ST. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

THE TREND OF LOAN RECOVERY PERFORMANCE IN BANKING INDUSTRY: A CASE STUDY OF OROMIA INTERNATIONAL BANK S.C.

A THESIS SUMMITED BY: GENET KEBEDE

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ADDIS ABABA, ETHIOPIA

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A THESIS PRESENTED TO SCHOOL OF GRADUATE STUDIES SAINT MARY'S UNIVERSITY

DEPARTMENT OF ACCOUNTING AND FINANCE

SUBMITTED BY: GENET KEBEDE

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ACRONYMS

CAR – capital adequacy ratio

ROI – Return on investment

EVA – Economic value additions

NPL- Non performing loan

AIB- Awash international bank s.c

OIB- Oromia international bank s.c

NBE-National Bank of Ethiopia

CBE -Commercial Bank of Ethiopia

LIB-Lion International Bank

OD- Over draft

AMC- Asset management companies

SOB- State owned banks

ATM- Automated teller machine

POS – pay on spot

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ABSTRACT

The objective of the study was to examine the trend of loan recovery performance of banking industry, a case study of Oromia International Bank s.c. Many factors attributed to the growth of banking industries. Among these, the major one is loan recovery performance of banking industry. A sample size of 68 respondents was used and simple random sampling method was adopted for the study. The data used to conduct this research was collected from both primary data and secondary data. Secondary data was collected from annual report of National Bank of Ethiopia and OIB's annual report and primary data was collected from 68 employees of OIB s.c who are working in the area of loan activity. Moreover, semi-structured and structured interview was also used to gather information that can be used as a case study from OIB's loan officers. In addition, questionnaires were employed to OIB city branch managers and credit department employees. Data was analyzed by using tables and a brief explanation by words. The findings of the study indicated that there are many factors which hamper loan recovery performance of Oromia International Bank s.co. For example: Luck of paying attention up on loan collection by all concerned parties, inadequate loan assessment and lack of follow up; lack of effective use of loan for the intended purpose; lack of appropriate revision of credit manual; social instability and market problem etc. The researcher recommends that the bank should provide Loan advisory service before and after the loan, the bank should effectively use the potential man power, the Bank should revise its credit procedural manual and follow up to reduce the amount of NPL.

***Key word**: credit, nonperforming loan, lending and NBE*

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

Financial institutions play an enormous role in development of a national economy. The financial sector serves important function for economic growth and development. Banks are generally chartered to support the community with adequate supply of loans in line with the competitively determined interest rate. Loan means any financial facts of a bank arising from a direct or indirect advance or commitment to advance funds, by the bank to a person, that are conditional on the obligation of the person to repay the funds either on specified date or on demands usually with interest (Adriaan et al,2002).

In fact many factors attributed to the growth of banking industries, but the rate of loan recovery performance has got an immense effect on the growth of the banking industries. An efficient financial system contributes to positive economic development. A financial system in its role as an intermediary performs important role of channeling saving to investment. When savings are allocated to projects that are profitable, they will result in generating high-return on investments. The more investments are productive, the higher the rate of economic growth Sonali, (2001).

As stated by Sonali, (2001), empirical evidence worldwide confirms that countries with well-developed financial systems tend to have better economic performance, while countries with weak financial systems are associated with low economic performance.

Financial institutions transform financial assets acquired through market and constitute them in to a different and more widely preferable type of assets (Fabozzi and Modigliani, 1996). Financial intermediaries include depository institutions (commercial banks, saving & loan associations, savings banks & credit unions, insurance companies, pension funds and finance companies). These intermediaries obtain funds by issuing financial claims against themselves to market participants, then investing those funds. The investment made by financial intermediaries can be in the form of loans and/or in securities (John, 1984).

Among the depository institutions, banks are the most important financial institutions in the economy. They are the principal source of credit for many households, for most local units of government and businessmen. The principal economic function of banks is to make loan. For most banks, loan accounts for half or more of their total assets and about two thirds of their revenue (Ibid, 1984). Commercial Banks are so named because they specialize in credit to commercial and industrial businesses. Commercial banks are owned by private investors, called stockholders or by companies called bank holding companies (Encyclopedia Deluxe, 2004).

The term credit may be explained as the provision of financial accommodation to a person, in return for a promise to repay it at some future date. Credit may be extended as a cash loan, or through the medium of deferred payment for the supply of goods and services. Credit transactions may also be classified according to the purpose for which they were extended, method of repayment and whether security is taken. Whatever the classification may be, the economic function of credit remains the same, i.e. it enables a person to spend in excess of his current or actual receipts, and to facilitate the present enjoyment of goods and services other wise beyond his means (Bonin and Yiping Huang, 2001). Shekhar(1993) further noted that, credit exploitation and banking go side by side. Banks in their stages of development are always related to credit. It is practically impossible to see one independent of the other.

