ST. MARRY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

BUSINESS FACALITY

"ASSESSMENT ON LOAN AND ADVANCE MANAGEMENT'' THE CASE IN SOME SELECTED PRIVATE BANKS OF ETHIOPIA

BY: BIRUK ESKINDER

ID: SGS 0396/2007A

JUNE, 2016

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A THESIS SUBMITTED TO ST. MARRY'S UNIVERSITY SCHOOL OF GRADUATE STUDIES IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE PROGRAM OF MASTERS OF BUSINESS ADMINSTRATION

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APPROVED BY BOARD EXAMINERS

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JUNE, 2016

ADDIS ABABA, ETHIOPIA

DECLARATION

I the under signed, declared that this project entitled on the topic of **"ASSESSMENT ON LOAN AND ADVANCE MANAGEMENT-THE CASE IN SOME SELECTED PRIVATE BANKS OF ETHIOPIA'',** is my original work and all sources of materials used for writing this thesis have been acknowledged. And I confirm that the thesis has not been submitted to any other higher learning institutions for the purpose of earning Degree/Diploma.

Name	**Signature**
St. Marry's University School of Graduate	**June, 2016**

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ACRONYMS & ABBREVIATIONS

ACB …………..Automatic Clearing Bureau
AdIB…………..Addis International Bank S.C
AIB ……………Awash International Bank S.C
BOA …………..Bank of Abyssinia S.C
BOD……………Board of Directors
CAD……………Cash Against Document
CBB …………..Construction and Business Bank
CBE……………Commercial Bank of Ethiopia
CBO……………Cooperative Bank of Oromia
CEO……………Chief Executive Officer
CIC…………….Credit Information Centre
CM…………….Credit Monitoring
CT……………..Credit Terms
DB……………..Dashen Bank S.C
DBE……………Development Bank of Ethiopia
DLL……………Discretionary Lending Limit
EC………………Ethiopian Calendar
FDRE…………..Federal Democratic Republic of Ethiopia
FIS……………..Financial Institutions
GC……………..Gregorian Calendar
GDP……………Gross Domestic Product
IMF…………….International Monetary Fund
KYC……………Know Your Customer
L/C……………..Letter of Credit
LAF…………….Loan Approval Form
MIS…………….Management Information System
NBE……………National Bank of Ethiopia
NPL…………….Non Performing Loans
OBC……………Outward Bills for Collection
OBP……………Outward Bills Purchased
ODBP…………Outward Documentary Bills Purchased
PSS…………….Proportionate Stratified Sampling
SC………………Share Company
SBB……………Supervision of Banking Business
TT……………..Telegraphic Transfer
VP……………..Vice President
ZB …………….Zemen Bank S.C

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ABSTRACT

Loan and advance management is one of the most important activities in banking industry and cannot be overlooked by any economic enterprise engaged in credit irrespective of its business nature. Sound credit management is a prerequisite for a financial institutions stability and continuing profitability, while deteriorating credit quality is the most frequent cause of poor financial performance and condition. As with any financial institution, the biggest risk in banking sector is lending money and not getting it back. The main objective of this study is to evaluate the performances of loan and advance management on some selected private banks of Ethiopia. Based on the broad objective, a number of specific research questions were developed. To achieve this broad objective, the study used mixed research (more of qualitative) approach. Sample size of 70 members of staff was drawn from the 132 populations in the selected six banks. The stratified random sampling method taking into consideration on this research as a cluster was used to identify banks and respondents sample size for the study. A survey study was conducted with professionals engaged in credit areas of the selected banks holding different positions and two main sources of data were used for the study namely, the primary (questionnaires and interviews) and secondary (audited financial statements, annual reports and NBE reports). Descriptive research method using table, graphs and percentages were used in analyzing the data. The findings of this study, among others, shows that based on the opinions' of the respondents, interviews argued and analysis of documents, the occurrences of default loans had highly influences the performances of banks and it scare the existence of loans and advances to the needy customer. Hence, the study recommends that banks should enhance their loan quality by updating their policies and procedures to lenient policies for effective debt recovery so as to minimize default loans.

***Key Words**: Default Loans, Loans and Advance Management, Loan Performance, Private Banks of Ethiopia*

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Commercial banks are useful to economic development through the financial services they provide. Their intermediation role can be said to be a catalyst for economic growth. Efficient and effective performance of banking industry over time is an index of financial stability in any nation. The extent to which a bank extends credit to the community for productive activities accelerates the pace of a nation's economic growth and its long-term sustainability.

The operations of private banks are roughly similar throughout the world. In all countries banks are financial intermediaries in the business of earning profits. Banks play such an important role in channeling funds to borrowers with productive investment opportunities by mobilizing deposit and they also play an important role in ensuring that the economy runs smoothly and efficiently.

Credit creation is the main income generating activity of commercial banks (Kallberg & Udell, 2003). However, it exposes the banks to credit risk. Among other risks faced by commercial banks, credit risk plays an important role on banks' profitability since a large portion of banks' revenue accrues from loans from which interest is derived (Rose, 2002).Thus commercial banks should provide strapping credit policy and manual for the framework of their entire credit management process and to set objectives, standards and parameters to guide credit personnel in the overall credit processing.

Lending is not an easy task for banks because of it creates a big problem that is called default loans. Failure to manage loans, which make up the largest share of banks assets, would likely lead to the incident of high level of non-performing loans. As many researchers' stated on their paper and facts observed in different countries banks performance, interest income on loans and commissions on advances contributes significantly a major income of private banks. Loans are the dominant asset and represent 50-70 percent of the total amount at most banks and generates the largest share of operating income and represent the banks greater risk exposure (Mac Donald and Koch, 2006).

Although providing loan and advances as a main source of generating income for private commercial banks, they take into account many considerations as an issue of loan and advance management which helps them to minimize the risk of default that results in financial distress and bankruptcy. This is due to the reason that while banks providing loans, they are exposed to default risk (risk of interest and principal repayment) which needs to be managed effectively to acquire the required level of loan growth and performance.

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

Charles (2003) stressed the importance of credit management: credit management process deserves special emphasis because proper credit management greatly influences the success or failure of financial institutions. This indicates that credit provision should be accompanied by appropriate and attractive credit policies and procedures that enhance performance of loan and advance management and protects the banking industry from failure.

Loan management means the total process of lending starting from inquiring potential borrowers up to recovering the amount granted. In banking sector, loan management is concerned with activities such as accepting application, loan appraisal, loan approval, monitoring, recovery of non-performing loans (Harris, 2003).

According to Sinkey (2002), loan management is extremely important as granting loan is considered to be the equivalent of investing in a customer. However, payment of the debt should not be postponed for too long as delayed payments and bad debts are a cost to the company. Thus, efficiency and effectiveness in performing each steps of loan and advance processing using various parameters has significant effect on performance of loan and advance management.

1.2 Banking Industry in Ethiopia

Modern Banking in Ethiopia was started in the year 1905 when the Bank of Abyssinia was established. Bank of Abyssinia was formed under a 50 years franchise agreement made with the National Bank of Egypt, which was owned by the British and it operate around twenty six years and the liquidation formally on August 29, 1931. During this time, the Bank of Abyssinia was replaced by the Bank of Ethiopia (NBE, 2010).

Bank of Ethiopia was a national Bank and one of the first indigenous banks in Africa (NBE, 2010). The Bank of Ethiopia operated until 1935 and ceased to function because of the Italian invasion. After evacuation of Italians, the State Bank of Ethiopia was established on November 30, 1943 with a capital of One Million Marian Treasury of the Ministry of Finance. Pursuant to the Monetary and Banking Law of 1963, the State Bank of Ethiopia that had served as both a central and a commercial bank was dissolved and split into the National Bank of Ethiopia and Commercial Bank of Ethiopia S.C. National Bank of Ethiopia's activities are central banking activities whereas Commercial Bank of Ethiopia's duty is performing business (normal banking operations).

In 1974 change of government and the command economic system, this had prevailed in the country, the Commercial Bank of Ethiopia S.C and other banks and financial institutions were nationalized on January 1st, 1975. The nationalized banks were re-organized in one Commercial Bank of Ethiopia and two specialized banks, the Agricultural and Industrial Bank (AIB), renamed as the Development Bank of Ethiopia (DBE) and a Housing and Savings Bank (HSB) currently named as the Construction and Business Bank (CBB) (NBE, 2010).

Following the fall of Derge regime in 1991 and the change of economic policy directions, financial institutions were re-organized to operate towards a market oriented policy framework. Accordingly the country enumerated policy and proclamation for operation. The Licensing and Supervision of Banking Business No.84/1994 under Monetary and Banking Proclamation No.83/1994 had allowed the establishment of private banks and has marked the beginning of new era in the Ethiopian banking sector. As a result of the enactment of the banking legislations in the country in the 1990s, a good number of private banks have been established.

Currently, after the proclamation of 1994, there are 19 banks in Ethiopia. Out of which 16 are private commercial banks, one governmental commercial bank and two state owned banks. The first private bank of Ethiopia is Awash International Bank which was established in 1994 by 486 shareholders paving a way to the establishment of related private banks such as Dashen Bank (1995), Abyssinia Bank (1996), Wgegan Bank (1997), United Bank (1998), Nib International Bank (1999), Cooperative Bank of Oromia (2004), Lion International Bank (2006), Zemen Bank (2006), Oromia International Bank (2008), Buna International Bank (2009), Birhan International Bank (2009), Abay Bank (2010), Addis International Bank (2011), Debub Global Bank (2012) and Enat Bank (2013).

The Ethiopian private commercial Banks, therefore, provide a service to the public of transforming one type of asset in to another. Instead of making a mortgage loan to a national, a person can hold saving deposits that enables a bank to make the loan to another person. The banks have, in effect, transformed the savings deposit to loan. Adverse selection in loan issuance occurs because of bad credit risk (those most likely to default on their loans) is the ones who usually line up for loans. In other words, those who are most likely to produce an adverse outcome are the most likely to be selected borrowers with very risky investment projects have much to gain if their projects are successful, and so they are the most worried to obtain loans, clearly. However, they are the least desirable borrowers because of the greater possibility that they will be unable to pay back their loans. Thus, the entire effort of this paper is intended to look in to the detail in dealing with loans and advances management system on some selected private commercial banks in Ethiopia.

1.3 Statement of the Problem

According to Sinkey (2002), credit plays an important role in the lives of many people and in almost all industries that involve monetary investment in some form. Loan and advances, the major credit parts of banks, are mainly granted by private commercial banks including to several other functions like deposit mobilizations, local transfers, international transfers, foreign currency exchange services. Hence, the issue of loan management has a thoughtful implication both at the micro and macro level. When loan is allocated poorly, it raises costs to successful borrowers, erodes the fund, and reduces banks flexibility in redirecting towards alternative activities. Moreover, the more the loan and advance disbursement, the higher the risk associated with it. The problem of loan default, which is resulted from poor loan management, reduces the lending capacity of banks. It also denies new applicants' access to loan as the banks cash flow management problems augment in direct proportion to the increasing default problem. In other words, it may disturb the normal inflow and outflow of fund that banks have to keep staying in sustainable credit market (Misikir, 2015).

The very nature of the banking business is so sensitive because more than 85% of their liability is deposit mobilized from the depositors (Saunders & Cornett, 2005). Banks use these deposits to generate loans for their borrowers, which in fact is a massive revenue generating activity for most banks. This loan and advance creation process, if not managed properly, exposes the banks to high default risk which might lead to financial distress including bankruptcy.

All the same, beside other services, banks must create loans for their clients following prudent loan management procedure to make some money, grow and survive in stiff competition in the market place. The fundamental goal of most business enterprise is to maximize shareholders wealth by making profit. In the area of private commercial banks, the greatest source of profit, among others, is coming from interest on loans and commissions from advances. Besides, to ensure banks profitability and existence there must be proper management of loans and advances.

Owing to the facts discussed above, it is supposed that poor credit management could be partly attributed to reduced collection levels and failure of loans to investigate the situation is likely to affect the banks' performance in light of achieving their objectives.

Hence the researcher is interested to the research area in particular and to the contribution and object of the banks in general in assessing the gaps in loan and advance management performances on private banks which is crucial to be studied in the prevailing stiff competition in line of the modern financial measurements. Therefore, credit management are important for the banks involved due to the high level of risk associated with wrong decisions and it needs proper management by the concerned organs. Thus, the study attempts to provide clear understanding of the overall problems regarding to credit by identifying the causes of problem related to loan and advance management, credit follow up and collection performances and their solutions by raising the following questions.

- Do private Banks consistently comply with their policy and procedures in entertaining their loan and advance applicants, processing, and collecting?
- To what extent do private Banks accelerating the performance of loan management in line to policies and national banks requirements?
- What efforts the credit departments extend to assure the repayment of the loans and advances and to minimize default loans?
- To what level do private Banks building up quality loans arresting NPL (non-performing) loans align to their policies & procedures and National Bank requirements?

1.4 Objective

The main objective of the study is to evaluate the performance of loan and advance management of private Banks of Ethiopia as compared to National Bank requirements.

1.4.1 Specific Objectives

- To examine the compliance of private Banks to their policies and procedures in processing loan applications.
- To examine the essence of credit follow up and reviewing the follow up systems.
- To examine the relationship between credit management and loan performance.
- To evaluate the Banks credit quality as compared to National Bank requirements and their credit policies and procedures.
- To identify the causes of NPL in private commercial Banks of Ethiopia.

1.5 Significance of the Study

As well known, loans and advances are main parts of revenue generating of all private banks. They occupy an important part in gross earnings and net profit of the banks. Bank lending is very crucial for it makes possible the financing of agricultural, industrial, construction, and commercial activities of a country. Therefore the ability of banks to formulate and adhere to policies and procedures that promote credit quality and curtail non-performing loans is the means to survive in the stiff competition. Inability to create and build up quality loans and credit worthy customers leads to default risk and bankruptcy as well as hampers economic growth of a country. However, little work is done to search the ways and means that enable to quality loan creation and growth as well as to determine the relationship between the theories, concepts and credit policies in the country.

Likewise the study would help banks to get insight on what it takes to improve their loan and advance qualities and the study also have great contribution to the existing knowledge in the area of factors that cause NPL and improper credit handling and their impact on the bank's financial performance.

