

Training given for credit customers on how to use the borrowed money is the very important part of loan processing in order to have successful collection. Bearing this in mind the respondents were asked whether

they have been given training or not and their response is organized as follows.

Table 3.12. Training Given to Credit Customers

Answer	No	Percentage
Yes	2	40%
Yes but not satisfaction	3	60%
No	-	0%
Total	5	100%

(Source: Primary Data, 2006)

It is believed that training given to customer's increases the successfulness of the customers and that it is very important for the bank in such a way that the borrowed money will be used effectively and collected as wished. As the table above shows even though training is given to credit customers, It is not enough for the need of the customers. This is agreed by the majority of the respondents that is, 60% of the total respondents.

3.8.8. Customers were asked the time taken to approve and disburse the approved loan.

Table 3.13. Time taken to Approve and Disburse the Approved Loan.

Time Taken	No	Percentage
From 3-7 days	-	0%
From 7-15 days	2	40%
From 15-21 days	3	60%
Above 30 days	-	0%
Total	5	100%

(Source: Primary Data, 2006)

According to findings gathered 40% of the respondents from the customer side have come across with difficulties in getting loan service.

Recording the speed, courtesy and cooperativeness no considerable problem is seen and almost all customers agree that the bank should exert the maximum effort on the improvement of the loan processing as there is exaggerated length of time taken between the loan application approval and disbursement.

In addition, the advisory service and training given to customers is not satisfactory and there is limited follow up made by the bank after the loan is disbursed.

Some customers are not willing to disclose every information necessary for the processing of a loan and some borrow divert borrowed fund for unintended purpose.

It is a sure fact that banks being intermediaries who mobilize money from the public at large, they need to utilize this public fund effectively and safely. Out of the ways banks can assure safety for mobilized

financial resources is by analyzing customer's applications following its own regulations requirement. But this does not mean that banks must erect unnecessary bureaucracies that might be found tiresome by most customers. As can be assessed from the above table, most of the customers are of the view that the number of days spent to secure loans is significant which is up to 21days. Standard banking practice indicates that decision for a loan applied must be given within 5 days. Hence one can see that the bank's service in disbursing loans need improvement as customers might start looking for better offers.

3.9. Causes of Credit Risk

As per the interview conducted with general manager of Tana area Nib Bank, most of the employees of the credit staff are assigned their position based on their job experience. Experience has proved that the pivotal issue for preservation of the quality of loan is existence of well-developed policies and procedures, effective credit control and the most critical element of all a well trained staff that is qualified to implement the system. Conversely the manager of tana area Nib bank also stressed that, absence of adequate guidelines to monitor administration of the lending function pave the way for occurrence of substantial amount of loans approval.

Therefore, the basis causes for the occurrence of credit risk are incomplete information, weakness in collateral arrangement, technical incompetence the ability to analyze financial statement and to obtain and evaluate other credit information, lack of adequate supervision of old and familiar borrowers etc.

3.9.1. Preventive Techniques Methods

As per the interview conducted with credit manager analyst Tana area Nib bank face problem due to the fact some of the loans and

advances granted to various users turned to be bad loans.

Different factors can be considered for some loans and advances of turn out to be bad loans. One of the main reasons is that borrowers do not use the fund for the purpose they had taken it for. Before granting a loan, branch manager and the credit investigator go and visit the working place of the applicant.

However, the loan processing is not considered complete simply because it is processed, approved and disbursed. It should be supported by adequate loan follow up to ensure the best performance of the bank in collections repayments as scheduled. After loan is granted it must be managed to ensure that it is repaid. Loan management is the most important responsibilities of a lending officer. Also the credit risk analysis management considers the following signals before the collateral is approved.

A. Early management warning signals

- Change in behavior /personal habits/life-style of the key people
- Change in attitude toward banks especially a seeming lack of consideration
- Failure to perform personal obligation
- Lack of experience in line of business
- Illness or death of key personnel
- Inability to meet commitments on schedule
- Poor financial reporting and control
- Change in the business of industry
- Unusual or unrealistic plans for the future

B. Early Financial Warning Signals

Balance Sheet

- Failure to get statements in a timely fashion
- Deterioration in customer is cash position
- Deterioration of working capital position
- Rapidly changing concentration in fixed assets
- Deterioration increase in current debt or decline in the current ratio.
- Refusal to provide auditor statements.