According to Pischke (1991), repayment performance is critical feature of credit because persistent poor repayment performance ultimately leads to financial failure in any lending institution. Financial failure is defined in hard term as the inability to cover cost out of the interest income and fees, or in soft term as a failure to attract fund sufficient to maintain the institution in a nut shell. If there will be low repayment performance for a continuous period, it exposes the financial position of the lending institution It also undermines public confidence in formal financial market and causes savers to withdraw their funds In addition, it increases staff turnover due to doubt on the capacity of the institution. If a bank neglects to do so or the recovery process is unduly protracted, the impact on it may be severe. The bank may end up with a large loan portfolio in arrears, which in turn would affect the bank's capital ratios.

In such circumstances, the bank may find itself having to offer higher than average deposit rates to attract more capital. Inevitably, these higher rates will be reflected in the bank's lending rate. Higher lending rates may in return adversely affect the average quality of future lending, forcing the bank to lend high-risk borrowers. If the bank is to lend to the more creditworthy borrowers, it may be forced to cut margins to levels, which would be insufficient to generate profits (Brown Bridge 1998). Evidence from many countries in recent years suggests that collateral values and recovery rates can be volatile and, moreover, they tend to go down just when the number of defaults goes up in economic downturns (Altman, Resti & Sironi, 2001).

The first step in a successful loan recovery is to put a dollar value on the loan recovery that will hold up in litigation. For example, the objective of liquidating real estate secured loan by foreclosure or mutual agreement is to change a mortgage into a loan recovery. A set of lender documents-promissory note, real estate security, environmental indemnity, standby letter of credit, and possibly other agreements collectively represent an "asset'' in accounting terms called a receivable. In the same light, the loan recovery represents a "prospective" asset, that is, a set of other property that will replace the mortgage on the lender's balance sheet, consisting of title to real estate (the collateral), cash, other receivables such as a judgment for damages against recourse parties, or a new promise to pay from take-out parties (Stillman, 2003).

1.2 Statement of the problem

The loan extended to various sectors of the economy must be recovered in full if the objective of circulating more and more financial resources to meet the increasing demand for credit and to keep the bank in sound financial health is to be achieved. The major source of income for the banking industry is interest on loans. Both the principal and interest must be recovered. The bank collects the principals and interest from the clients on the due date. But default may occur on the side of the client due to various reasons. If there is high incidence in the deficit of client, this leads the bank to be insolvent and weak in its financial position. Finally this situation will paralyze the investment program as well as the economy as a whole.

Various studies have been conducted to assess the non-performing loan in different countries. A set of studies have been conducted in relation to NPLs and its implication for the economy. The high level of non-performing loan in the banking industry has been a hindrance to economic stability (Kwambai, 2013).

According to (Hossain, 2017), if the invested funds in an economy are not recovered, it limits the recycling of the funds is reduced by the amount of classified loans which may lead to economic stagnation. NPL affects banks' profitability adversely because of the provision of classified loans and consequent write-off as bad debts, reduces return on investment (ROI), and disturbs the capital adequacy ratio (CAR). It also increases the cost of capital, widens assets and liability imbalance and upsets the economic value additions (EVA) by banks. EVA is equal to the net operating profit minus cost of capital. Banks may face liquidity problem due to high rate of NPL amount.

In our country case there are a research conducted on other commercial banks. According to (Feyisa, 2009) the amount of fund that is being lent by the bank is being decreased which has a negative impact up on its profit. These research was classifies the recovery performance by sectorial out of eight loan sectors of AIB under study five of sectors' recovery rates are less than 22%.And out of the total loan demand of AIB during the period, on average only 34% was recovered. This implies on average 66% of the total loan demand was not recovered.

Therefore, this study was find out the loan recovery performance and investigates the major factors affecting loan recovery performance of the bank. Factors such as associated with lack of obtaining potential creditors, estimating and checking appropriate values of collateral and loan documentation of creditors, preparing customer's disbursement instruction and follow up their periodic loan repayments was assessed in depth. There is no research done on Loan recovery performance in OIB recently so far to my knowledge is concerned, Girma (2011) conducted a research credit risk management and focusing on credit risk management techniques and practices. Therefore, this study was filled this gap by taking the case of OIB. Thus, the study illustrated the loan recovery performance of Oromia International Bank S.Co(OIB) in particular between the Periods 2015 to 20017.

1.3 Research questions

This study has answers to the following major research questions.

1. What are the causes of nonperforming loans?

2. What are the consequences of nonperforming loans?

3. What kind of measures the banks use to protect the occurrence of nonperforming loans?

4. Is the trend of loan recovery performance in Oromia International Bank S.Co satisfactory by sector?

1.4. Objectives of the Study

1.4.1. General Objective

The main objective of the study is to examine and assess the non-performing loan and its recovery performance of the banking industry in general and Oromia International Bank S.Co in particular.

1.4.2. Specific Objective

- ✓ To find out the reasons for the occurrence of non-performing loans.
- ✓ To find out the consequence of nonperforming loan
- ✓ To evaluate measures taken by the bank to protect the occurrence of non-performing loans.
- ✓ To examine the efficiency of Oromia International Bank in loan recovery performance by sector.

1.5. Significance of study

It is believed that this paper will clearly reflect most of the difficulties observed or the major factors that affect loan recovery performance of this Bank and gives possible solutions as to how to handle loan effectively and properly take up measures when problem occurs.