Hence, this study would help Ethiopian private Banks to get insight on what it takes to improve their loan qualities and assumed to be significant in indicating best practice and concepts for prudent lending to enhance the performance of credit management to all managers and policy makers of the banks as well as to all financial institutions. Therefore, the major beneficiaries from this study are those decision makers of the investigated banks, regulatory bodies, credit customers and the society as a whole. So:

- It will provide clear and detail information for decision makers in managing the loans and advances activities in the banks.
- It will help the management of the banks as a feedback for proper use of procedural manuals.
- It will provide basis for loan and advance management planning programs.
- It will be important for the banks to take measures and to improve inefficiency.
- It will be enable the concerned government body to see the loan and advance management of those banks and legal implications.
- It will be used as a base for other researchers who want to study on loans and advances management.

1.6 Scope of the Study

Since Banks are profit making organizations and most information are held secret, assessing all credit information might be difficult, the analysis is delimited to conduct only on loan and advance management in six private commercial banks of Ethiopia. Thus, the study didn't explore macro-economic issues that cause loan and advance defaults. It has been prepared based on NBE guidelines and it is also difficult to cover all commercial bank branches through limited time & resources. So, the scope of this paper has been delimited at head office level of the selected banks.

1.7 Limitation of the Study

Although studying at all level and in all branches of the banks would have better results, due to time and budget constraints, access to all credit information of banks, except officially disclosed financial information, was not possible.

In addition to this, non-availability of some data from Banks may hinder the quality of the finding. However, the researcher tried his best to obtain and ensure genuine and adequate data from the respective Banks.

1.8 Operational Definition

Borrower: is the one who borrows money from the lender (Bank).

Credit: is a financial assistance in the form of loans and advances granting by banks to their customers.

Credit Policy/Procedures: are the rules and regulations that guiding banks in their lending.

Credit Risk: it is the risk that a financial contract will not be concluded according to the agreement. It is the risk that the counterparty to an asset will default.

Lending: is the provision of resources (granting loan) by one party to another party where the second party doesn't reimburse the first party immediately there by generating a debt and instead arranges either to repay or return those resources a later date.

National Bank of Ethiopia (NBE): it is the reserve or central bank of Ethiopia. Besides licensing and supervising banks, insurers and other financial institutions, NBE fosters a healthy financial system and undertakes other related activities that are conducive to rapid economic development of Ethiopia (Proclamation No.592/2008, FDRE, 2008).

Loans and Advances: according to NBE Directives No SBB/43/2008 sub number 4.6 "Loans" or "Advances" means "any financial assets of a bank arising from a direct or indirect advance or commitment to advance funds by a bank to a person that are conditioned on the obligation of the person to repay the funds, either on a specified date or on demand, usually with interest". According to National Bank of Ethiopia Directive number SBB/43/2008, Asset Classification and Provisioning, there are five tiers system of standard loan classification for the system of reporting, follow-up and provisioning them. These are:

i. Pass loan: loans and advances in this category are fully protected by the current financial and paying capacity of the borrower and are not subject to criticism. In general, loans and advances, which are fully secured, both as to principal and interest, by cash or cash substitutes, are classified under this category regardless of past due status or other adverse credit factor.

ii. Special Mention: any loan or advance past due 30 days or more, but less than 90 days is classified under this category.

iii. Substandard: on-performing loans or advances past due 90 days or more but less than 180 days is classified under this category.

iv. Doubtful: non-performing loans or advances past due 180 days or more but less than 360 days is classified as doubtful.

v. Loss: loans and advances with pre-established repayment programs past due 360 days or more. In the case of overdraft facility the debt remains outstanding for 360 consecutive days or more beyond the scheduled payment date or maturity.

Non-Performing Loans (NPL): loans or advances whose credit quality has deteriorated such that full collection of principal and/or interest in accordance with the contractual repayment terms of the loan or advances are in question; or when principal and/or interest is due and uncollected for 90 (ninety) consecutive days or more beyond the scheduled payment date or maturity (NBE Directive, SSB/43/2008).

1.9 Organization of the Study

The research report is organized into five chapters. Chapter one discusses orientation of the study that would give introduction and a brief overview of banking industry in Ethiopia. The chapter also discusses research questions, objectives, scope, limitations and significance of the study and definition of important terms. In chapter two related literature review of the study is presented. This chapter covers important issues related to the loan and advances, lending, and related empirical studies. Chapter three describes the research methodology. It explains the research design, the sample population, data collection method, measuring instruments, and data analysis techniques. Also this chapter discusses reliability and validity of data and pointed ethical issues. The fourth chapter is all about results and discussion. And the last chapter discusses summary of findings and based on that conclusions and recommendations are given.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

2.1.1 Loan & Advance

Loan is the thing that is lent; especially a sum 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, an obligation to repay the borrowed money plus interest (Sinkey, 2002). A loan is a type of debt, which entails the redistribution of financial assets every time, between the lender and the borrower. The borrower initially does receive an amount of money from the lender, which he/she has to pay back, usually but not always in the form of installment to the lender. This service is usually provided at a cost of referred to as interest on the debt. A borrower may be subject to certain restrictions known as loan agreement under the terms of the loan. Acting as a provider of loans is one of the principal tasks of financial institutions. For other institutions, issuing debt contracts such as bonds is a typical source of funding. Legally, a loan is contractual promise between two parties where one party, the creditor, agrees to provide a sum of money to a debtor, who promises to return the money to the creditor either in one lump sum or in parts over a fixed period of time. This agreement may include providing additional payments of rental charges on the funds advanced to the debtor for the time the funds are in the hands of the debtor interest (Koch & Scott, 2003).

Advances are credit facilities in the form of written promises that should not necessarily be given on physical money as in loans. There are many types of advances given by commercial banks. An advance payment assurance is one type of advance given by banks. It is a form of protection that makes it possible for a buyer to recover any advance payments extended to a seller in the event that the seller fails to abide by the terms and conditions that govern the purchase of goods or services. A guarantee of this type may be used in a number of situations, including deals where goods are imported or exported. It is also used with domestic transactions, such as the purchase of heavy equipment, construction projects, or even large lots of retail goods. When a contract to purchase goods or services requires some sort of payment in advance, there are usually terms that protect the buyer in the event that the seller is unable to meet his or her obligations. For example, if the seller required an advance payment prior to shipping all or part of the order, and the seller subsequently fails to ship that order, the buyer can declare the deal null and void, and receive a refund of the advance payment. The advance payment guarantee ensures the buyer does not sustain a loss of any real money invested in the transaction, although it does not provide any recompense for any loss of income or profits that the buyer sustained when the goods were not shipped (NBE, 2008).

Commercial banks render various types of services to their customers, among which notably are the mobilization of financial resources and lending these resources to the business community. Loans and advances are defined in the respective laws of different countries. In Ethiopia, under Article 13 (FDRE 592/2008) and (NBE/43/2008) Article (4.6) loans and advances are defined as:

"…any financial assets of a bank arising from a direct or indirect advance (i.e. unplanned overdrafts, participation in a loan syndication, the purchase of loan from another lender etc.), or commitment to advance funds by a bank to a person that are conditioned on the obligation of the person to repay the funds, either on a specified date or on demand, usually with interest. The term includes a contractual obligation of a bank to advance by the bank on behalf of a person. The term does not include accrued but uncollected interest or discounted interest."

2.1.2 Characteristics of Loans and Advances

- Trust and Confidence: - trust is the fundamental element of credit. The bank will lend his money or goods on the trust and confidence that the borrower or buyer will pay back the money or price on time.
- Time Element: - all credit transactions involve time element. Money is borrowed or goods are bought with a promise to repay the money or pay the price on some future date.
- Transfer of Goods and Services: -loan involves transfer of goods and services by the seller to the buyer on the pay back promise of the buyer on some future date.

- Willingness and Ability: -loans and advances depend in a person's willingness and ability to pay the borrowed money. In fact, credit of a person depends on his character, capacity, conditions, collateral and capital.
- Purpose of Loan: -banks and financial institutions give large amounts of credit for productive purpose rather than for consumption purposes.
- Security: - security in the form of cash, properties, gold, guarantees, bonds or shares are important element for rising loans (Harris, 2003).

2.2 Theoretical Review

Bank is a financial institution that acts as an intermediary by matching supply and demand of funds. Koch and Scott (2003), defines banks as intermediaries between depositors and borrowers in an economy that are distinguished from other types of financial firms by deposit collection and offering loan products. Many researchers agree on that banks are special intermediaries because of their unique capacity to finance production by lending their own debt to agents willing to accept it and to use it as money. What enable them to function as financial intermediaries are; banks collect funds from savers in the form of deposit and then supply it to borrowers as loans. Thus, banks accept customer deposits and use those funds to give loans and advances to other customers or invest in other assets that will yield a return higher than the amount bank pays the depositor (McCarthy, 2010). It follows that customers' deposit is the primary source of bank loan and hence increasing or guaranteeing deposits directly has a positive effect on lending. In doing so, banks earn income when they lend money out at a higher interest rate than they pay to depositors for use of their money. The main sources of income of commercial banks are interest income on loans. Banks pays out at a lower interest rate on deposits and receives a higher interest rate on loans. The difference between these rates represents the bank's net income. Banks and other financial institutions exist in order to earn a profit and to ensure that shareholders value is maximized.

Commercial banks are the dominant financial institutions in most economies of any country and they play a critical role to emerging economies where most borrowers have no access to capital markets. Well-functioning commercial banks accelerate economic growth, while poorly functioning commercial banks are an obstruction to economic progress and aggravate poverty.

Banks can be government owned or private owned which facilitate or obstruct the economy of one country. The resent crises seen in developed countries are the result of households & firms default. The banking sector is still the primary form of financial intermediation in the world, and as such is the largest conduit for the mobilization of domestic savings and the main source of external capital to firms and the key player in the payment system. Consequently, the development of an efficient banking sector is crucial for the growth of the economies in the country. As liberalization of the banking sector around the world continues rapidly, banking markets in different countries are now becoming increasing (Barth and Song, 2008).

2.3 The Role of Banks

Banks role in the economy of any country is very significant. They play intermediation function in that they collect money from those who have excess amount and lend it to others who need it for their investment. Banks mobilize deposits and allocate the mobilized money efficiently to the most productive uses of investment in the real sector. Availing credit to borrowers is one means by which banks contribute to the growth of economies. The banking sector makes a meaningful contribution to the economic growth of every country. Banks contribution to the growth lies in the role they play in mobilizing deposits and allocating the resources efficiently to the most productive uses investment in the real sector. So, making credit available to borrowers is one means by which banks contribute to the growth of economies. Banks pool resources together for projects that are too large for individual shareholders to undertake (Barth and Levine, 2004). They are also considered the most important enabler of financial transactions in any country's economy and are the principal source of credit.

Commercial banks extend credit to different types of borrowers for many diverse purposes, either for personal, business or corporate clients (Saunders & Cornett, 2005).

Besides, banks are also the custodians of nation's money, which are accepted in the form of deposits and paid out on the client's instructions (Sinkey, 2002; Harris, 2003).

Despite all other activities, banking industry considers lending as their most important function for utilization of funds. Since the major portion of gross profit of the industry is earned from loans and advances, the administration of loan portfolios seriously affects the profitability of banks.

2.3.1 Deposit Mobilization

Deposit mobilization is the process of campaigning and collecting customers' money for deposit. The main objectives of mobilizing deposits are:

- To provide relatively secure deposit services that meet the demand of large numbers of people on an ongoing basis, and
- To improve the sustainability of institutions that provide credit services to the society by developing a relatively stable means to finance their portfolios (Sinkey, 2002).

The primary motivation for promoting savings by banks is to develop communities and empower themselves through the development of enlarging credit to the needy and generate huge income. Thus, deposit mobilization is paramount to community development or empowerment objectives of the banks that guide the development of deposit services that backed by effective supervision to protect clients' deposits from losses. Outreaching is more important in mobilizing of deposit through opening of branches nearer to places. Outreach refers to "expanding access to increasing numbers of low income". Sustainability financial and institutional provides the means to expand and maintain outreach. It is appropriate that a range of institutions provide deposit services. Different types of institutions use specialized methods to serve particular market niches. The main business for banks in accepting deposits is for granting loans. The more the loans the banks disburse the more profit they make. Also, banks do not have a lot of their own money to give as loans. They depend on customer deposits to generate funds for granting loans to other customers. So a deposit mobilization scheme would encourage customers to deposit more cash with the bank and this money in turn will be used by the bank to disburse more loans and generate additional revenue for them. Based on their deposit banks provide credit (lending) facility. The next topic discuss lending and its processes.

2.3.2 Lending

The principal profit-making activity of commercial banks is creating loans to their customers. In allocating funds, the primary objective of bank management is to earn income while serving the credit needs of its community (Charles, 2003). Therefore, Lending represents the heart of the industry. Bank lending is the most profitable use to which the bank's funds may be put. Besides, lending is the most constructive use which to the highest degree serves and benefits our customers.

As discussed in the preceding sections and observation in banks report, interest on loans contributes significantly to interest income of commercial banks. In other words, Lending represents the heart of the banking industry, because the dominant asset, represent 50-75 percent of the total amount at most banks, generate the largest share of operating income and represent the banks greater risk exposure (Mac Donald and Koch, 2006; NBE, 2008).

Moreover, its contribution to the growth of any country is huge in that they are the main intermediaries between depositors and those in need of fund for their viable projects (creditors) thereby ensure that the money available in economy is always put to good use.

2.3.2.1 General Principles of Good Lending

A bank essentially is custodian of depositor's funds. An overwhelming percentage of the funds a bank manages are subject at all times to the claims of the depositors. The successful management of a commercial bank's funds, therefore, requires careful consideration.

Although bank assets are highly concentrated in loans and investments, the loan portfolio generally dominates the traditional banking function. There are a few general principles of good lending which commercial banks of Ethiopia have to know.

❖ **Safety**: - is the most important of good lending principle. When a banker lends, he/she must feel certain that the advance is safe, and the loan is confidently collectable. If, for example, the borrower invests the money in unproductive or speculative venture, or if the borrower himself is dishonest, the advance would be in problem. Similarly, if the borrower suffers losses in his business due to his incompetence, the recovery of their money may become difficult. The banker ensures that the money advanced by his/her goes to the right type of borrower and is utilized in such a way that it will be safe at the time of lending but will remain so throughout, and after serving useful purpose in the trade or industry where it is employed, and is repaid with interest (Koch and Scott, 2003).