Income Statements

- Declining gross profit margin
- Declining of revenue

C. Early Operation Warning Signals

- Changes in the nature of the company's business.
- Poor financial records and operation controls.
- Poor Employee attitude and morale banking.

D. Early Banking Warning Signals

- In ability to get timely financial information
- Sudden or excessive borrowing.
- Declining bank balances
- Transfer or operation account to another bank.
- Marked changes in borrowing or repayment patterns.

Early detection of warning signals is crucial to maximize corrective action and minimize potential losses. Supervision is particularly important when loan mature or became past due or terms of agreements are

violated. Assessment of these reviews lead to the expansion, modification, renewal or cancellation of existing facilities.

Finally, as interview conducted the credit management department about the preventive techniques used to reduced risks is occurrence of risk stick loans could be minimized through prudent analysis made prior to release of the loan procedure is implemented. Strong and regular follow-up practice is exercised. Beside, controlling methods and approaches are revised periodically to fit the dynamic business environment.

3.9.2. Mechanism to Reduce Credit Risk

This study also tries to indicate some methodologies that are used in tana area Nib Bank to reduce credit risk. In Nib Bank there are low stages to implement different mechanisms to reduce credit risk. One is before disbursement new loan and the other is after disbursement.

I. Before Disbursement Mechanisms

According to the loan manual in Nib Bank before disbursement mechanisms include proper credit analysis, proper design and implantation of loan eligibility criteria and proper loan disbursement procedure.

Credit Analysis in Nib Bank:- Credit analysis should include a clear indication of the bank's target. This analysis should set out who eligible for credit and for how much, what type of credit are available and what term and condition the credit should be granted. According to Nib Bank loan manual the 5c's of credit are practicable techniques in the bank. The 5c's of credit are already mentioned in chapter two as credit analysis factors.

Loan Eligibility Criteria in NIB Bank:-In evaluation of loaned subjective judgment are to some extent unavoidable. But NIB Bank set loan eligibility criteria to minimize the effect of individual perceptions in loan evaluation. One NIB Bank's manual these eligibility criteria are state broadly according to the purpose of the loan and type of the loan. But in general, the basic loan eligible criteria are:-proof of engagement in a licensed business, presentation of financial statements or filling of financial credit report, presentation of collateral to secure the loan, and feasibility study in the case of project finance.

Credit Disbursement Procedure in NIB Bank

According to the loan manual, try to explain how the loans process starts, now a series of duties are performed at the various stages of the process. That is initiation valuation and approval.

Initiation:- The basic document necessary to proceed on loan processing is the loan application. It is simply a letter lodged by a customer to a bank that explains its desire to have a bank loan. The loan application should be accompanied by valid and currently renewed trade license. This helps to prove the legal formation of the business organizations and its existence. Once the loan application is found in order and copy of relevant trade license are proved valid and genuine the next step to be followed would be evaluation.

Evaluation:- is a process through which applicant's actual need for bank loan is assessed, viability of the business he/she runs is studied, and repayment capacity is measured. However, handling this task is not as such simple. It requires analysis of financial statement of the borrower to check financial soundness and gathering relevant information regarding

character, credit worthiness of the applicant. Assessment of financial soundness can be done by analyzing financial statement of the applicant (Balance sheet and Income statement) which could be audited or provisional. But, it is not always possible to base the analysis on financial statements, as most of the customers do not maintain required for analysis in a format prepared to serve the purpose. The next step is collecting credit information.

Credit information: - is information related to applicant performance and reputation. Personal integrity, character and credit worthiness have to be collected from different sources carefully and as much as possible genuinely. Useful sources could be other banks. In recent time National Bank of Ethiopia has started new system of sharing credit information of any borrower's with in all banks.