And for other researchers it can be used as an additional reference. It is also hoped that this research paper gives guidelines to concerned managers of the bank with regard to how they can properly address the major factors that mainly affect Bank's loan recovery.

1.6. Scope of the Study

The researcher intends to address different issues regarding loan recovery performance of this Bank. The research has taken specifically Oromia International Bank (OIB)s.c as a sample case for practical considerations. Because of financial and time constraints, it has been found too difficult to consider all Banks in Ethiopia in detail. Thus, the scope of the study is limited to discussing the practice in Oromia International Bank s.co.

1.7. Organization of the study

The paper has five chapters. The first chapter deals with the introductory parts, which have back ground of the study, statement of the problem, research questions, objectives of the study, significance of the study and scope of the study. The second chapter contains the related theoretical and empirical literature review. The third chapter deals with research design and approach, sample and sampling techniques, data collection instrument, data analysis tools and research methodology. The fourth chapter deals with the data presentation, analysis and interpretation of the study finally, the fifth chapter contains the conclusion and recommendations of the research study.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews loan recovery performance of banking industry, covers discussion on non-performing loans and also provides highlight on the history of Oromia International Bank s.co.

*"Timely repayment of loan is important to ensure the financial soundness of lenders. Where borrowers are in default, lenders may reschedule loans, but ultimately they rely on recovery procedures and the courts to compel debtors to pay up. If the courts and judicial system in a country fail the lenders, bad debts will begin to mount in number (*Murgatroyd, P.1993).

Loan (credit) repayment is the loan amount clients installed within the reporting period. Loan repayment will consist of loan principals and interest. It will be affected based on the agreement entered between the bank and the client. Banks encourages timely repayment. To this end, it requires to make the borrower aware of the advantage of paying loan on or before due date. The relationship between the borrower and the lender is important. The more distance the lender is from the borrower, the less control the lender has over the repayment of the credit (Shekhar, 1993).

In determining the loan recovery performance of the period, the technique used is to determine the proportion of loan recovery rate. This is arrived at by dividing recovery against demand to total demand and then multiply by hundred. Total demand is the amount of due loans both the principal and interest of the bank expects to recover at a particular period (it is the summation of beginning arrears and current demand).Loan recovery against demand is the portion of Loan recovery during the period under consideration and overdue is the amount of loan repayment period has matured but was not realized. Advance collection is the portion of loan which is collected prior to payment, Gita, (1993).

2.2. Definition of loan

Loan is an arrangement of advancing a sum of money on interest for a pre-agreed period sometimes for a particular purpose as well. The main features of loan advanced by a bank are the bank sanctions a sum of amount as loan for (a) pre-arranged period and (b) at an agreed rate of interest, a separate Loan account is opened in the name of borrower with the amount of loan sanctioned ,the loan sanctioned has to be taken in full and not partially as the full amount is transferred to the debit side of the account and starts bearing interest from the date of entry in the debit side, from his loan account the customer is allowed to transfer the amount to his current account, installment repayment of loan is not permitted. But relaxation depends on the bank's discretion (Kumar et al, 2002).

The main business of a banking company is to receive deposits and lend money. Receiving deposit involves no risk, since it is the banker who owes a duty to repay the deposit whenever it is demanded. On the other hand, lending always involves much risk because there is no certainty of repayment. But, a banker earns a bulk of his income only through lending.

A banker should be very cautious in lending because he is not lending money out of his own capital. A major portion of the money lent comes from deposits received from the public. These deposits are mostly repayable on demand (Mithani et al, 2008).

In finance, a loan is the lending of money from one individual, organization or entity to another individual, organization or entity. A loan is a debt provided by an entity (organization or individual) to another entity at an interest rate, and evidenced by a note which specifies, among other things, the principal amount of money borrowed, the interest rate the lender is charging and date of repayment. A loan entails the reallocation of the subject asset(s) for a period of time, between the lender and the borrower (Guttentag, 2007).

Loan is generally provided at a cost, referred to as interest on the debt, which provides an incentive for the lender to engage in the loan. In a legal loan, each of these obligations and restrictions are enforced by contract which can also place the borrower under additional restrictions known as loan covenants.

2.3 Factors that make a borrower eligible to enjoy a credit facility from lending banks

Some of the factors that affect the ability of a borrower to repay a loan are very difficult to evaluate but they must be dealt with as realistically as possible in preparing financial projections. This involved looking in to the past record of the borrower as well as engaging in economized forecasting (Reed and Gill, 1985).Furthermore, they suggest that there are the ingredients that determine the lending officer's faith in the debtors' ability and willingness to pay the obligation in accordance with the terms of the loan agreement. Some writers like Sheker (1982) classified the factors in to 5 C's.