Liquidity: - Liquidity may simple be defined as the ability of a bank to convert to a sufficient amount of assets in cash readily and at favorable price to satisfy at any time the normal and abnormal high withdrawal demand of its operation. A bank is said to be liquid if the has immediate access to funds at reasonable cost at precise time as the funds are needed (Rose, 2002). In order to ensure liquidity of the bank, it is necessary to check liquidity of the loan to be granted. Therefore, it is not enough that the money will come back, it is also necessary that must be collected on demand or according with agreed terms of repayment. The borrower must be in a position to repay with a reasonable time after a demand for repayment is made. The reason why bankers attach as much importance to liquidity as to satiety of their funds is that bulk of their deposits is repayable on demand or at short notice.

Purpose of the loan proceeds: - Another principle of good lending that must be looked into is the purpose of the loan proceeds. The range of business loan needs is unlimited. Firms may need cash for operating purposes, to pay overdue suppliers, to make a tax payment or pay employee salaries. Similarly, they may also need funds to pay off debt obligations or to acquire new fixed assets. Frequently a firm recognizes that it is short of cash but cannot identify why. The first issue facing the credit analyst is what the loan proceeds are going to be used for. Loan proceeds should be used for legitimated business operating purpose, including seasonal and permanent working capital needs, for the purchase of depreciable assets, physical plant expansion, acquisition of tier firms and extra ordinary operating expenses. Speculative asset purchases and debt substations should be avoided. The true need and use determines the loan maturity, the anticipated source and timing of repayment, and the appropriate collateral (Koch and Scott, 2003).

Profitability: - is also equally important principle in bank advances. Like other commercial institutions, banks must make profits. Firstly, they have to pay interest on the deposits received by them. They incur expenses on establishment, rent, stationary, etc. they make provision for depreciation of their fixed assets and also for any possible bad or doubtful debts. After meeting all these items of expenditure, a reasonable profit must be made. Otherwise, it will not be possible to carry anything to be reserved or pay dividends to shareholders. It is after considering all these factors that a bank decides upon its lending rate. It is difficult to increase interest rates in order to increase profit as lending rates are affected by interbank competition and by the reserve banks directives, if any. However, the rates may differ depending on the borrower's quality, nature of security, mode of changes, and form and type of advance, whether it is cash credit, pre-shipment finance or a consumer loan (MacDonald and Koch, 2006).

2.4 Major Issues in Credit Management

2.4.1 Credit Policies and Procedures

A credit policy is not something that is only operated by the credit and risk department. All employees involved with customers, in any way, need to be aware of the credit policy and ensure that it is operated consistently (Koch and Scott, 2003).

Banks should have credit policies that guide them in the process of awarding credit. The policy sets the rules on who should access credit, when and why one should obtain the credit including repayment arrangements and necessary collaterals. The method of assessment and evaluation of risk of each prospective applicant are part of a credit control policy, Harris (2003) and IMF (2013) observed that sound credit policy would help improve prudential oversight of asset quality, establish a set of minimum standards, and apply a common language and methodology (assessment of risk, pricing, documentation, securities, authorization, and ethics), for measurement and reporting of non-performing assets, loan classification and provisioning.

In order to be effective, credit policies must be communicated throughout the organization, implemented through appropriate procedures, monitored and periodically revised to take into account changing internal and external circumstances. They should be applied, where appropriate, on a consolidated bank basis and at the level of individual affiliates. In addition, the policies should address equally the important functions of reviewing. Economic conditions and the firm's credit policies are the chief influences on the level of a firm's account receivable. Economic conditions, of course, are largely beyond the control of the financial manager. As with other current assets, however, the manager can vary the level of receivables in keeping with the tradeoff between profitability and risk. Lowering quality standards may stimulate demand, which, in turn, should lead to higher profitable receivables, as well as a greater risk of bad debt. The credit and collection policy of one firm are not independent of those of other firms. If product and capital markets are reasonably competitive, the credit and collection practices of one company will be influenced by what other companies are doing. Such practice related to the pricing of the product or service and must be viewed as part of the overall competitive process.

The examination of certain policy variables implies that the competitive process is accounted for in the specification of the demand function as well as in the opportunity cost associated with taking on additional receivables. The policy variables include the quality of the trade accounts accepted; the length of the credit period, the cash discount, any special terms such as seasonal dating and the collection program of the firm. Together, these elements largely determine the average collection period and the proportion of bad debt losses pooled and made available to lending banks (Horne, 2005).

2.4.2 Credit Processing

Credit processing (assessment) encompasses every activities involved in lending including sales, customer selection and screening, the application and approval process, repayment monitoring and delinquency and portfolio management. It is also linked with the institutional structure pertaining to the credit process. Quality of credit methodology is one of the most determinant factors for the efficiency, impact and profitability of the institutions. Thus, getting the credit methodology and product mix right is therefore one of the most demanding as well as rewarding challenges of every financial institutions and or banks.

The major issues in credit assessment include credit information, credit analysis process, credit appraisal and credit monitoring processes. The fundamental objective of commercial and consumer lending is to make profitable loans with minimal risk. Management should target specific industries or markets in which lending officers have expertise. The credit process relies on each bank's systems and controls to allow management and credit officers to evaluate risk and return tradeoffs.

2.4.3 Credit Information Sharing

Engagement in financing begins with customer recruitment. An issue of knowing the customer, commonly known as KYC is so vital before proceeding to details. Private Banks use various means to obtain such information about the existing or potential customer. Use of financial statement, credit report from credit bureau, customers' history if not new is the potential sources of information (Jappelli and pagno, 2005).

The purpose of information sharing is to communicate relationship information from existing lending relationships to outside lenders (Gehrig and Stenbacka, 2007). Credit providers use credit information to conduct credit risk analysis of prospective borrowers in order to mitigate credit risk. Kallberg and Udell, (2003) highlight that information sharing is useful both at the origination stage and after credit has been extended. Especially at the origination phase, information sharing reduces the problems of adverse selection.

In fact the exchange of credit information improves NPL ratios, leads to fewer losses through write offs and decreases interest rates for good credit risks (Jentzsch, 2008). He further supports that sharing credit information between lenders intensifies competition and increases access to finance. Jappelli and Paggano, (2005) indicate that credit information sharing results in improved bank's knowledge of applicant's character, easing adverse selection and reduce the informational rents that banks could otherwise extract from their customers. Credit information also acts as a borrower-disciplining device, by cutting insolvent debtors off from credit and eliminates or reduces the borrower's incentive to become over-indebted by drawing credit simultaneously from many banks without any of them realizing it.

Further, Gehrig and Stenbacka, (2007) highlight that information sharing reduces adverse selection problems and thereby promotes financial stability; it serves as a borrower disciplining device and it reduces the informational rents that banks can extract within the framework of their established customer relationships. According to Khuzwayo (2008), greater information sharing of trade credit data, particularly in the informal sector, could greatly expand credit access for small and medium enterprises.

In addition, Barth, Lin, C. Lin & Song (2008) show that information exchange will assist in minimizing lending corruption in banks by reducing information asymmetry between consumers and lenders, improving the bribery control methods and reducing informational rent, and hence the bargaining power of lenders. The exchange of consumer credit information disciplines borrowers to repay loans because borrowers do not want to damage the good report, which can make it difficult for them to get credit (Swiss National Bank, 2008). Once credit information on the loan request is obtained, bank officers precede with credit analysis.

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

The role of the NBE shall be restricted to administering the Credit Information Sharing system, providing in writing credit information on borrowers available at Credit Information Center to banks, ensuring that access to online system to update or alter credit information is given only to authorized persons and ensuring that the system is operating smoothly and reliably;
The NBE shall not be responsible for any damages, claims or liabilities that may arise as a result of inaccurate, misleading or incomplete credit information on borrowers supplied to the Credit Information Center by individual banks and shared, through the NBE, with other banks.
Each bank shall provide, electronically, the initial credit and other related information to the Credit Information Center on each and every one of its borrower;
Each bank shall be fully responsible for providing accurate, complete and timely credit information to the Credit Information Center. In cases where errors have been made, such errors shall be corrected promptly by the concerned bank;
Each bank shall be fully responsible for any damages, claims or liabilities that may arise as a result of providing inaccurate, misleading or incomplete credit information to the Credit Information Center or failure to provide, inadvertently or otherwise, information to the Center that should have been provided in line with these directives;
Each bank shall use the credit information on borrowers obtained from the Central Database of the Credit Information Center only and only for making a lending decision. Such information shall be treated with utmost confidentiality and shall not be disclosed to any third party or used for any other purpose;
Each bank shall be fully responsible for any damages, claims or liabilities that may arise as a result of disclosure of credit information on borrowers obtained from the Credit Information Center to third parties or use of that information for purposes other than for making a lending decision (NBE, 2010).

2.4.4 Credit Analysis

Credit analysis is the first step in the process to tailor makes a solution to fit the customer's needs. The analysis starts with an understanding of the customer's needs and capacities to ensure there is a good fit in terms of the financing solution. Credit analysis is the most important safeguard to ensure the underlying quality of the credit being granted and is considered an essential element of credit risk management. The credit quality of an exposure generally refers to the borrower's ability and willingness to meet the commitments of the facility granted. It also includes default probability and anticipated recovery rate (Saunders & Cornett, 2005). Credit analysis thus involves assessing the risks involved in financing and thereby anticipating the probability of default and recovery rate.

A credit analysis is used by the credit official to evaluate a borrower's character, capital, capacity, collateral and the cyclical aspect of the economy, or generally referred to as the five C's. The credit analysis process, traditionally employed by the first banks, does not differ fundamentally from the processes used today. The five C's were considered as the fundamentals of successful lending criteria. These provided an even more comprehensive view and clearer understanding of the underlying risk and resulting lending decision. These are:-

Character: Character refers to the borrower's reputation and the borrower's willingness to settle debt obligations. In evaluating character, the borrower's honesty, integrity and trustworthiness are assessed. The borrower's credit history and the commitment of the owners are also evaluated (Rose, 2002). A company's reputation, referring specifically to credit is based on past performance. A borrower has built up a good reputation or credit record if past commitments were promptly met (observed behavior) and repaid timely (Saunders, 2005). Character is considered the most important and yet the most difficult to assess (Koch & Scott, 2003).

Bankers recognize the essential role management plays in a company's success. Critically analyzing quality of management has been one of the ways of assessing character. The history of the business and experience of its management are critical factors in assessing a company's ability to satisfy its financial obligations. The quality of management in the specific business is evaluated by taking reputation, integrity, qualifications, experience and management ability of various business disciplines such as finance, marketing and labor relations into consideration. These factors can be seen as a risk mitigates, if a banker views these parameters positively. Much of its success can in fact be attributed to competent leadership. However, Companies with strong and competent management teams tend to survive in an economic downturn.

Capacity: Capacity refers to the business's ability to generate sufficient cash to repay the debt. An analysis of the applicant's businesses plan, management accounts and cash flow forecasts (demonstrating the need and ability to repay the commitments) will give a good indication of the capacity to repay (Koch et.al., 2003). To get a good understanding of a company's capacity evaluating the type of business and the industry in which it operates is also vital .It plays a significant role since each industry is influenced by various internal and external factors. The factors that form the basis of this analysis includes: Type of industry, Market share, Quality of products and life cycle, whether the business is labor or capital intensive, the current economic conditions, seasonal trends, the bargaining power of buyers and sellers, competition and legislative changes (Koch et.al, 2003; Nathenson, 2004). These factors lead the banker to form a view of the specific company and industry. The banker would regard this as a potential risk mitigate if he/she is confident about the company and industry and prospects for both appear to be positive.

Besides, the financial position is also a critical indication of a business' capacity. The company's financial position is evaluated by assessing past financial performance and projected financial performance. A company's past financial performance is reflected in their audited financial statements. Financial projections consist of projected cash flows demonstrating the need for the facility and the ability to repay the facility (Sinkey, 2002). In this regard at least three years audited financial statements (balance sheet and income statement) are required for data analysis. A financial spreadsheet is used to undertake the analysis.

Commercial banks utilize the financial spread (i.e. audited financial statement analysis and ratio calculations) and it is applied through the Moody's Risk Advisor (MRA). The model also performs a peer comparison and calculates the probability of default. The following financial ratio analyses are very critical in assessing business' position (Koch & Scott, 2003): liquidity ratio, activity ratio, leverage ratio, and profitability ratio. Cash flow from operations gives an indication of how much cash is generated from normal business activities. The cash flow generated must be sufficient to service the banking facilities (Charles, 2003).These assumptions are evaluated against the company's past performance, industry averages and expected economic trends. An assessment of the financial capacity of a company should always include an evaluation of trends. Evaluating trends over a three to five year period gives a clear picture of the direction a firm is heading. Ratio results should always be compared to a peer group of or an industry comparison. Is the firm collecting faster or slower than the rest of the industry? Is this company more profitable than other companies? In this regard making a maximum use of ratios by comparing the firm to its peers using established benchmarks is so vital. Comparison of the company to firms in the same line of business, geographic area and employee size provides a more accurate comparison. The projections also reveal the purpose, amount and type of finance required. It also provides insight into the company's ability to generate sufficient cash flow to service the debt (Nathenson, 2004).

Analysis of the financial capacity of the organization should also be carried out in order to determine a borrower's ability to meet financial obligations in a timely fashion. Its ability to pay may be much more important. It is critical to understand the difference. Watching customer payment habits over time is an excellent indication of cash flow. Also, checking bank and trade references, as well as any pending litigation or contingent liabilities are pivotal. Further checking for a parent company relationship is important, as a parent company's guarantee may be available. Intercompany loans might affect financial solvency. Agency ratings that predict slow payment or default should be carried out before completion of investigating capacity of a borrower.

Capital: Capital refers to the owner's level of investment in the business (Sinkey, 2002). Banks prefer owners to take a proportionate share of the risk. Although there are no hard and fast rules, a debt/equity ratio of 50:50 would be sufficient to mitigate the bank's risk where funding (unsecured) is based on the business's cash flow to service the funding (Harris, 2003). Lenders prefer significant equity (own contribution), as it demonstrates an owner's commitment and confidence in the business venture.

Conditions: Conditions are external circumstances that could affect the borrower's ability to repay the amount financed. Lenders consider the overall economic and industry trends, regulatory, legal and liability issues before a decision is made (Sinkey, 2002). Once finance is approved, it is normally subject to terms, covenants, and conditions, which are specifically related to the compliance of the approved facility. Banks normally include covenants along with conditions when credit facilities are granted to protect the bank's interest. Conditions normally stipulate that all the security relevant to the loan should be in order before any funds will be advanced.

Collateral: Collateral also called security is the assets that the borrower pledges to the bank to mitigate the bank's risk in event of default (Sinkey, 2002). It is something valuable which is pledged to the bank by the borrower to support the borrower's intention to repay the money advanced. Security is held to mitigate the bank's risk in the event of default and is considered as a secondary source of repayment (Koch & Scott, 2003).