Loan Approval:- All the steps taken in the evaluation process could only serve one purpose i.e. to give decision on a loan request of a customer whether the analysis made on the financial statement, and credit information collected gives positive or negative results, the request for a loan has to have an answer. Thus, the next stage of the loan processing cycle will be decision making i.e. approval or rejection. To arrive at a fair decision. Analysis made on the financial statement and information gathered is summarized in bank format knowledge loan Approval form (LAF). All the information given under the LAF is meant to serve the final stage of the loan process i.e. Approval. The individual or the committee authorized to pass decision on loan requests thus have summarized information about the loan request, hence, after reviewing the information available in the LAF, and discussions are made with the committee members, decisions will be made. The decision is written on the decision space of LAF and is signed by the committee member.

Approval date is also written. If there are deviations from recommendation reasons will be given here.

Once it has approved it has to be communicated to the customer then there should be a loan contract. Moreover, securities should be registered and even if type and extent of insurance coverage differ from property to property and the risk involved in any case the borrower is required to insure the property. Completion of the contract registration, receipt of documentary evidence of properties held as collateral and insurance policy end or seed in the name of the bank proves formalities for disbursement of the loan

Documentation:- All documents beginning from the loan application up to the last paper have to be properly filled in a loan life . Loan file have to be properly kept under the control of responsible person. Security documents, such as land holding certificate, car ownership booklet, and the like together with original contracts are separately kept in safe under look.

II After Disbursement Mechanisms

According to the loan manual and different internal memos, in Tana area NIB bank broadly used after disagreement mechanism to reduce credit risk, is proper credit follow up.

Credit follows up in Tana area NIB bank

In practicing proper follow up, once funds are disbursed the concerned bank officer cannot afford to rest and expect that a repayment will be collected as schedule .Therefore, the loan officer prepare schedule which contain the repayment data and telephone address of the loans in order to make the follow up task easy. After this the officer is expect to call when payment is not made of the payment data.

Even if the payment is regular follow-up by visiting customers business or factory is necessary to create long lasting friendly relationship. This may elicit future payments and development partnership relation. Sometimes borrowers seem to ignore repayments for one reason or another. In such case Tana NIB bank undertakes the following. Follow up activities are the following:

Giving verbal reminder after calling the customer and discussing the matter. If this fails and no payment is made then the bank choose to the second step personal visit is more reproductive than telephone calls. This should be performed with in one week after the installment is due.

- Sending first written reminder using language of general persuasion and explaining that the money the bank lent. Out belongs to the banks depositors and that is accountable. This should be done if installment is our due by a month.
- If the first reminder fails the second written reminder that shows the bank is legally and morally bound to collect the debt would follow. The remainder will be order in such as way as to show the banks determination to proceed with further measures if repayments are not forth coming. It is very important that the bank use every means to make the borrower come up with alternative proposals if possible until the bank make fairly certain that payments are unlikely to come. If the customer does not show any cooperation than we would write and send the third reminder.

Problems in NIB Banks Credit Risk Management

According to the respondent's response, in Nib Bank there are internal and external problems.

Internal problems

- Poor credit assessment in determining the viability of a business due to lack of information and this forced the bank to follow collateral based lending process.
- A very long property (Collateral) valuation and documents checking process irrespective of the type of customer and requested product type.
- Absences of research work to provide the credit staff with appropriate information about the national, geographical, sector information, which could increase their performance.
- Unnecessary delay in credit information processing as a result of poor internal and external communication media, negligence of the credit staff to timely initiate a request and responding to a request and absence accountability.
- Absence of transparency among the staffs of the Bank at different and the staff and the banks customers.
- Loan diversion is the main cause for reaching loan an agreement.
- Poor negotiation skill from the credit staff side and absence of any guidance to this effect from the top management and absence of standard, which crease lack of confidence to the staffs.

External problem

- Presence of unfavorable economic development like drought, effect of the world economy.
- Absence of record keeping which creates difficulties in preparing true financial statements and disclosing performance of the business.
- Lack of cooperation among banks on sharing customer's credit information. And they said that centralized credit information system is not up to date and it is operating inefficiently.