2.3.1. Capacity (Repayment Ability/Borrowing Capacity)

Capacity of a borrower requires two aspects to be assessed. First, borrower must have legal capacity to borrow. For example, banks will not lend to minors. An assessment of the "financial capacity" of a borrower is relevant in ascertaining the repayment ability of a borrower (Sonali, Abeyrante, 2001). W.Reed and K.Gill (1985) also added that Banks are interested not only in the borrower's ability to repay but also in his or legal capacity to borrow .Banks make few loans to minors since they can disaffirm at a later date unless the proceed of the loan are used for essential purpose when a loan is made to a minors. A parent, guardians or other person of legal age is usually asked to cosign the note.

2.3.2. Character (Human /Management Factor)

Character of a borrower plays an important role in the credit assessment process. A lending bank will look in to a borrower's past record, its banking operations, integrity and reputation to establish his character (Sonali, Abeyrante, 2001). Reed and Gill (1985) stated that the concept of character definition relates to credit transaction which means not only willingness to repay debt but also a strong desire to settle all obligations within the terms of the contract. A person character usually possesses attributes such as honesty, integrity and morality but character is difficult thing to evaluate. It is entirely possible for a person not to have all these qualities but still wish to repay financial obligations. Character worthy of credit is largely function of a person's honesty and integrity. Clemens (1989) also addressed character as "the banker should have complete confidence in the integrity and ability of the customer to use the money to advantage and to repay it within a reasonable period.

In the absence of such confidence it is preferable to decline to lend, no matter how much security may be available. Every banker needs to fix in his mind a clear picture of the ideal customer. This is true when the manger has known the customer well and has been personally dealing with him over many years. Sinkey, Joseph (1996).Ibid (1996) also noted out that factor such as management goals, objectives and motivations need to be addressed. In a business loan assessment, adequate financial, technical and business management ability needs to be analyzed critically before making decision.

2.3.3. Capital (Financial position)

Capital is the amount of funds invested by the borrower in a business to support both fixed asset and current assets in other words it described as 'net worth support' (Flesig, 1995). Banks should make sure that every borrower has sufficient equity to enable the creditors to recover their funds through the sales of assets other than the collateral pledged for the loan.

'The equity of a company is an important factor to consider if the potential borrower is small business and also new to a bank, or where the business is relatively new. In the first few years of a small business it will usually have little or no retained earnings, and very little external financial help. It would, therefore, have to rely on its own capital in the event of externally imposed challenges such as

interest rate fluctuations, inflation and changes in market conditions' (Sonali, 2001).

2.3.4. Condition (Economy)

Economic conditions affect the ability of the borrowers to repay financial obligations but are beyond the control of the borrower and the lender, according to Shaker (1982).In addition Ibid (1982) stresses that economic conditions make up the environment within which business units and individual operate, therefore, he noted out that the loan officer must become an economic forecaster. Market conditions as well as social and economic conditions, affect a potential borrower's business activities. It is quite possible that a borrower may satisfy all the other elements of credit assessment but if the potential borrower were engaged in a business that has an uncertain market, lenders would be reluctant to advance the money. A prudent lender will always closely study the prevailing conditions in a county before granting a loan (Sonali, 2001).

2.3.5. Collateral (Security)

Collateral is not mandatory in the securing of a loan. Lenders, however, will favor the availability if in the bank's view; there is an element of doubt as to the repayment capacity of a borrower. The amount of collateral that is taken must reflect that element of doubt (Sonali, 2001). Collateral refers to the particular assets of the firm that the bondholders receive if the firm defaults on the bond/loan (Barrow and et al 1981).Loans are frequently secured by assets of the borrowers, most cars, for example are purchased on credit and automobile serves as collateral for the loan. Security is taken in most instances to strength a weakness found in one or more of the credit factors such as ability to create income (Clemens, 1989).

2.4. Principles of Good Lending Policy

According to (Bedi & Hardikar 1993) when evaluating loan requests, bankers can make two types of errors. The first is extending credit to a customer who ultimately defaults; the second is denying a loan request to a customer who ultimately could repay the debt. In both cases, banks loose a customer and its profits. To minimize such errors and prevent problems of loans before their occurrences, there are few general principles of good lending that should be noted while considering an advances proposal. These include safety, liquidity, and purpose of loan proceeds, profitability and diversification.

2.4.1. Safety: the most important principles of good lending. When a banker lends, he must feel certain advances is safe. That is the loan is certainly 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 loss in his business due to his incompetence, the recovery of the money may become difficult. The banker ensures that the money advanced by him 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.

2.4.2.Liquidity: may simply defined as the ability of bank to convert to a sufficient amount of assets in cash readily and at favorable price to satisfy at any time both the normal and abnormally high withdrawal demand of its operation. A bank is said to be liquid if it has immediate access to funds at reasonable cost precise time as the funds are needed. 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 it must be collected on demand or in accordance with agreed terms of repayment. The borrower must be in a position to repay within a reasonable time after demand for repayment is made. This can be possible only if the money is employed by the borrower for short-term requirement and not locked up in acquired fixed assets, or in schemes that take long time to pay back. The source of repayment should be definite. The reason why bankers attach much importance to liquidity as to safety of their funds in that bulk of their deposits is repayable on demand or at short notice.