Supporting of the aforementioned, Rose (2002) define secured lending in banks as the business where the secured loans have a pledge of some of the borrower's property (such as home, machineries, merchandise or vehicles) behind them as collateral that may have to be sold if the borrower defaults and has no other way to repay the lender. The purpose of security is to reduce the risk of giving credit by increasing the chances of the lender recovering the amounts that become due to the borrower. Security increases the availability of credit and improves the terms on which credit is available. The offer of security influences the lender's decision whether or not to lend, and it changes the terms on which it is prepared to lend, typically by increasing the amount of the loan, by extending the period for which the loan is granted and by lowering the interest rate (William & Morris, 2004).

According to Strischek (2008), in the banking environment, security is required for the following three reasons:

- to ensure the full commitment of the borrower to its operations,
- to provide protection should the borrower deviate from the planned course of action outlined at the time credit is extended, and
- to provide insurance if the borrower default.

The security value of an asset is based on the estimated re-sale value of the assets at the time of disposing of it (McManus, 2008) The specific type of property is valued by the bank to determine the property's market value for security purposes.

Besides the physical collateral, a third party can provide a surety ship for the debt of the borrower should not be in a position to repay the debt, the bank will then call on the surety for repayment (Koch & Scott, 2003). It is normal banking practice for the banks to take the surety ships of the shareholders/directors when funds are advanced to a company (Rose, 2002). The five 'C's are well-known credit assessment principles and commercial banks have developed their own qualitative credit risk assessment models to assess whether the bank will agree to lend to a specific business. Based on the credit information obtained about the borrower and credit assessment carried out, either by quantitative or qualitative model or by combination of both, credit sanctioning is done.

2.4.5 Financial Analysis

Review, appraisal and follow-up are three basic elements in loan management and decision making. At the time of considering fresh proposals or enhancement proposals, the banker reviews the past operations with to judge the health status of the client. Sinkey, (2002) identified three basic elements used in credit management to evaluate the creditworthiness of clients.

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

b) Credit Appraisal: -implies consideration of fresh or enhancement proposals on the basis of futuristic data. While appraising proposals, banker tries to find out: financial need of the client, end-use of funds, viability of operations and risk involved. In case of proposals involving working capital finance, the banker can ascertain the aforesaid factors only when he/she is supplied with the business plan of the borrower for the ensuing period. Business plan is expressed through operating statement, balance sheet, funds flow, and cash flow statements, all on projected basis.

c) Follow-up: -is defined as a continuous activity aimed at ensuring observance of stipulations laid down by the bank, picking up signals on health status of client's position, remedial action and ensuring results of action on a continuous basis. Safety, need-based finance and end-use are the key assumption of lending. A banker needs various types of data and information from the borrowers for taking the credit decisions. Such information is generally available in various financial statements such as income statement, balance sheet, cash flow statement, funds flow statement, etc. But mere collect of these financial data from the borrowers is of little help unless the banker is able to use these statements; arrange or classify them according to his/her needs and analyze them with a view to draw meaningful conclusions.

2.4.6 Credit Approval and Implementation

Extending credit is the careful balance of limiting risk and maximizing profitability while maintaining a competitive edge in a complex, global marketplace. Banks go through a thorough process in approving credit to hit the balance. Credit approval is the process of deciding whether or not to extend credit to a particular customer. It involves two steps: gathering relevant information and determining creditworthiness (Oesterrichische, 2008).

As has been discussed in the preceding section, the credit analysis process consists of a subjective analysis of the borrower's request and a quantitative analysis of the financial information provided. The individual steps in the credit approval process and their implementation have a considerable impact on the risks associated with credit approval.

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

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

Once information has been gathered, analysis has been done the bank faces the hard choice of either granting or refusing credit. Many financial managers use the five C's of Credit analysis tool as their guide. As discussed above, identify and evaluate the credit risk resulting from a possible exposure to sanction the credit. After sanctioning the loan, the next big job is its monitoring.

The individual steps in the credit approval process and their implementation have a considerable impact on the risks associated with credit approval. The quality of credit approval processes depends on two factors, i.e. a transparent and comprehensive presentation of the risks when granting the loan on the one hand, and an adequate assessment of these risks on the other. Furthermore, the level of efficiency of the credit approval processes is an important rating element. Due to the considerable differences in the nature of various borrowers and the assets to be financed as well as the large number of products and their complexity, there cannot be a uniform process to assess credit risks. The quality of the credit approval process from a risk perspective is determined by the best possible identification and evaluation of the credit risk resulting from a possible exposure (Barth & Song, 2008).

2.5 Loan Collection Techniques

Effective credit collection techniques are one of the necessities for financial institutions in any economic climate. Knowing how to encourage customers to pay their outstanding debts to financial institutions like banks on time can increase the cash flow of banks (Horne, 2005).

Therefore a number of collection techniques are employed. Under normal circumstances loan clients are expected to pay in cash or deposit or keep their installment repayment as per the agreement made. As the loan account becomes past due or overdue the collection effort becomes more personal and strict. According to Rose (2002), basic loan collection techniques are the following:

- **Telephone Calls:** If the loan client passes the due date, a telephone call may be made to the customer to request immediate repayment and up to date his or her account.
- **Personal Visits:** - If the telephone call made is not resulted positive response vesting his business and discussing the issue with the customer can be a very effective collection procedure.

- ❖ **Letters: -** If the efforts made so far is unsuccessful and not resulted positive response a polite letter is to be served reminding the customer of its obligation followed by warning letters for the action to be taken in future and its consequence. Collection letters are the first step in the collection process for past due and overdue loan accounts.
- ❖ **Using Collection Agencies: -** Firms can turn uncollectible accounts over to a collection agency or an attorney for collection. The fees for this service are typically quite high; the firm may receive less than fifty percent on accounts collected in this way.
- ❖ **Legal Action:** legal action is the most stringent step in the collection process. It is an alternative to the use of a collection agency not only is direct legal action expensive, but is may force the debtor in to bankruptcy, thereby reducing the possibility of future business without guarantying the ultimate receipt of overdue amount.

2.5.1 Credit Monitoring

Lending decision is made on sound credit risk analysis or appraisal and assessment of creditworthiness of borrowers. Nevertheless, past records of satisfactory performance and integrity are no guarantee future, though they serve as useful guide to project trend in performance. A loan granted based on not sound analysis might go bad because of the borrower may not meet obligations per the terms and conditions of the loan contract. It is for this reason that proper follow up and monitoring is essential. Monitoring or follow-up deals with the following vital aspects:

- ➢ Ensuring compliance with terms and conditions,
- ➢ Monitoring end use of approved funds,
- ➢ Monitoring performance to check continued viability of operations,
- ➢ Detecting deviations from terms of decision,
- ➢ Making periodic assessment of the health of the loans and advances by nothing some of the key indicators of performance that might include profitability, activity level and management of the unit and ensure that the assets created are effectively utilized for productive purposes and are well maintained,
- ➢ Ensuring recovery of the installments of the principal and interest in case of term loan as per the scheduled repayment program, and

- Identify early warning signals, if any, and initiate remedial measures thereby averting from possible default.

2.5.2 Default Problems

Non-payment of loans has several undesirable consequences. It gradually destabilizes the credit system. Costs of loan administration of overdue loans are high. And defaults push up lending costs without any corresponding increase in loan turnover. Defaults reduce the resource base for further lending, weaken staff morale, and affect the borrower's confidence. Fofack (2005), after a comprehensive survey of defaults in Sri Lanka, identified six factors which contributed to defaults:

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

b) Defects and inadequacies in the organization disbursing credit;

c) Attitudinal conditions not conducive to repayment;

d) Misallocation of borrowed funds;

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

According to Fofack, (2005) Barth & Song, (2008) and Koch and Scott (2003), causes of delinquencies and defaults are classified as relating to three levels: borrower level, financing institution level, and economy level.

a) Causes at borrower level:

- Borrowers who deliberately divert loans to non-essential consumption find it difficult to meet repayment commitments on time.
- Investments fail to generate sufficient incomes due to improper technical advice; absence of supporting services, inadequate marketing, etc. investments also fail due to unforeseen causes like floods, drought, etc. in both cases repayment would be affected.
- When borrowers have liabilities towards informal lenders, they get precedence over institutional lenders.

- Contingencies at borrower household like death, sickness, etc…, affect repayment performance. Formal institutions which do not extend consumption and emergency loans are liable to have higher default rates.

b) Causes at financing institution level:

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

c) Causes at economy level:

- When overall government policies, particularly those relating to pricing of inputs and outputs, marketing, etc., discriminate against the specific sector.
- Faulty monetary and fiscal policies of governments could result in high inflationary conditions. Borrowers tend to delay repayments in such a situation to take advantage of the fall in value of currency.
- Interest rate policies of government have a vital role in the promotion of repayments. When the real rate is excessively low, borrowing and consumption will be much more profitable than saving and repayment.
- Excessive government intervention in the day-to-day administration of financial institutions could result in bad loans.
- Calamities like droughts, floods, market glut, etc. could result non-performing loans.

2.6 Credit Management Systems

2.6.1 Credit Terms

This refers to the conditions under which Banks advances credit to its customers. The credit terms will specify the credit period and interest rates. Credit period refers to the period of time in which the credit is granted. The length of the credit period is influenced by collateral value, credit risk, the size of the account and market competition (Saunders and Cornett, 2005). Debt in a particular class will have its own interest rate in accordance with the theory of term structure. The interest rates charged is a cost on borrowed funds and may affect the loan performance.

2.6.2 Credit Risk Control

Credit risk is an investor's risk of loss arising from a borrower who does not make payments as promised. Such an event is called a default. Another term for credit risk is default risk investor losses include lost principal and interest, decreased cash flow, and increased collection costs. Credit risk can be mitigated using risk based pricing, covenants, credit insurance, tightening and diversification (Rose, 2002).

2.6.3 Collection Policy

There are various policies that Banks should put in place to ensure that their credit management is done effectively. One of these policies is a collection policy which is needed because all customers do not pay their loan repayments in time. Some customers are slow payers while some are non- payers. The collection effort should, therefore aim at accelerating collections from slow payers and reducing bad debt loans (McManus, 2008).

2.6.4 Economic Cycles

The term economic cycle (or business cycle) refers to economy-wide fluctuations in production or economic activity over several months or years. These fluctuations, according to Rose (2002) occur around a long-term growth trend, and typically involve shifts over time between periods of relatively rapid economic growth (an expansion or boom) and periods of relative stagnation or decline (a contraction or recession). The economic cycles also play an important role to Banks choice of issuing or not issuing loans and advances.

2.6.5 Credit Processing and Monitoring

Credit processing includes encompasses every activities involved in lending including sales, customer selection and screening, the application and approval process repayment monitoring and portfolio management.

2.6.6 The five C's

The five C's (Capacity, Character, Capital, Conditions and Collateral) were considered as the fundamentals of successful lending criteria. These provided an even more comprehensive view and clearer understanding of the underlying risk and resulting lending decision. According to Harris (2003), these principles should be the cornerstone of every lending decision.

2.7 Empirical Studies

There are numerous researches conducted in credit management on financial performance, and how could the effective credit management assist in reducing the possibility of failure and restricting the uncertainty of achieving the required loan performance. Most of these researches support the notion that there is a positive relationship between effective credit management and bank loan performance. Some of these are:

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

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

Boahene, Dasah and Agyei (2012) examined the relationship between credit management and banks' profitability. They found a positive relationship between credit management and bank's profitability. Ndwiga and Waithaka (2012) investigated the effect of credit management techniques on the banks' performance of unsecured loans. They concluded that financial risk in a banking organization might result in imposition of constraints on bank's ability to meet its business objectives. Kolapo & Ayeni (2012) showed that the effect of credit risk on bank performance measured by ROA was cross-sectional invariant, though the degree to which individual banks were affected was not captured by the method of analysis employed in the study.

Padamaphan (2005) explored the various credit risk management indicators that affected banks' financial performance; he found that the most indicators affected the bank financial performance was the default rate. Musyoki and Kadubo (2012) seek to assess various parameters pertinent to credit risk management as it affects banks' financial performance. They concluded that all these parameters had an inverse impact on banks' financial performance; however the default rate was the most predictor of bank financial performance, on the contrary of the other indicators of credit risk management. Ogboi and Unuafe (2013) concluded that bank's financial performance had been affected by sound credit management and capital adequacy. Singh (2013) revealed that Effective credit management was critical to any bank for achieving financial soundness.

Achou and Tenguh (2008) also conducted research on bank performance and credit management found that there is a significant relationship between bank performance (in terms of profitability) and credit management (in terms of loan performance). Better credit management results in better performance. Thus, it is of crucial importance that financial institutions practice prudent credit management and safeguarding the assets of the institutions and protect the investor's interests. Method used by the researchers is mixed research method.

Sindani (2012) in her study on Effectiveness of Credit Management System on Loan Performance: Empirical evidence from banking sector in Kenya found out that credit terms formulated by the banks' do affect loan performance; the involvement of credit officers and customers in formulating credit terms affects loan performance. Interest rates charged had a negative effect on the performance of the loans, the higher the interest rates the lower the loan performance. Credit risk controls adopted by banks have an effect on loan performance, credit insurance, signing of covenants with customers, diversification of loans, credit rating of customers, reports on financial conditions, and refrain from further borrowing had an effect on loan performance. Collection policies adopted by banks' had an effect on loan performance, stringent policy had a great impact on loan performance, and the lenient policy had an effect but was not as great as that of stringent policy.

Misikir, B. (2015), examined credit risk management and its impact on performance in Ethiopian commercial banks and his finding revealed that it has a significant impact on the profitability of the banks performances and he concludes that the bank with good or sound credit risk management policies have lower loan default rate and higher profitability.

Orua (2009) did a study on the relationship between capital structure and financial performance of private banks and it revealed that short-term debt significantly impacted banks outreach positively. Long term debt however showed positive relationship with outreach but was not significant with regard to default rates, both short and long term debts showed expected results but were not significant indicating that maturity may not necessarily be of essence. Generally highly leveraged banks' were found to perform better by reaching out to more clients. It was also revealed that such banks also enjoyed economies of scales and therefore were better able to deal with moral hazards and adverse selections which also enhanced their ability to manage credit.

On his study, Ayalew (2005), financial performance of private sectors banks in Ethiopia, mentioned some important factors that cause poor performances and loan default which include: lack of willingness to pay loans coupled with diversion of funds by borrowers, willful negligence and improper appraisal by credit officers.