Chapter Four

Summary, Conclusions and recommendations

The study was designed to assess the practical implementation of loan processing system in the case of NIB bank . This chapter presents the summary of the findings of the study, the conclusion drawn from the finding and recommendation of the student researcher about the measures that should be taken by the procedure of loan processing system in NIB bank.

4.1 Summary

As per the findings the student researcher summarizes the under listed points to answer the basic research question which asked in chapter one.

- The respondents said that the bank have to assess the type of loan..
- All respondents said that the bank has to see the loan evaluation system.
- Most respondent responded regarding bank loan processing to examine the problem will face by the bank & borrowers.
- Most of the respondent responded regarding bank loan procedure they said it have some problems especially collateral estimation, long process and selection of sectors.
- From the finding we understand the bank differentiate business sectors to give a loan it is to implement government policy and to maximize its profit.
- The respondents said that the bank have to see the loan management system contributes to non performing loan (NPL).
- As per the respondent response the bank evaluate its customers to provide a loan it identify customers business sector if its illegible or not , profitability of a business , value of collateral , good payment practice , attractive cash flow etc.
- The study finds that the time taken of loan has a positive attitude to wards to customer. This means that, there is no exaggeration of waiting time for loan. But there is comparison of loan time taken from our study.

- The bank controls its employees by the bank rules and procedures.
- NIB bank loan have some differentiation and similarities e.g related to similarities all banks (Private and government) should follow NBE rules, procedures and directives to set their loan procedure. Regarding dissimilarities by business sector selection to give a loan.

4.2. Conclusions

The analysis made in chapter three and comparison of the result against the literature review has resulted in the under mentioned conclusion and later recommendation.

According to findings gathered 40% of the respondent's from the customer side have come across with difficulties in getting loan and service .Recording the speed, courtesy and cooperativeness no considerable problem is seen and almost all customers agree that the bank should exert the maximum effort on the improvement of the loan processing as there is no exaggerated length of time taken between the loan application approval and disbursement.

In addition, the advisory service and training given to customers is not satisfactory and there is limited follow up made by the bank after the loan is disbursed. Some customers are not willing to disclose every information necessary for the processing of a loan and some borrows divert borrowed fund for unintended purpose.

4.3. Recommendations

Providing loans supports in promoting nation economic growth through the invisible hand. That is, if a bank provides loans to all sector of the economy, it is turn helps the society as a whole. This gradually increases number of transactions in the business market among the different sectors and leads to economic growth.

The more the bank lends the more profitable it becomes and in turn increase capital of the bank in the form of reserve along with its deposit mobilizations. Growth in capital leads to proportional growth of loadable funds.

Thus, from finding of the paper the following recommendations can be made for further growth and development of the bank as well as to reduce Non-performing loans in the bank.

- ✓ Emphasis should be made on the importance of strengthening credit facilities while processing loans. Like, favoring some areas of the loan sector that enhance for the economic development i.e., agricultural sector. And finally the bank should provide training to the staffs that works in credit sections, which makes the more efficient.
- ✓ It is inevitable, among other things; loans that are not well processed turn to Non-performing loan. Therefore, serious attention should be given and areas should be well addressed in order to reduce NPL while processing loans.
- ✓ Attention should be given in credit customer handling.
- ✓ Emphasis should be made on the importance of enhancing credit follow-up activities after credit disbursed.
- ✓ Continuous awareness should be created among borrowers that they should be close to the banks and consult the bank when they observe any symptom that they will be facing difficulties in meeting obligation.
- ✓ Financial statements presented by the customers must cross analyzed.

On the Side of the Borrowers

- ❖ Conducting study regarding important and viability of the business undertaken before approaching to Bank for credit.

- ❖ Forecast the capital required to perform the task.
- ❖ Preparing plan that shows applications of the loan.
- ❖ Preparing plan that shows settlement of the bank loan.
- ❖ Compile all the information and document requested by banks to process the loan.