2.4.3. Purpose of the loan proceeds: Another principle of good lending that must look in to the purpose of the loan proceeds. The range of business loan needs is unlimited. Firms may need cash for operating purpose to pay overdue suppliers, to make a tax payment or pay employees salary. Similarly they may also need funds to pay off debt obligations or to acquire new fixed assets. Frequently a firm recognizes business operating purposes, including seasonal and permanent working capital needs, for the purchase of depreciable assets, physical plant expansion, acquisition of other firms, and extra ordinary operating expenses.

2.4.4. Profitability: Like other commercial institutions, banks must make profits. Firstly they must have to pay interest on deposits received by them. They incur expenses on establishment, rent, stationery, etc. they make provision for depreciation of their fixed assets and also for any possible bad or doubtful debt. After meeting all these items of expenditure, a reasonable profit must be made, otherwise it will not be possible to carry anything to be reversed or pay dividends to shareholders.

2.5. Loan repayment

Loan (credit) repayment is the loan amount clients installed within the reporting period. Loan repayment will consist of loan principals and interest. Loan repayment will be effected based on the agreement entered between the bank and the client. Banks encourages timely repayment. To this end, it requires to make the borrower aware of the advantage of paying loan on or before due date. The relationship between the borrower and the lender is important. The more distance the lender is from the borrower, the less control the lender has over the repayment of the credit (Shekhar, 1993).

Lending decision is made on sound credit risk analysis /appraisal and assessment of creditworthiness of borrowers. But 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 on the basis of 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. According to the National Bank of Ethiopia, 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
- Identify early warning signals, if any, and initiate remedial measures thereby averting from possible default.

Basically there are three types of loan follow up systems. These are: Physical follow up, financial follow up and legal follow up (NBE Directives, 2010). Each is discussed in section that follows:

A. Physical Follow -up

Physical follow-up helps to ensure existence and operation of the business, status of collateral properties, correctness of declared financial data, quality of goods, conformity of financial data with other records (such as taxes ,register books), availability of raw materials, labor situation, marketing difficulties observed ,undue turnover of key operating personnel, change in management set up among others.

B. Financial Follow- up

Financial follow up is required to verify whether the assumptions on which lending decisions was taken continues to hold good both in regard to borrowers' operation and environment, and whether the end use is according to the purpose for which the loan was given.

C. Legal Follow- up

The purpose of legal follow up is to ensure that the legal recourse available to the Bank is kept alive at all times. It consists of obtaining proper documentation and keeping them alive, registration, proper follow up of insurances. Specific issues pertaining to legal follow up include: ascertaining whether contracts are properly executed by appropriate persons and documents are complete in all aspects, obtaining revival letters in time (revival letters refer to renewal letter for registration of security contracts that have passed the statutory period as laid down by the law), ensuring loan/mortgage contracts are updated timely and examining the regulatory directives, laws, third party claims among others.

2.6. Nonperforming Loan

Loans and advances constitute the primary source of income by banks. As any business establishment a bank also seeks to maximize its profit. Since loans and advances are more profitable than any other assets, a bank is willing to lend as much of its funds as possible. But banks have to be careful about the safety of such advances. Nonperforming loan means loans or advances where credit quality has deteriorated such that full collection of principal and/or interest in accordance with contractual repayment terms of the loan or advance is in question.

According to NBE directive No.SBB /43/2008 define none performing loans (NPLS) as loan or advances with pre-established repayment program in which principal and/or interest is due and uncollected for 90 consecutive days or more beyond the scheduled repayment date.

In addition to this directive also states that OD and Loans or advances that do not have pre-established repayment program shall be none performing when:

• The debt remaining outstanding for 90 days or more beyond the scheduled repayment date or maturity,

• The debt exceed the borrower approved limit for 90 consecutive days more,

• Interest is due and uncollected for 90 consecutive days or more,

For overdraft accounts:

• The OD account has been inactive for 90 consecutive days,

• Deposits are insufficient to cover the interest capitalized during 90 consecutive days,

• The account fails to show 5% or less debit balance of the approved limit once in a year.

2.6.1. Classification of nonperforming loans

The extent to which authorities have been involved in developing criteria to distinguish between "good'' and "bad'' loans differs substantially between countries. Some countries use quantitative criteria, for example number of days of overdue Scheduled payments, while other countries exclusively rely on qualitative norms (such as a variability of information about the clients' financial status, management judgment about future payments). Loans with pre-established repayment program are non-performing when principal and/or interest is due and uncollected for 90 (ninety) days or more beyond the Schedule payment or maturity (NBE Directive, 2008).

In our country's case the National Bank of Ethiopia has issued directive number SBB/43/2008 pursuant to the authority vested in it by article 41 of the Monetary and Banking proclamation number 83/1994 and by article 15 (1) and 36 of the Licensing and Supervision of Banking Business proclamation number 84/1994.