The research conducted by Million (2014) shows that there is significant positive relationship between Loan loss provision and commercial banks performance. On this study might indicate the presence of potential earning management activities by bank managers.

2.8 Summary of the Empirical Review

The above empirical review of literature emphasizes that all the studies so far conducted are mainly discussing the relationship between loan performance and credit management, loan recovery problems, determinant factors for default of borrowers in financial institutions in general, credit risk and its impact on loan performance and possible causes of loan default.

The summary begun by providing a brief discussion on key theoretical approaches and findings reported in earlier related studies credit management and bank loan performance. And also the review concentrated on empirical facets of credit management and default loans. Besides, this research improves on some of the existing studies, in that it investigates the sub-total and overall effect of credit management and its indicators on loan performance of private commercial banks.

Local studies that have been done on banking sector do not focus on the effect of credit management on the loan performance of banks'; there is therefore a gap in the empirical evidence available. This study seeks to bridge the gap.

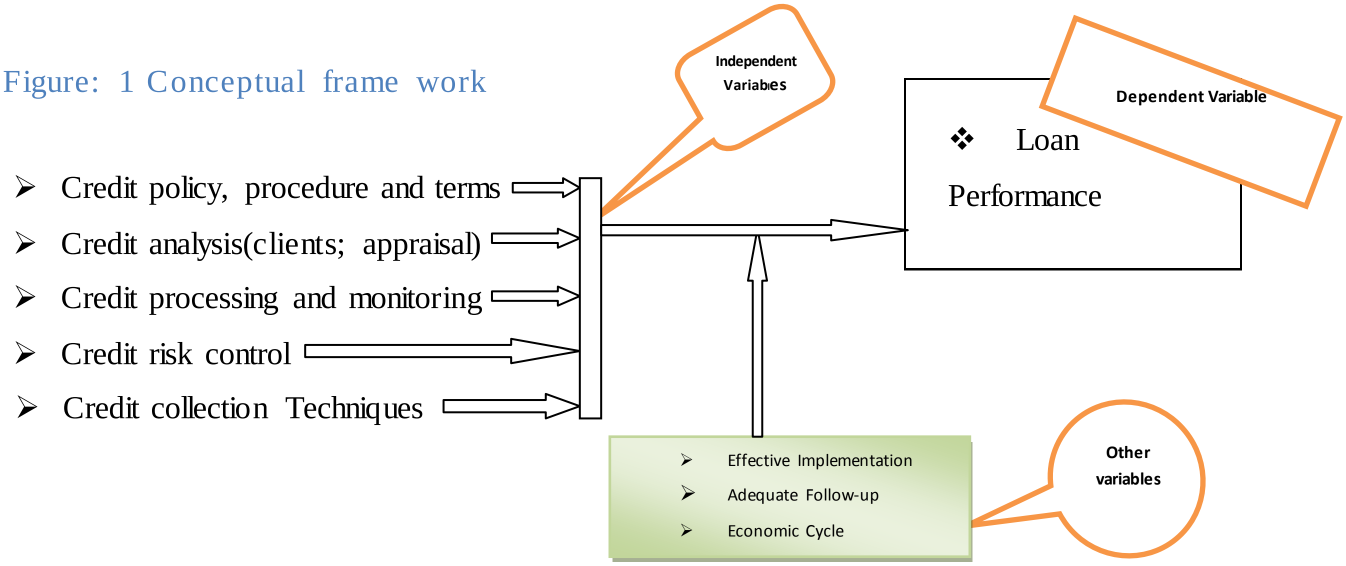
Most of the reviewed studies made in Ethiopia including the above were focusing on credit risk management and banks performances and it assessed how the financial sector manages credit risks and impacts of the performance. Therefore this study tries to fill the gap by identifying the problems related to lack of effective credit management by focusing on loan and advance management performance in Ethiopia's private Banking industry.

2.9 Conceptual Framework

Conceptual framework was expressed as the way ideas are organized to achieve a research project's purpose. It is connected to the research purpose. A conceptual framework is a basic structure that consists of certain abstract blocks which represent the observational, the empirical and the analytical aspects of a process or system being conceived. The interconnection of these blocks completes the framework for certain expected outcomes (Leedy and Ormrod, 2005).

Hence, the researcher developed the following conceptual framework to easily assess the relationship between credit management and loan performances.

Figure: 1 Conceptual frame work



Source: *Own survey result from secondary data sources*

CHAPTER THREE

RESEARCH METHODOLOGY

This chapter discusses the research methodology. It explains the research design, the sample population, data collection method, measuring instruments, and data analysis techniques. Also this chapter discussed reliability and validity of data and its components to justify the methods applied in this research. The ethical issue also noted in this chapter as the researcher used and acknowledge the sources for secondary data.

3.1 Research Approach and Design

Considering the research problem and objective shown in the first subsection and fill the gap, descriptive research design with mixed research approach (more of qualitative) is appropriate for this study.

3.2 Quantitative Aspect of the Study

In quantitative approach, survey design which provides a quantitative or numeric description of trends, attitude or opinion of a population by studying a sample of that population used. The purpose of the quantitative aspect of this proposed study is to seek information about loans and advance defaults. The study used survey design with a structured self-administered questionnaire, semi-structured interview and structured record reviews. To gather data which was used in the study, self-administered questionnaires were distributed to research participants and for structured record reviews (documentary analysis) financial information were collected from audited financial statement reports of surveyed banks, and other relevant sources from NBE.

3.3 Qualitative Research Approach

Qualitative research approach makes considerable use of inductive reasoning. Under this approach, many specific observations will be made to draw inferences about larger and general phenomenon while personal and literary style language will be used when reporting the findings. The researcher used interviews and questionnaires developed based on the literature search which is one of the qualitative methods of collecting data and fill the gap that quantitative approach misses by interviewing key senior banks staffs. Also literature search, talking to experts in the field, interviews and surveys are analyzed under qualitative approach.

3.3.1 Target Population

The target population in this study is all private banks registered by National Bank of Ethiopia up to the fiscal year 2014/15 and all head office staffs engaged on credit area of surveyed banks.

3.3.2 Data Type and Source

The data types used for this research were both primary and secondary data. As a primary data self-administered questionnaire and key informant interview were incorporated. The target groups for the interview were managers and directors on credit area, credit analysts' and loan officers at head office. The secondary data was audited financial statements of surveyed banks ranging from June 30, 2011 to June 30, 2015 for five years.

3.3.3 Sampling Method

The survey study design was employed in this study. The study was based on opinion view of private commercial banks employees in Ethiopia. The sample was constructed at two levels. The first level of sampling being choice of sample banks from all private banks and the second level of sampling was the choice of respondents. Hence the following sections discus the two levels of construction of sampling technique for the study.

3.3.3.1 Sampling Technique Used

Since the study was based on employee's opinion and five years data of selected target population (sample) out of all private banks registered by the National Bank of Ethiopia (NBE) in the year 2014/15, putting cut off year is mandatory. Therefore, the selected banks should be in operation before the fiscal year 2014/15. The cut off year was set due to the importance of experience in the industry. In line with this 16 private banks fall in the sample frame.

Thus, the sampling technique used for the purpose of this study is stratified random sampling. The basis for the researcher to use this technique was to gather information about the component part of private banks in Ethiopia. There are three peer groups in Ethiopia's private banks. Each peer forms strata and sampling within each stratum has been selected and as a result the researcher distributed questionarriees and interviews to the selected banks.

According to Bank groupings based on their age of operation there are three peer groups of private banks in Ethiopia. The first groups are banks who are involved in operation more than fifteen years, Awash International Bank S.C, Dashen Bank S.C, Bank of Abysinia S.C, Wegagen Bank S.C, United Bank S.C and Nib International Bank S.C. The second peer group who worked between six and fifteen years are: Cooperative Bank of Oromia S.C, Lion International Bank S.C, Oromia International Bank S.C, Buna International Bank S.C, Birhan International bank S.C and Zemen Bank S.C. The third peer group who involved in operation less than six years are: Abay Bank S.C, Addis International Bank S.C, Debub Global Bank S.C & Enat Bank S.C.

Further, because of time and budget constraint to survey all the aforementioned banks, a representative sample of six private banks was selected among the banks. Selection of sample was based on stratification of banks according to their peer groups, grouped in terms of their age of operation in the banking industries to get well experience and relevant data. In this case, the researcher randomly select six banks constituted the sample to be selected (two samples from the peers).

Accordingly, Awash International Bank S.C & Dashen Bank S.C from the first peer group who are in operation more than fifteen years, and Cooperative Bank of Oromia S.C & Zemen Bank S.C from the second peer group which are in operation for seven to fifteen years and Abay Bank

S.C and Addis International Bank S.C from the third peer groups as of their recent age in operation.

The second level of sampling was the choice of respondents. Due to the fact that bank lending process is practiced by few employees, not all bank employees and officials, the sample frame was confined to those involved in credit analysis, appraisal and approval, credit monitoring, risk management and credit relationship managers of the selected banks.

The total staffs involved in credit management of the selected banks are 132 of which, 93 staffs has six and above years of experience on the credit area and considered as a target population. Since the researcher understood that the information gained from experienced staffs would have a better relevance in the study than who has less experience. After identifying target population the researcher used the sampling formula to get sample size.

$\boxed{n=N/1+N\,(e)^2}$ * Whereas, n = sample size

N= target population

e = standard error used (0.05) or 95% confidence interval.

‘n= 93/1/93$(0.05)^2$

‘n= 70

3.3.3.2 Sample Proportion Allocation

Sample proportion allocation among the six selected banks is performed according to their staffs work experience. Staffs who have worked more than six years on credit area have been taken as a sample. This is because the number of experienced staff’s in each bank is different. So to get appropriate representative total sample size (70) divided to staffs that have six and above work experience (93).

Therefore, the researcher used the percentage ratio of sample size (70) to target population (93) i.e. (70/93) = 75.3% to get the number of participants for questionnaire distribution to each bank.

Table 3.1 Sample size

Staffs' Experience	Selected Banks						Total
	Awash	Dashen	CBO	Zemen	Abay	Addis	
Greater than 6 Years	27	26	18	10	7	5	**93**
Less than 6 Years	5	7	9	8	7	3	**39**
Total staffs	32	33	27	18	14	8	**132**
Sample size taken	**19**	**18**	**15**	**8**	**6**	**4**	**70**

Source: HR Department in Each Bank

Accordingly, all staffs engaged in credit related activities for more than six years were randomly selected from each bank and questionnaires were physically distributed to 70 staff members in total. In addition, ten credit managers and senior credit analysts involved in lending activities were interviewed in the selected banks.

3.3.4 Instrument Design and Data Collection Method

The survey was conducted using a structured questionnaires, semi structured interviews and structured document analysis adopted from interdisciplinary journal of contemporary research of Business Vol. No 4, (2012), and modified by Wondimagegn (2012). The questionnaire was prepared in English language and it was classified into four sections. The first parts of the questions (1-7) were designed to personal information. The second part of questionnaires (8-20) is deal with procedural manuals of the banks. The third part of the questionnaires (21-27) was about loan offering and process and the final part of questionnaires (28-39) is about credit follow-up and collection procedures of the banks.

3.3.5 Data Analysis Method

The primary data collected through questionnaire and interview were carefully checked, coded, summarized and presented with Microsoft Excel, Version 2010, for descriptive analysis. Secondary data was obtained from the banks published audited financial statements to find out how loans and advances are handled or managed in terms of credit deficit and performances of banks.

Moreover, in order to evaluate the performance of loan management problems of Ethiopia's private Banks, findings which reflect a high magnitude of problems were selected from interview and questionnaires, the raw data were analyzed, presented, and interpreted to give solutions for the research problem. Percentages for these data were calculated in order to facilitate the analysis and to make it presentable for the readers. The data collected were more of qualitative in nature. Thus, they were presented by using descriptive analysis.

3.4 Measurement of Validity and Ethical Issues

3.4.1 Validity

Validity and reliability are important aspects of the research methodology to get a better explanation of the study. Validity determines whether the measuring instrument truly measures what it was intended to measure or how truthful the research results are. To measure the validity of results, the researcher considers the theory and the measuring instrument used. Validity can be measured by factor Analysis. In order to check and establish the validity and to increase the accuracy of this research, the quality of research design can be defined in terms of validity of measurement instrument used in the research. The major types of validity are internal validity, external validity; construct validity, statistical conclusion validity (Leedy and Ormrod, 2005).

i. **Content Validity:** Content validity is the extent to which the measurement method covers the entire range of relevant behaviors, thoughts, and feelings that define the construct being measured. The instrument was tested through different stages. In the first stage, the questionnaire is distributed to selected staffs who work in credit department. It is reviewed and some basic modifications were conducted to avoid ambiguity of items and maintain the precision to be clear for the participants to answer correctly. In addition to this, one participant was contact and trained from each bank to provide the necessary and relevant data which helps to build on the relevancy of the questionnaire.

ii. Internal Validity: The internal validity of a research study is the extent to which its design and the data it yields allow the researcher to draw accurate conclusions about the relationships within the data. In this case, it's less likely that there will be a Hawthorne effect since the respondents have professional background and has knowledge about bank lending and credit management and those who were involved in the interview were not expected to change their behavior during interview. They were also asked to give their consent and they were given all the right not to answer any questions, if they did not wish to.

iii. **External Validity:** External validity is related to the extent to which the findings from one research can be applied to other similar situations. In other words, how the conclusions drawn can be generalized to other contexts (Leedy and Ormrod, 2005). Here the researcher used representative sample from selected banks, two banks from each three peer groups who are in operation for more than six years.

iv. Construct Validity: Construct validity defines how well a test or experiment measures up to its claims. It refers to whether the operational definition of a variable actually reflects the true theoretical meaning of a concept and quality of an instrument. The researcher has tried to refer different literatures regarding the constructs only with some customization and thereby matching with the basic theories. So, all behaviors under each construct are measured properly realizing the issue of construct validity.

3.4.2 Ethical Issues

For data that has been collected from credit department of banks, permission also be obtained from themselves. The confidentiality of responses and information obtained from the credit analysts, credit managers, and loan officers and even from the financial statements of concerned banks has been kept properly. In order to keep in secret of the banks internal operation only audited and provisional financial statements provided by the banks has been used.

In addition, at the time of data collection the researcher gave respect to the participants and asked permission about their voluntariness for response. The researcher was also ethically consider not to put the participants at risk and not to act against the human rights of the county as stated on the covering letter, i.e. by not including their names and by making codes. For the analysis of the data collected, the researcher ethically used only for this research project with integrity. The findings of the research were presented without any deviation from the outcome of the research. On top of these, the researcher gave full acknowledgements to all the reference materials used in the study.