On the Bank Side

- ✚ Collect all the data, information and documents related to the loan application to handle assessment and appraisal of credit.
- ✚ Evaluate acceptability of the purpose for which the loan is requested and the proposal regarding its settlement.
- ✚ Consult the applicant on the outcomes of the evaluation that is made based on the information, data and documents submitted.
- ✚ Short-term training and workshops for personnel engaged in the analysis work should be organized regularly

In general the bank should maintain and strengthen credit administration of the following areas:

- ✚ Consultation.
- ✚ Efficient loan processing.
- ✚ Encourage Customer participation.
- ✚ Advocate credit growth to address customer needs and to focus on the direction of economic growth.

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APPENDIX

St. Mary University

Faculty of Business

Department of Accounting

NIB Bank's loan processing system questionnaire

To be filed by:- Staffs of credit department

The questionnaire has been prepared to get the relevant data about the loan processing system of NIB Bank S.C. This paper is prepared as a partial fulfillment of BA Degree in accounting.

Remark: Please respond to the items frankly and honestly. Your feedback is very important. There is no need to write your name on the questionnaire. Put tick mark . If necessary explains.

1. Back ground of the respondent

Sex

Male Female

2. Education back ground

Diploma Degree above degree

3. Work experience

1-2 years 3-5 years 5-10 years above 10 years

4. What is your present position (title)?

5. What is the requirement expected from the applicant to get loan from the bank and mention

6. How does the bank evaluate the credit worthiness of the customer?

7. Which organ of the bank approved credit facility request by perspective borrowers? You can tick more than one box if it is needed

Branch cr committee Executive management credit committee

Manager cr committee Board committee

8. If your answer for question n° 7 is more than one please give detail limitation approvals

9. Please indicate in which form of the business ownership the rate of NPL is high? What are the reason you mostly observed?

10. Mention the major internal factor that aggravates the occurrence

11. Mention the major external factors that intensify the occurrence of NPL?

12. Are customer willing to disclose every information the bank need for loan processing?

Yes No

13. What is the role of legal department in loan approval?

14. Does the bank make the necessary follow up after the loan disbursement?

Yes Yes but limited No

15. Please mention if you have any idea that can contribute for the improvement of loan and advance possessing system of Tana area NIB Bank _____

St. Mary University College

Faculty of Business

Department of Accounting

NIB Bank's loan processing system questionnaire

To be filed by: Customers

The questionnaire has been prepared to get the relevant data about the loan processing system of NIB Bank S.C. This paper is prepared as partial fulfillment of BA Degree in accounting.

Remark: Please respond to the items frankly and honestly. Your feedback is very important. There is no need to write your name on the questionnaire. Put tick mark If necessary explain.

1. Back ground of the respondent

Sex Male Female

2. Education back ground

Diploma Degree above degree

3. For long have you been in the business?

<1 year 1-4 y ear 4 -8 year >8year

4. How do you evaluate the service on getting loan?

V.good Good Fair Need improvement

5. How do you evaluate the loan and advance processing system

compared to other similar commercial banks

V.good Good Fair Poor

6. Have you got training facility by the bank?

Yes Yes, but limited No

7. For how long have you stayed as a customer of NIB bank?

< 1 year 1-3 yrs 3-5 yrs

5 -8 yrs > 8 yrs

8. Have you got advisory service from the bank?

Yes No

9. How long does it take to approve and to disburse the approved loan?

From 3 – 7 days From 7- 15 days

From 15 – 21 days Above 30 days

10. Do you observe problem on speed, courtesy and cooperativeness of front line officers of the loan section?

Yes No

DECLARATION

Advisee's Declaration

We, the Undersigned, declare that this senior essay /project is our original work Prepared under the guidance of Ato Getahun Guta/ all sources of materials used for manuscript have been duly acknowledged.

1. Name:- _____

Signature:- _____

Place of Submission:- _____

Date of Submission:- _____

2. Name:- _____

Signature:- _____

Place of Submission:- _____

Date of Submission:- _____

3. Name:- _____

Signature:- _____

Place of Submission:- _____

Date of Submission:- _____

Advisor's Declaration

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

1.Name:- _____

Signature:- _____

Date:- _____

ACRONYMS

L/C Letter Of Credit

NIB..... Nib International Bank

NPL..... Non Performing Loan

NBE..... National Bank of Ethiopia