According to this directive banks shall classify non-performing loans, weather such loans have pre-established repayment Schedule or not, in to the following five classifications using the criteria described below.

a) Pass - loans or 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 any loan or advances or portion thereof, which is fully secured, both as to principal and interest, by cash or cash substitutes, shall be classified under this category regardless of past due status or other adverse credit factors.

b) Special Mention – loans or advances with pre-established repayment programs past due 30(thirty) days or more, but less than 90(ninety) days and overdrafts and loans/advances that do not have a pre-established repayment program shall be classified under this classification.

c) Substandard - loans or advances with a pre-established repayment programs past due 90(ninety) days or more, but less than 180(one hundred eighty) days and overdrafts and loans/advances that do not have a pre-established repayment program shall be classified under this classification.

d) Doubtful – loans or advances with a pre-established repayment programs past due 180 (one hundred eighty) days or more, but less than 360 (three hundred sixty) days and overdrafts and loans/advances that do not have a pre-established repayment program shall be classified, at a minimum, as doubtful.

e) Loss – Non – performing loans or advances with a pre-established repayment programs past due 360(three hundred sixty) days or more and overdrafts and loans/advances that do not have a pre-established repayment program shall be classified as loss (NBE, 2008).

2.6.2. Causes of Nonperforming loans

A more or less predictable level of nonperforming loans, though it may vary slightly from year to year, is caused by an inevitable number of wrong economic decisions by individuals and plain bad luck (inclement weather, unexpected price changes for certain products, etc) under such circumstances, the holders of loans can make an allowance for a normal share of nonperformance in the form of bad loan provisions, or they may spread the risk by taking out insurance. Enterprises may well be able to pass a large portion of these costs to customers in the form of higher prices. For instance, the interest margin applied by financial institutions will include a premium for the risk of nonperformance on granted loans. The amount involved in nonperforming loans may rise considerably as a result of less predictable incidents, such as when the costs of fuel, prices of key export products, foreign exchange rates or interest rates change unexpectedly. A similar effect may be caused by the sudden failure of a major company in an overly optimistic financial market. If the resulting loss of confidence beings to snowball toward a crisis, at least three effects tend to further aggregate the situation, a fall in the prices of loan collaterals may cause more loans to become classified as doubtful(wiki. answers.com).

Large bad loan portfolio will affect the affect the ability of banks to provide credit and the resulting liquidity crises may suffocate otherwise good creditors; depositors and foreign investors may start a run on the banks, pushing them into bankruptcy.

The chance for the financial sector to derail are usually considered to be much higher under conditions of deficient bank management, poor supervision, and overoptimistic assessments of creditworthiness during boom economics, and moral hazard that results from (too) generous government guarantees or the expectation of assured bailouts. Large exposure to international financial markets can also complicate considerably (Bloemetal, 2001)

2.6.3. Loan Recovery through the courts

A bank may institute an ordinary debt recovery suit by presenting a written document to a court of competent jurisdiction. The court will thereafter order summons to be issued to the defendant ordering him to appear before it on a given date to answer the claim against him. But if defendant refuses to acknowledge the service of summons, it could be served by affixing a copy of it on the outer door of his house (Sonali, Abeyrante, 2001). On the day stated in the summons, both the plaintiff and the defendant must be present in court either in person or by their respective attorneys and the defendant must file a written statement of his defendant in court.

The court will, thereafter, fix a date for the trail. Where the defendant does not appear and it is proved that a summons was duly served and that his absence was intentional, the court may order the suit to be heard (Takwani, 1994). At the trial, issues will be framed, oral and documentary evidence will be recorded and arguments by both parties will be advanced. After the case has been fully heard, the court will pronounce its judgment in open court either on that day or on a future date. Once judgment is given it is followed by a decree. If a plaintiff is unhappy with the judgment, he can appeal to the court of appeal against the judgment on a question of law or mixed fact and law, and then to the Supreme Court. Having obtained a decree from a court to recover the outstanding debt from the judgment debtor the lender must then proceed to execute the decree (Ibid 2001).

According to Sonali, Abeyrante, (2001), if a lender has to go to court to enforce its security, it will benefit only at the stage of execution. The property is effectively removed from the market until the process of litigation, sometimes spread over many years, is over. When the legal process for the recovery of over –due debts becomes excessively long, it may further encourage dishonest borrowers to exploit deficiencies in the system. Theses borrowers may obtain loans with the deliberate intention of avoiding payment or, where loans have already been obtained, discontinue repaying the loan because of the well-known delays experienced in the courts.

It is also likely that such a borrower would have invested the credit unwisely. It is clear that the problems encountered by lenders cannot be resolved only by enacting effective laws. There is a vital need to provide suitable training to judges who deal with commercial cases. In addition the administrative staff in the courts and the fiscal department must be made aware of the new procedure, and made to comply with the procedure set out in the new debt recovery laws. It is equally important to encourage the members of the legal profession to act in the spirit of the enacted reforms (Wheeler, Oldfeild, 1992).

2.6.4. Disposal of nonperforming loans

Once the loan became non – performing, the bank official try to exert effort in collecting the loan balance. The first step is communicating the borrower through different means to repay the loan. The last resort is to acquire the collateral, provided that the collateral is foreclosed. Acquiring the collateral property as an alternative means of debt settling is not without cost. The collateral property is not readily sold in the market. The bank has to incur maintenance and administrative cost as previously mentioned. Thus disposing non – performing loans through sale proceeds of its collateral is not easily successful.