CHAPTER FOUR

RESULTS AND DISCUSSION

This chapter is discussed data presentation, analysis, and interpretation. The data obtained through primary sources (Questionnaires and interviews) and secondary sources (audited financial statement, annual reports and NBE reports) has been discussed and analyzed in this section. To change the qualitative data in to quantitative data, the questionnaires were carefully coded and checked for consistency and entered into Microsoft Excel Spreadsheet 2010. The necessary information is presented in such a manner that easy to grasp and understand. The data representation is made through tables.

4.1 Questionnaire Response Rate and Interview Success Rate

The questionnaire was distributed to credit related professionals like credit department managers, credit analysts and senior loan officers in the selected banks. Out of the 70 questionnaires physically distributed to the target population, 68 responses were collected, which constitutes 97.14% while to questionnaires that is 2.86% are left unreturned.

Out of the ten projected interviews, eight were successfully conducted, giving a success rate of 80%. Two interviews were unsuccessful because of the targeted interviewees were time constrained and unwilling to respond when they are free. Despite this, the target population was fairly represented considering that department managers and or senior credit analysts who are relevant to the study were interviewed.

Table 4.1 Questionnaire and interview success rate

Data Items	Target Respondents	Successful Response	Success Rate (%)	Unsuccessful Response	Un Success Rate (%)
Questionnaires	70	68	97.14	2	2.86
Interviews	10	8	80	2	20

Source: Survey and own computation from primary data sources

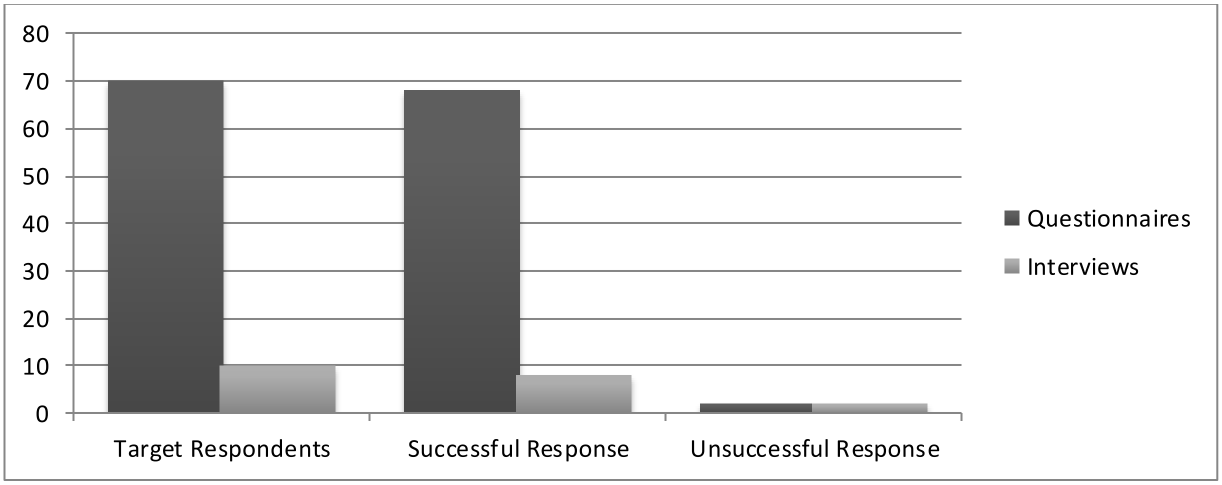


Figure 2: Questionarriees and interviews response rate

4.2. Demography of the Employee

Table 4.2 Educational status

Status	Frequency	Percentage (%)
<u><</u>Diploma	0	0
BA Degree	60	88.2
Masters and above	8	11.8
Total	68	100

Source: *Survey and own computation from primary data sources*

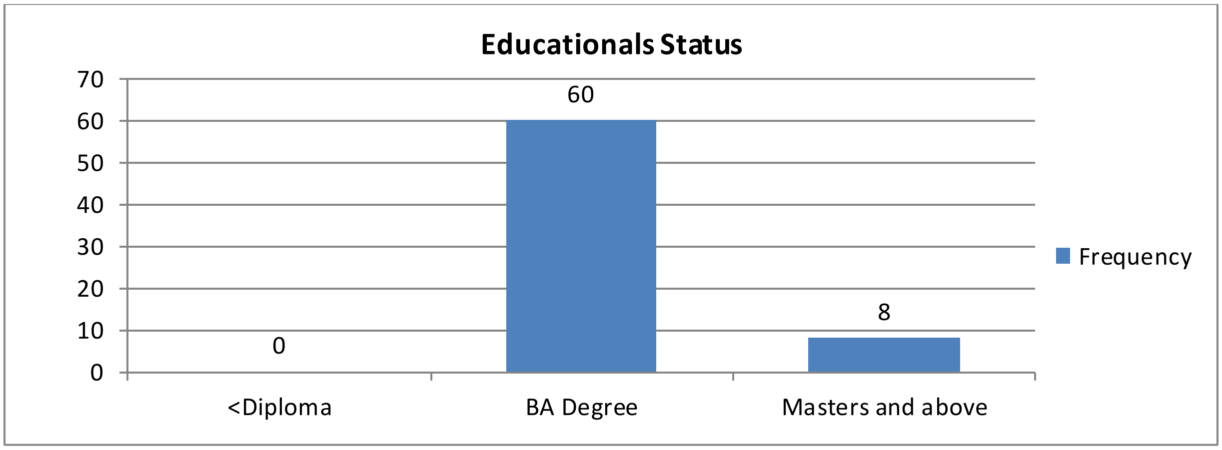


Figure 3: Educational status of the respondents

Educational background of employee is an important factor to be considered with regard to making business decision. Education improves the skill, capacity, communication and access to development endeavors. Educational back ground of major respondents, 88.2% is Bachelor degree and eight staffs, 11.8% have Master Degree and above as indicated in table 4.2above. From this we can understand that majority of the banks employees who are working in the loan areas are high level professionals. This may help Banks to have a good credit assessment on loans and advances.

In addition to these, since most of the respondents are with good educational status, the researcher believes that they can easily understand and respond the questionnaires and interviews correctly.

4.2.1 Respondent's Current Position

Majority of the respondents were senior credit analysis representing 61.8% of the total. Loan officers and credit department managers represent, 29.4% and 8.8% respectively as shown in the table 4.3 below. Hence the reliability of the respondents is constant or concrete.

Table 4.3 Respondents current position in Banks

Employees Position	Frequency	Percentage (%)
Loan Officers	20	29.4
Credit Analysts	42	61.8

Credit Department Managers	6	8.8
Total	68	100

Source: *Survey and own computation from primary data sources*

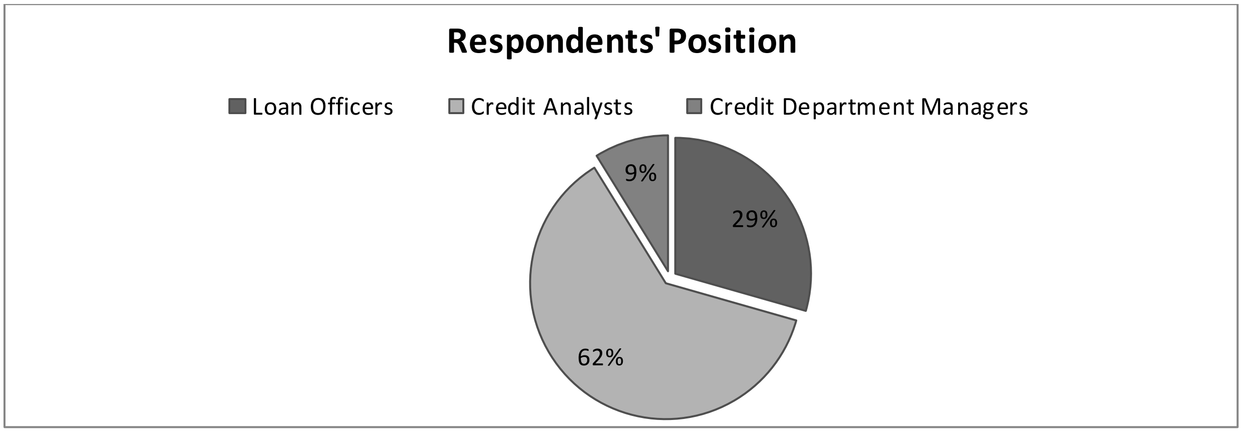


Figure 4: Current work position the respondents'

4.2.2 Respondent's Work Experience in the Banking Industry

The working experiences of all respondents are more than six years in banking industry as indicated in the table 4.4 below. As employees are more experienced, their exposure to risk also increases.

Table 4.4 Respondent's Work experience in banking industry

Bank Experience	Frequency	Percentage (%)
Less than 6 Years	0	0
6 to 10 years	39	57.4
11 to 15 years	19	27.9
16 to 20 years	6	8.8
> 20 years	4	5.9
Total	68	100

Source: *Survey and own computation from primary data sources*

4.2.3 Respondent's Work Experience in the Credit Area

Majority of respondents (82.4%) work experience in credit area are in between six and ten years. as indicated in the table 4.5 below, eight staffs (11.7%) are11 and above year's credit experience. The remaining (5.9%) are with less than 6 years of credit experience.

When we see the experience of other staffs in credit department, excluded from sample they need more exposure or experience to analysis loans and advances carefully and identify loophole of loan default. As it is shown in table 4.5 below is that more than 94% of the respondents have worked within the bank in credit related area for more than six years. It is believed that all respondents possess required knowledge and experience of the lending activities to respond properly for this questionnaire.

Table 4.5 Experience in credit processing (lending area)

Experience in lending area	**Frequency**	**Percentage (%)**
Less than 6 years	4	5.9
6 to10 years	56	82.4
Greater than 10 years	8	11.7
Total	68	100

Source*: Survey and own computation from primary data sources*

4.3 Credit Policy and Procedure

Table 4.6 Credit policy, processing, and collection procedures

Valid	**Yes**		**No**		**I Don't Know**	
	Frequency	**%**	**Frequency**	**%**	**Frequency**	**%**
1. Does your bank have a credit policy/manual?	68	100	0	0	0	0

2. Is the credit policy/manual up to date?	48	70.6	20	29.4	0	0
3. Is the credit policy compliance to NBE?	45	66.2	3	4.4	10	14.7
4. Is loan growth as required?	24	35.3	35	51.5	9	13.2
5. Is loan service as client's preference?	27	39.7	41	60.3	0	0
6. Is Lending and overriding limit convenient?	48	70.6	15	22.1	5	7.4
7. Is the collection technique effective?	54	79.4	14	20.6	0	0

Source*: Survey and own computation from primary data sources*

Preparing and developing credit policy and procedures as well as other pertinent manuals and guidelines help to create common understanding and uniformity among all employees of the banks. Lending is the core product line which contributes the biggest share to the profitability of banks. It is crucial to have credit policy document to protect the bank against over exposure, mal-administration of credit arresting, the creation of non-performing loans, and arrive at a trade-off between returns and risks.

In the above table 4.6, 100% of the respondents replied positively as banks have credit policy and procedural manuals.70.6% of the respondents forwarded their comments on the existing credit manuals which was revised in 2005 following the application of modern banking (core banking system) and it needs to be up to date as so many amendments was made over it, while

29.4% of them are yet recognizing it as up to date. Moreover, 66.2% of the respondents agreed on the compliance of the credit policy and credit procedures to the regulation and directions of the National bank of Ethiopia (NBE), which is the regulatory body of the nation.

Though loan and advance provision is the main product of the bank as it is the main source of income and its growth is not as expected almost in the studied banks. This is disclosed by 65%of the respondents and by the interviewers made with the senior staffs and department managers.

In the table 4.6, above more than half of the total respondents (51.5%) are not satisfied on the prevailing growth of loans while 35.3% accepted the current status of growth as satisfactory and 70.6% of the respondents assured the lending and overriding limit of the banks are convenient. The remaining 39.7% of respondents recognized the deviation of the loan service provided with the preference and expectation of the potential loan clients.

Regarding collection technique effectiveness 79.4% of respondents revealed that the collection techniques of the banks are effective. While 21.6% are said ineffective.

Table 4.7 Credit collection techniques

Collection technique	Frequency	Percentage (%)
Debiting client account as per pre-undertaking	41	60.3
Cash or cheque payment	17	25
Collection agencies	0	0
All	10	14.7
Total	68	100

Source: *Survey and own computation from primary data sources*

The collection technique so far adopted by the Banks is cash or check payment, debiting own account as per the given authorization and transferring through their branches excluding commission charge.

When we come to the convenience of collection techniques applied by banks, 100% of respondents agreed as if the collection techniques are convenience. As it shown on the above table 4.7, the credit collection techniques respondents rated, 60.3% for debiting the clients account, 25% for cash collection system and 14.7% for uses either cash or debiting account system of collection technique. No one say through collection agencies.

The analysis shows that, the most common collection techniques used by the selected banks are made through debiting clients account up on the agreement made on disbursement.

Table 4.8 Credit offering by banks

Credit is Offered by	Frequency	Percentage (%)
Staff approaching promoted clients	17	25
Client approaching with request	44	64.7
Other	7	10.3
Total	68	100

Source*: Survey and own computation from primary data sources*

As shown on the above table 4.8, 64.7% of the respondents said that credit service is provided to customers when they are approaching the bank with credit request. Whereas, 25% of them said that is created offering is made through approaching potential loan clients. And the remaining 10.3% of respondents mentioned that loan is offered to customers by some other mechanisms like commissioning, third party communication, and customer-to-customer approaches.

This shows that Banks needs to improve or exert some extra efforts to approach potential loan clients as it is the best potential loan clients' so as to create quality loans and reduce default loan rate.

Table 4.9 Credit policy and procedure of the Banks

Is the credit policy and procedures	Frequency	Percentage (%)
Rigid	8	11.8
Flexible	12	17.6

Average	48	70.6
Total	68	100

Source*: Survey and own computation from primary data sources*

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

Hence, In order to know the nature of commercial Banks credit policy, the researcher raised questions for the employees of the Banks and interviewed senior bankers and branch managers. Consequently, as revealed in table 4.9, 70.6% of the respondents' said the credit policy and procedure of the banks is on average in its flexibility and 11.8% claimed as it is rigid. While, 17.6% of them said that the credit policy of the Banks is flexible. In the semi-structured interview made most of the senior bankers and credit managers have agreed on the importance, attractiveness and convenience of flexible credit policies and procedures as it assists for loan creation and growth.