In Ethiopian case Proclamation no. 90/97 gave banks full right to foreclose and sell the collateral property after serving 45 days of legal notice to the borrowers. However, this does not help much the banks and yet have been possessing large number of collateral property that should have been sold.

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

i) It sends out delinquency letter information the customer of the past-due status of the account

ii) It makes a telephone call to the customer

iii) It employs a collection agency

iv) It takes legal action against the customer.

2.7. Non- performing loans and Banking crisis in different countries

Studies reveal that the recent Asian financial crises were due to increased volume of non-performing loans. Non-performing loans create problems for the banking sectors balance sheet on the asset side. They also create a negative impact on the income statement as a result of provisioning for loans losses. Thus, banks have exerted substantial effort and manpower to recover bad loans consequently adversely affecting their normal banking operations. Banks have sometimes written off their bad loans to reduce Non-Performing rate and to improve loan asset quality.

Virtually all research on the cause of bank failures find that institutions have large proportions of non –performing loans prior to failure and the asset quality is statistically significant predictors of insolvency (Demirguc-Kunt 1989) and also Berger and Humphrey (1992) have found that failing banks tend to have high ratios of loans Problem.

"The impact of non –performing loans is not limited to only financial institution, loan losses also influences the employment rate. Qualitative analysis based on panel data (Dyama and Tanka, 2003) confirms that banks losses influence the unemployment rate. The outcome indicates that the structural shift in the bank's loan loss ratio in the late 1990s in Japan accounts for roughly 20 % of the total shift in the unemployment"

According to Working Paper done John P. Bonin and Yiping Huang January 2001, Chinese banks suffer from serious financial fragility manifested by high proportions of non-performing loans and low capital-adequacy ratios. A key policy introduced recently by the Chinese government to reduce financial risks is the establishment of four asset management companies (AMCs) for dealing with bad loans.

The Chinese government has taken a series of measures designed to build a strong banking system including: recapitalization of the state-owned banks (SOBs), adoption of the international standard accounting system, for dealing with bad debt. A discussion of China's banking problems concentrate on NPLs, although the exact quantification of these is difficult. Chinese authorities do not release official data for confidence reasons. Prior to 1998, Chinese banks used a loan classification system based on actual loan performance that divided NPLs into three types: overdue, doubtful and bad. This approach underestimated NPLs, as it did not include highly risky loans that were still paying interests and were not yet overdue (Ibid 2001).

In a study of loan losses of U.S banks McGovern (1993), argued that character has historically been paramount factor for credit and major determinant in the decision to lend money. The study suggests that bankers should make fairly accurate personality, morale, profile assessment of prospective and current borrowers and guarantors.

Dyama and Tanaka (2003) studied the relation between nonperforming loans and macro-economic factors in Japanese banks. They found that large part of rise in loan losses ratio of Japanese banks since the beginning of 1990s can be explained by real estate collateral factors.

2.8. Empirical Review

The following section reviewed empirical studies conducted on loan recovery performance and possible cause of loan default. More specifically, studies touching loan recovery performance and possible causes or default risk were reviewed.

Ahmed, (2010) indicated Causes for Poor Recovery and Reasons for loan becoming NPL. There are a number of factors responsible for low recovery and increase in size of NPL of commercial banks. According to Ahmed (2010) a few prominent reasons for loans becoming NPL are mentioned as under:

- ✓ Poor credit appraisal system
- ✓ Lack of vision/foresightedness while sanctioning/reviewing or enhancing credit limits
- ✓ Lack of proper monitoring
- ✓ Reckless advances to achieve the budgetary targets
- ✓ Lack of sincere corporate culture
- ✓ Inadequate legal provisions on foreclosure and bankruptcy
- ✓ Change in economic policies/environment at the macro level
- ✓ Non-transparent accounting policy and poor auditing practices
- ✓ Lack of coordination between banks and their customers

Ahmed, (2010) also concludes that a number of factors are responsible for poor recovery and increasing volume of NPL of banks. These are poor credit appraisal system, lack of foresightedness while sanctioning credit limits, lack of proper monitoring, reckless advances to achieve the budgetary targets, lack of sincere corporate culture, inadequate legal provisions on foreclosure and bankruptcy, change in economic environment at the macro level, non-transparent accounting policy, poor auditing practices, and lack of coordination between banks and their customers.

Ahmad, (1997), mentioned some important factors that cause loan defaults which include; lack of willingness to pay loans coupled with diversion of funds by borrowers, willful negligence and improper appraisal by Credit Officers.

Gorter and Bloem, (2002) argue that the true underlying cause of NPLs is entirely of our own making Poor risk management. This is a situation whereby the bank credit officials do not properly access the suitability of advancing credit to their customers. They do not adhere to the good lending principles. Practically all affected banks display similar symptoms; insider lending; poor monitoring of loan accounts, under-qualified staff, little or no cash flow appraisal of loan requests, continuous monitoring of customer conditions and proper follow up on how the loan has been utilized as there is a possibility that the loan may not be utilized for the intended purpose leading to project failure.