Table 4.10 Credit providing procedures

Credit provision is	**Frequency**	**Percentage (%)**
Based on creativity	7	10.3
Conservative	14	20.6
Moderate	47	69
Total	68	100

Source*: Survey and own computation from primary data sources*

In table 4.10, 69% of the respondent revealed that the credit providing procedure of the Banks is moderate and 20.6% acknowledged it as conservative. Whereas, 10.3% of the respondents stated the credit delivery is based on creativity.

4.4 Credit Analysis

Table 4.11 Rate of credit analysis and processing

Rate	Frequency	Percentage (%)
Excellent	3	4.4
Very good	14	20.6
Good	41	60.3
Fair	7	10.3
Poor	3	4.4
Total	68	100

Source*: Survey and own computation from primary data sources*

In relation to credit analysis, as indicated in table 4.11, 60.3% of the respondents rated the credit analysis of the bank as good, 20.6% rated very good, 10.3% rated fair while 4.4% rated each poor and excellent. Thus, there is a gap needed to improve the quality of credit analysis and loan processing at head office level to the status of excellent and very good level that enables to create quality loans and arresting non-performing loans.

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

Table 4.12 Loan recommending/approving

Loan recommending/ approving procedure by:	Frequency	Percentage (%)
Branch Credit Committee	0	0
Credit Department at H.O	0	0
Board of Directors	0	0

CEO/president	0	0
Loan committee at all level	68	100
Total	68	100

Source*: Survey and own computation from primary data sources*

As it is shown in table 4.12 above , 100% of the respondents confirmed that all loans and advances of the bank is recommended or approved by the loan committee at all levels as per the discretions provided. This is to mean that there are some conditions that the branch credit committee, credit department loan committee, CEOs and BODs has their own approving limits of loans and advances.

4.5 Loan Recovery Methods

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

Table 4.13 Methods used to improve repayment for default loans

Measures	**Frequency**	**Percentage (%)**
Loan rescheduling	14	20.6
Frequently insisting the client	31	45.6
Additional loan disbursement	3	4.4
Other	20	29.4
Total	68	100

Source*: Survey and own computation from primary data sources*

As indicated in the above table, 4.13, 45.6% used to settle the default loans through frequent follow up and insisting the loan client. Moreover, 20.6% of the respondents replied that the bank reschedules loans when the case of default occurs justifiable. Whereas, 4.4% of the respondents replied that giving additional loans are reduces loan defaults. The remaining respondents, 29.4% put there are other mechanisms like changing type of loans.

As per the questionnaires and interviews response, in all banks credit is transferred to the legal service when it fails to regularize or settle the loans in default and when all efforts to amicably settle the loans fail and it is ascertained that legal action is to be the last alternative.

Table 4.14 Enforcement measures

Measures	Frequency	Percentage (%)
Court proceeding	24	35.3
Foreclosure	44	64.7
Total	68	100

Source*: Survey and own computation from primary data sources*

If the efforts made to settle loans in default is exhausted the legal proceeding is taken as enforcing measurement. In the above table 4.14 shows, 64.7% of the respondents replied foreclosure is used while 35.3% replied court proceeding is used.

Table 4.15 Effectiveness of forcing measures

Measure Used	Frequency	Percentage (%)
Effective	51	75
Ineffective	17	25
Total	68	100

Source*: Survey and own computation from primary data sources*

With regard to the enforcing mechanisms, the researcher raised questions and made interviews to assess their effectiveness.

As shown in above table 4.15, 75% of the respondents confirm the effectiveness while 25% disclosed its ineffectiveness.

The main reason for the ineffectiveness, according to respondents reply, is that in most cases people do not want to buy others property which is held as collateral by banks. This is mainly observed in the regional cities and towns as a behavior of the cultural society observed to be the most burdens to all commercial banks.

4.6 Interview Analysis on Default Loans

In order to get deep understanding about the loans and advance management, in-depth interview was conducted with senior bank officials. All of the interviewees for the selected banks are with experiences of 10years and above on credit areas. In terms of profile, a Department Managers, Credit Managers and Senior Credit Analysts were participated. The respondents have so many things in common as to what they believed in credit assessments on customer applications (client appraisal), causes and occurrence of default loans and its consequences.

Besides, the factors that are thought to be most critical for the occurrences on default loans are pinpointed. In addition, factors that ascribe to the very nature of the Ethiopian banking industry contributing to the NPL occurrence are specifically presented. Respondents indicated that several factors contribute to loan defaults.

Having interviewed the interviews, the researcher summarizes the different factors that bring loan default in the following way. Those factors are categorized in to three. These are banks' internal situations, the external environment and borrowers related factors and are depicted below.

4.6.1 Banks Internal Factors

These are the reasons relating to internal inefficiencies due to systems, governance, human resource issues and the related. Under this most of the interview participants raised the following issues:

- ✓ Credit analysts' capacity limitation,
- ✓ Banks aggressive lending to maximize profit,
- ✓ Not conducting Know your customers (KYC) principles properly before lending,
- ✓ Over trading/over financing (lending above the borrowers capacity),
- ✓ Not understanding and seeing critically the macroeconomic environment,
- ✓ Excessive lending by banks on a particular sector – poor portfolio diversification,
- ✓ Poor collateral valuation – over engineering estimation of collaterals,
- ✓ Poor monitoring and follow up,

- ✓ The credit approval process not being practical and failing to comply with the existing bank policies,
- ✓ Absence check and balance-in loan processing, follow up and monitoring.

4.6.2 Customer Related Factors

These are factors that emanate from borrowers and have strong bearing on occurrences of loan default. Under this ground the following issues were raised by interviewees:

- ✓ Fund being directed to unintended purpose,
- ✓ Borrowers lack of experience in the business area on which the loan is intended to use,
- ✓ Poor record keeping by businesses, individuals,

4.6.3 External Factors

These are factors that were beyond the influence of banks and borrowers. These are:

- ✓ Intervention of external bodies in credit decision making both in private banks,
- ✓ Society's culture – one doesn't buy foreclosed properties of others in same village in some society,
- ✓ Poor credit culture,
- ✓ Macroeconomic factors like inflation, market problems etc.,
- ✓ Unavailability of data to conduct project analysis,
- ✓ Capacity limitation of the supervisory organ.

4.7 Document Analysis on Default Loans

For the purpose of trend analysis annual reports and audited financial statements of the surveyed six banks are used from June 2011 to June 2015. To see the trend of NPL increment in absolute value and ratio and its impact on profit and credit reduction the relevant data of five years were collected from surveyed six banks. In addition to the argument of the respondents the audited financial statements of each banks trend shows that there is a problem of non-performing loans in Ethiopian private banks even though, it seems decreasing in some banks and the examination of the trend in respect of NPL ratio over the period covered by the study reveals that the NPL ratio has been decreasing since 2011 except that of Zemen, Addis and Abay Banks.

The total loan trend of each surveyed six banks has increased on average from 10.8 billion to 34.8 billion as seen from the table (appendix a) during the five years in consideration. On the other hand the absolute value of total non-performing loan shows ups and down while the trend of middle group of banks continuously increases year to year, but that of Zemen Bank is beyond the acceptable range as set by NBE for all banks i.e. 5%.

Analysis of the document mainly attributed the downward trend in non-performing loans ratio to the growth of each banks loan during this favorable political and economic condition. However, the significant increase in the ratio of non-performing loans to total loans of Zemen Bank S.C from 1.8% in June, 2011 to 6% in June, 2015 was mainly attributed to the poor performance on handling of loans. The impact of non-performing loans on the profitability of banks has abundant effect as seen from the audited financial statement of each banks. From the data (appendix a), we can also see the non-performing loan of Dashen Bank, for the year 2012 & 2013, as it increased from birr 193,380 million to birr 482,190 million which are an increment of birr 288.8 million or 149.4%. When we see Zemen Bank, data of the profit before tax of this bank almost stagnant in the year 2012 and 2013 at ETB 123 million while its non-performing loan raised from 18.1 million to 116.7 million in the year 2013. On the contrary the loan outstanding balance of Zemen Bank increased by almost 63.7% during 2012 operation year, but almost stagnant in the year 2013 & 2014. Therefore, non-performing loan has high impact on credit advancement which is the income sources of banks in developing and developed countries.

In general as most of the respondents agree and also reflected by the interviewees the occurrence of non-performing loans on banks can highly affect the profitability and credit availability of banks as well as it highly affect the liquidity of banks and as indicated on the documents analysis. So banks should be vigilant in lending money and have to have transparent system for credit management control.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

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

5.1 Summary

This study assessed loans and advance management practices in some selected private commercial banks of Ethiopia. The research was conducted to evaluate banks performances on loans and advances issuing. This was carried out by analyzing the process of accessing loans; credits control processes and credits collection strategies. This was done against the background that there was default loans on private banks as a result of non-performing loans affecting the financial status and loan performances of the banks.

Descriptive survey method was used for the study analysis. Based on the broad objective a number of specific research questions were developed. To achieve this broad objective, the study used mixed research (more of qualitative) approach. Sample size of 70 members of staff was drawn from the 132 staffs (of which 93 staffs has more than 6 years experience's) in the selected six banks. The stratified random sampling method taking into consideration on this research as a cluster was used to identify banks sample size for the study.

Two main sources of data were used for the study namely, the primary (questionnaires and interviews) and secondary (audited financial statements, annual reports and NBE reports) sources of data. Questionnaires and interviews were used as the main instrument to collect the primary data on access to credit manuals and procedures, loans and advance offering procedures, credit control processes, credit collection strategies and techniques and default loans and its causes. The questioners had a response rate of 97.1% and the interview has 80% success rate. All of the respondents have more than or equal to six years work experience on credit area and the interviewees also have on average more than ten years on credit related activities in addition to their other banking experiences.

5.2 Conclusion

Now a day's banking industry plays an irreplaceable for one country development. Being one of the major activities of banks, credit contributes vital role for once country growth through financing different industries. Without credit facility it is difficult to run a business smoothly competitively. The source of this credit facility is deposit mobilization from the wide population. As it greater importance credit has to be managed and manipulated carefully. Unless credit management is examined carefully, the associated risks likely happening, like the happening's of non-performing loans/default loans increases.

After the data analysis has been made, and based on the findings, the researcher come up with the following conclusions.

- The credit analysis and procedures which is being followed by each banks is lengthy and reluctant to approve adequate amount per the requisition and intended purpose of the business, requiring improvement so as to speed up and satisfy the delivery of loan to its clients and become acceptable in the eyes of potential customers.
- The collection techniques so far adopted by the banks are cash payment and debiting clients' account as per the given authorization which is appropriate and convenient to most loan clients to manage it. Consistent to the convenience of the collection techniques, the repayment behavior of most loan client is improved to the required level revealing one step forward in the culture of meeting obligation and trustworthiness.
- Private Banks are compliant to all directions of the regulating body in all of its activities of credit management. Hence the way of categorizing and holding provisions for the non-performing loans are as per the direction and requirement of the NBE. Despite the fact that 66.2% of the respondents said that the studied banks credit policy fulfills the requirements set by NBE, the remaining 33.8% shows that there is still a gap that should be addressed or narrowed. Since any failure to deny NBE directives poses fines or penalties.

- Regarding, the credit policy/manual up to date, even though banks have their own credit policy and manual to provide credit facilities, 29.4% of respondents said they are failed to revise or update their credit policy. This indicates that, since banks are living in a dynamic environment in which things are changing from day to day, they shall to revise or update their credit policy to stay in the market competitively.
- Private Banks have yet considerable areas coverage in Ethiopia relative to other banks so far easing access of the society to finances and other bank services such as deposit, transfer, and currency exchange service. However, the loan growth and client reputation is not as required due to the weakness which most of the respondents have disclosed in valuing the collateral offered, in loan processing and approving, and in repayment schedule.
- Moreover as a majority of respondents (70.6%) revealed that the targeted banks have a convenient lending and overriding limit of loans and advances. The researcher reaches in a conclusion that the existence of convenient lending and overriding limits minimizes the chances of default loan to be happening.
- On issues related to the collection techniques effectiveness, as it is clearly indicated in the analysis part most of the respondents replied as if the collection techniques applied by the studied banks is effective. This helped them to have a low rate of default loans.
- Though loan and advance provision is the main product of the bank and main source of income, its growth is not as expected almost in the studied banks. This is disclosed by 65% of the respondents and by the interviewers made with the senior staffs and department managers.
- The loan recovery method used by all the selected banks is treated in the same fashion as of credit collection methods. The measures that are used include strict follow up and insisting the client, debt rescheduling, court proceeding, and foreclosure. As per the questionnaires and interviews response, in all banks credit is transferred to the legal service when it fails to regularize or settle the loans in default and when all efforts to amicably settle the loans fail and it is ascertained that legal action is to be the last alternative
- The forcing measures applied by the selected banks are somehow ineffective. The main reason for the ineffectiveness, according to respondents reply is that in most cases people do not want to buy others property which is held as collateral by banks. This is mainly observed

in the regional cities and towns as a behavior of the cultural society observed to be the most burdens to all commercial banks.

- Findings further indicated that non-performing loans have negatively affected the loan performance of the banks in terms of credit crunch and profitability. It was recognized that an increase in non-performing loans resulted in a reduction of bank's profitability as well as it reduces the loan to be granted to the needy. Despite strategies put in place by management to reduce non- performing loans, problem loans continue to increase in amount even though its ratio seems decreasing in some banks surveyed.
- The default problem in the selected banks is due to three major factors. These are internal, customer related, and external factor. Internal factors are inefficiencies due to systems, governance, human resources etc. Whereas customer related factors are those which are emanated from borrowers. The third factor which has a significance contribution for loan default is external factors which are beyond the control of banks and borrowers. These all leads to credit risks that has bad consequences on the Bank's financial stability, clients' business performance and economy of the country.
- Internal factors can be easily controlled while external factors can be a threat to the viability of private banks. Hence private Banks have to be vigilant in their lending decisions so as to avoid loan losses and the accumulation of non-performing loans. Banks need to concentrate on sectors that are performing well and minimize lending to those sectors which have high risk that already recorded a significant amount of non-performing loans in some banks. One thing to note is that these results can be generalized to the whole banking sector in Ethiopia as almost all the banks have been affected by non-performing loans.

5.3 Recommendations

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

- The credit policy and procedure of each Bank should be updated since banks are living in a dynamic environment in which things are changing day after day and to become more competitive in the banking industry and meet their objectives. In other words, it is better for the Banks to make their credit policy flexible to meet its potential loan clients and thereby putting a good administrative set up that improves credit lending and administration.

- Private Banks shall take into consideration potential future changes in macro economic conditions when assessing borrowers' credit portfolios and their risk exposures under stressful conditions.
- Private Banks should enhance their client appraisal techniques so as to improve their financial performance. Through client appraisal techniques, private banks will be able to know credit worth clients and thus reduce their non-performing loans.
- There is also need for private banks to enhance their credit risk control this will help in decreasing default levels as well as their non-performing loans. This will help in improving their financial performance.
- To minimize default loans, emphasis should be taken by the banks on the importance of strengthening credit process, credit analysis, credit approval, credit monitoring and credit follow-up activities before and after loan disbursed.
- Private Banks shall establish and enforce internal controls and other practices to ensure that expectations to policies, procedures and limits are reported in a timely manner and update their credit policies and procedural manuals to come up with the current situation.
- Private Banks should have to clearly define continuous procedures for identifying potential default loans. Within this system, there should be formal procedures for the continuous review of all large loans and all areas of lending concentration. These reviews should place particular emphasis upon the borrower's continuing ability to serve the loan. Failure to do these continuous reviews and monitoring will lead to loss to banks.
- Prudence of policies that govern Bank loans should continuously be ensured in light of international best practices, macroeconomic situations, level of development of banks and the economy in general by NBE.

5.4 Limitations and Recommendation for Further Study

- The findings of this study are limited to bank specific issues on loans and advances in Ethiopian private banks which is based on experienced staffs' observation and limited to some documents analysis. Another limitation of this study was the sample taken. The sample was only pulled from six private banks in Ethiopia and only from Head office staffs.
- The study is only focused on loans and advances performances of private banks of Ethiopia, while there are also other performance measurements like profitability, liquidity etc. Therefore, it is worth to study in comprehensive level in order to solve the persistent problems and promote the banks as per their vision to the competitive level.
- Besides, I recommended for future researchers to look in to large sample size including other banks and branches to generalize the findings that can work in the broad context and will provide more significant factors to derive relevant policy actions.
- By and large, macroeconomic determinants of default loans in Ethiopia can be studied and support the country and banks as a whole. Therefore, I recommend that a related study can be conducted on this.

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DECLARATION

I the under signed, declared that this project entitled on the topic of **"ASSESSMENT ON LOAN AND ADVANCE MANAGEMENT- THE CASE IN SOME SELECTED PRIVATE BANKS OF ETHIOPIA'',** is my original work and all sources of materials used for writing this thesis have been acknowledged. And I confirm that the thesis has not been submitted to any other higher learning institutions for the purpose of earning Degree/Diploma.

________________________________	____________
Name	**Signature**
St. Marry's University School of Graduate	**June, 2016**

ENDORSEMENT

This thesis has been submitted to St. Marry University, School of Graduate Studies for Examination with my approval as a University advisor.

Advisor	**Signature**
St. Marry's University School of Graduate	**June, 2016**

(ANNEX A)

Financial Data for the Surveyed Banks

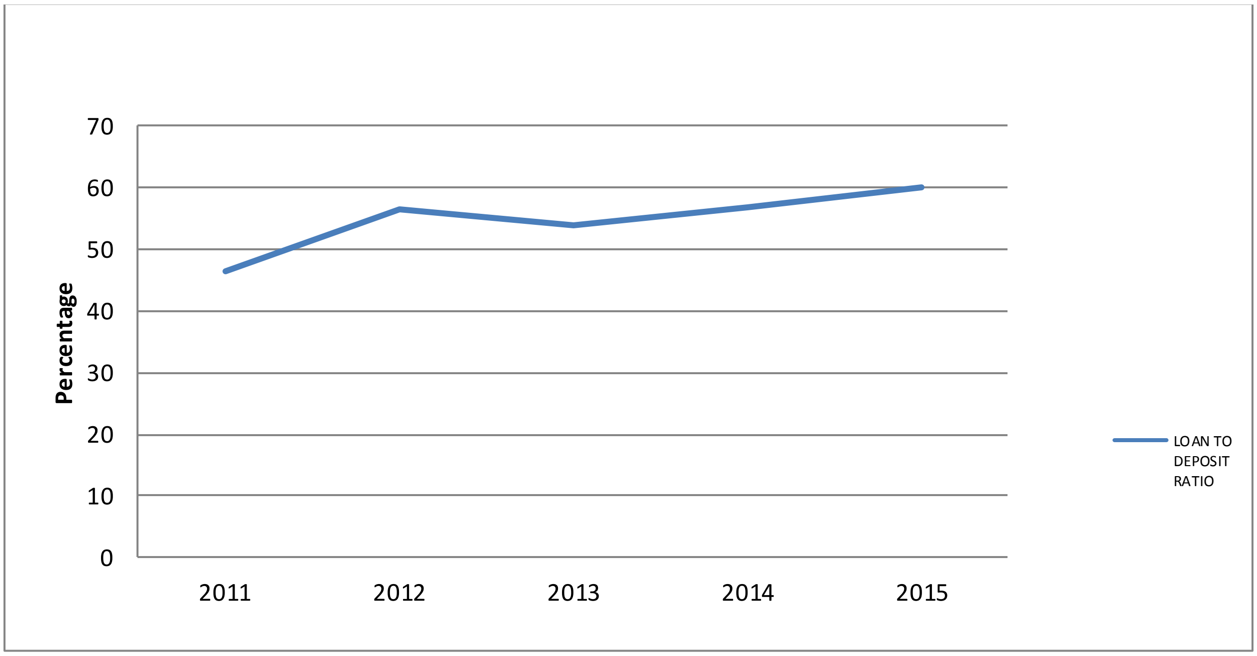
BANKS	PARTICULARS	YEARS				
		2011	2012	2013	2014	2015
AWASH	TOTAL DEPOSIT	8,044,535	9,564,540	13,104,797	16,117,833	21,000,000
	TOTAL LOAN	3,986,524	5,511,613	7,737,115	9,176,360	11,333,085
	TOTAL NPL	146,232	105,038	204,350	208,757	184,650
	NPL RATIO	3.7	1.9	2.6	2.3	1.6
DASHEN	TOTAL DEPOSIT	11,841,239	14,065,600	15,851,264	17,681,343	21,000,000
	TOTAL LOAN	6,141,670	8,042,000	8,836,630	9,607,827	11,526,994
	TOTAL NPL	204,390	193,380	482,190	167,755	181,085
	NPL RATIO	3.3	2.4	5.5	1.7	1.57
CBO	TOTAL DEPOSIT	1,980,416	2,797,540	4,465,039	5,450,097	7,368,000
	TOTAL LOAN	799,450	1,383,460	2,116,060	3,712,476	6,560,000
	TOTAL NPL	28,530	8,600	36,341	68,360	NA
	NPL RATIO	3.6	0.6	1.7	1.8	NA
ZEMEN	TOTAL DEPOSIT	1,162,559	1,792,883	2,505,527	3,030,871	3,800,000
	TOTAL LOAN	645,227	1,012,691	1,369,655	1,429,960	2,283,000
	TOTAL NPL	11,491	18,132	116,729	126,278	136,980
	NPL RATIO	1.8	1.8	8.5	8.8	6
ABAY	TOTAL DEPOSIT	263,383	778,905	1,475,935	2,518,200	3,623,800
	TOTAL LOAN	152,227	452,577	740,743	1,517,100	2,377,900
	TOTAL NPL	1,601	5,205	10,765	18,247	29,336
	NPL RATIO	1.05	1.15	1.45	1.2	1.23
ADDIS	TOTAL DEPOSIT	211,400	349,900	561,300	877,500	1,100,000
	TOTAL LOAN	154,500	190,300	328,000	511,000	771,600
	TOTAL NPL	NA	1,571	3,286	5,598	9,209
	NPL RATIO	0	0.8	1.00	1.1	1.2
TOTAL DEPOSITS		23,503,532	29,349,368	37,963,862	45,675,844	57,891,800
TOTAL LOANS		10,879,598	16,592,641	20,462,203	25,954,723	34,852,579
LOAN TO DEPOSIT RATIO		**46.3**	**56.53**	**53.9**	**56.8**	**60.2**

Source: Audited financial statement of each banks

N: B Amount is in thousand (‘000) *** NA - data is not available**

(APPENDEX B)

Figure: 5 Loan to Deposit Ratio



Source: Own computations from secondary data source

(APPENDEX C)

QUESTIONNAIRES

ST. MARRY UNIVERSITY

SCHOOL OF GRADUATE STUDIES

BUSINESS FACALITY

To be filed by Credit Staffs

Dear respondents,

Your response to this questionnaire will serve as source of information to the research paper to be done for thesis purpose **"ASSESSMENT ON LOAN AND ADVANCE MANAGEMENT-THE CASE IN SOME SELECTED PRIVATE BANKS OF ETHIOPIA''**.

The research is undertaken as academic requirements of MBA degree in Business Administration. It also helps to gain practical knowledge on the topic under investigation and other prospective researchers as a stepping stone to carry out further investigation. Any response you provide here is strictly confidential and used solely for the academic research purpose. Your honesty in responding the right answer is very important for the research outcome to be reliable.

I want to assure you that your responses is only used for academic research purpose and kept confidentially.

Contact Address:

If you any enquiry, please do not hastate to contact me and I am available as per you convenience.

Mobile: + 251913-725811/+251938-044802

E-mail: birukesg1@gmail.com

Thank you!!!

Instruction

There is no need of writing your name. Please circle or/and fill in the blank spaces your possible answer to the corresponding question and comment on open questions. Thank You.

I. Personal Details:

1. Gender:

a) Male b) Female

2. Age:

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

3. Marital Status:

a) Single b) Married c) Other---.

4. Educational qualification

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

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

---.

6. The responsibility (Current Position) that you are involved in it: ----------------.

7. Years of experience?

a) In the bank ------------------------years.

b) In the current position-----------years.

c) In other institution's-------------years.

II. Details on Manuals and Procedures:

8. Do you have a credit manual or policy?

a) Yes b) No

9) Do you think the credit manual/policy is up to date & convenient for loan& advance creation and/or collection?

a) Yes b) No

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

---.

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

a) Yes b) I don’t know c) No

12. If your answer to Q no. 13 is **No**, please specify the gaps

---.

13. Does your bank provide loan and advance service that fit to the preference of the borrowers/clients?

a) Yes b) No

14. If your answer to Q no. 19, is **No**, please specify the reasons

---.

15. Do you think your bank’s loan growth is as it is expected?

a) Yes b) No

16. If your answer to Q no. 15 is **No,** please specify the reasons

---.

17. Do you think the bank’s lending limit and overriding limit has any impediment in branches loan providing capacity and growth?

a) Yes b) No

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

---.

19. Do you think your bank's credit collection techniques are effective?

20. If your answer to Q no. 15 is No, please specify the appropriate techniques that you think are best? ---.

III. Loan and Advance Offering and Procedures

21. How can you see your bank's credit policy and procedure on loan offering?

a) Rigid b) Flexible c) Average

22. Most of your current loan and advance is created by:

a) Approaching promoted clients b) Clients approached with request c) Other----.

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

a) Based on creativity b) Conservative/traditionally) Moderate

24. What are the main reasons to loan and advance client's dissatisfaction in the processing?

---.

25. Your bank's loan and advance approving/recommending procedure of the credit proposal of clients is based on:

a) Loan committee at all level b) Branch credit committee) Loan/credit department at H.O level

d) Board of directors) CEO's/President

f) Other, specify---.

26. Would you please indicate the pros and cons facing due to your answer to Q no.25?

Pros: ---.

Cons: --.

27. How do you rate the credit analysis and procedure followed by the bank in extending credit?

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

IV. Credit Follow-up and Collection Techniques

28. Which of the following credit collection technique/s is/are adopted on your Bank?

a) Cash/check payment b) Using collection agencies c) Debiting client account as per pre-undertaking d)All g) Other techniques --.

29. What do you think is/are the major reason/s for default on loan and advance in your Bank?

a) Lack of follow-up b) knowledge gap of credit analysts' c) Failed to implement five C's

d) Loan/advance diversion e) Absence of record keeping f) Lack of market for clients' product g) Unfavorable environmental conditions h) Others, specify ----------------------.

30. What preventive measures do you think effective to be used before failing loans and advances to default? ---.

31. What measure/s assumed to be taken on the side of your bank to improve their payment situation for default loans?

a) Loan rescheduling b) Additional loan disbursement c) Frequently insisting the client

d) Others---.

32. Do the measures applied bring a significant improvement in repayment?

a. Yes b) No

33. If your answer to Q no. 33 is **No**, what measures are taken by the bank to enforce repayment?

a. Foreclosure b. Court proceedings c) Others------------------------------------.

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

a) Foreclosure b) Court preceding c) Both d) Other------------------------------.

35. How do you evaluate the loan enforcement mechanism?

a) Effective b) Ineffective

36. If your answer to Q no. 32 is **"Ineffective",** what is/are the reason/s/ behind this?(Hint: you can check all answers that apply)

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

b. Limited purchasing power of the society

c. High initial bid amounts

d. Others ---.

37. Would you please specify any problem/s/ of loan and advance management that your bank's faces so far apart from the above raised issues? ----------------------------------.

38. Would you please specify the major credit problems you think? -----------.

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

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Thank you!!

(ANNEX D)

INTERVIEW QUESTIONS

ST. MARRY UNIVERSITY

SCHOOL OF GRADUATE STUDIES

BUSINESS FACALITY

To be answered by Department Managers and or Senior Analysts

The following interview questions are designed to collect information about default loans and advances of private banks of Ethiopia. The information shall be used as primary data in many research **"ASSESSMENT ON LOAN AND ADVANCE MANAGEMENT- THE CASE IN SOME SELECTED PRIVATE BANKS OF ETHIOPIA''** which I am conducting as a partial requirements of my study at St. Marry University for completing my thesis program.

I want to assure you that your responses is only used for academic research purpose and kept confidentially. Therefore, your genuine, honest and prompt responses are valuable input for the quality and successful completion of the project.

1. Do you think banks are adequately assessing credit applications of customer? If no what strategy they have to use to overcome such problem?
2. In your opinion none performing loan is a problem in Ethiopia?
3. What are the major causes affecting NPL occurrences in Ethiopia banks?
4. What is your recommendation to mitigate the occurrences of default loans in Ethiopia Banks?
5. Your general view on loans and advances management.

Thank you so much!!!