Kiayai, (2003) argue that the poor fiscal policy had resulted to high inflation rates and that this could be one of the contributors of NPLs. Inflationary expectation is a factor that is embedded in the interest rate. Interest will remain high if investors believe that the government will introduce inflation in future by adding money in circulation through extended credit form the central bank.

Agresti et al, (2008). The need to give due attention to borrower, thus need not be overemphasized in order to ensure loan performance. There is a tendency by borrowers to give better attention to their loans when they perceive they got better attention. Some of the loans defaults ascribe to lower level of attention given to borrowers. It is advised that banks keep up with their loans timely. It is clear that effective credit monitoring involves looking into various operations of the company including operations of the loan, checking whether the company is properly managed, and the environment in which the company is carrying out its business is satisfactory.

Hu et al, (2006) with a panel dataset covering the period 1996-1999, used a regression analysis and analyzed the relationship between NPLs and ownership structure of commercial banks in Taiwan. The study showed that banks with higher government ownership recorded lower non-performing loans. The finding of the study showed that bank size is negatively related to NPLs while diversification may not be a determinant.

Berger and DeYoung, (1995) indicated that, one major problem which the banks in India are facing is the problem of recovery and overdue of loans. The reasons behind this may vary for different financial institutions as it depends upon the respective nature of loans. Here an attempt is made to find out some of the causes of default of loans due to which financial institutions are facing the problems of overdue of loans. These reasons may be useful for the Banks for the better recovery of loans in future. After surveying different banks, the following were identified to be the main causes of default of loans from industrial sector, improper selection of an entrepreneur, deficient analysis of project viability, inadequacy of collateral security/equitable mortgage against loans, unrealistic terms and schedule of repayment, lack of follow up measures and default due to natural calamities.

Daniel and Wandera, (2013) conducted the study on the effects of credit information sharing on the nonperforming loan of commercial banks in Kenya. The objectives of the study was to assess the impact of credit information sharing on nonperforming loans, to identify the factors that account for bad loans and to determine the economic sector that records higher bad loans and the efforts taken to reduce the risk in this sector. Data was collected from primary sources and secondary data between 2007 to 2012 period. The variables included in the study were Information Asymmetry; Interest/lending rates, Management of loans and legal framework and Credit Criteria. The study found as lending rates has positive significant effect on NPLs.

Okorie, (1986) shows that, the nature of time disbursement, supervision and profitability of enterprises which benefited from small holder loan scheme in Ondo State in Nigeria, contributed to the repayment ability and consequently high default rates. Other critical factors associated with loan delinquencies are; type of the loan, term of the loan, interest rate on the loan, poor credit history, borrowers income and transaction cost of the loans.

Girma, (2011), examined "credit risk management and its impact on performance in Ethiopia Commercial Banks" and his finding revealed that is a significant impact on the profitability of the bank performance and he concluded that the bank with good or sound credit risk management policy have lower loan default rate (bad debt loan) and higher interest income (profitability) . Girma, (2011) Suggests Possible Causes of Loan Defaults like fund Diversion, sickness or inability to work, loss of a job, failed of Business & over committed by high interest debts.

Abay Zembelachew, (2015) who conduct study on "assessment of loan recovery performance in construction & business bank" considered the bank must have to develop a strong credit assessment and follow up to facilitate the control of NPL status of loan and improve its service delivery.

2.9 Organizational profile of Oromia International Bank S.C

Oromia International Bank is a privately owned share company formed in Ethiopia which started operations on October 28, 2008 with a subscribed capital of birr 279.2 million and a paid up capital of birr 91.2 million. The number of shareholders reached 11,500, while the total capital (including paid up capital, share premium, retained earnings and legal reserves reached over 1.6 billion as of June 30, 2017. Oromia International Bank owns a 13 storey building Headquarters in Addis Ababa City on Bole road next to Getu Commercial Center. The Bank is now one of the most influential and popular private banks in Ethiopia and also known for pioneering Interest free banking services.

The bank is governed by the board of directors, president, CEO, four vice presidents (vice president Information Technology, Credit &International Banking, corporate support and Branch Banking) and thirteen Directors. The overall management is entrusted to the management team which comprises the president, who is appointed by the board of directors. The number of permanent employees of the bank stood at

3,066 at the end of June 30, 2017. (Oromia International Bank S.C Annual Report, 2016/17).

Currently, the bank offers full-fledged banking services and products which include the following. Deposit, all Kinds of Loans, international Banking, money Transfer, corporate Banking, personal banking , Electronic banking outputs such as Card banking known as Oro-Card(ATM and POS), Mobile Banking named as Oro-Cash, Agent Banking-Oro Agent and Internet banking namely Oro-Click. The number of OIB branches has now reached 231 throughout Ethiopia all connected by core banking system. (Oromia International Bank S.c Brochure, 2017).

The bank provides a credit facility to its customers in different forms depending on their need and the nature of their business. Some of the credit lines offered include: overdraft facilities, term loans, letter of credit facilities, merchandise loans and personal loans.

The other service the bank renders is deposit services including demand deposit, savings deposit and time/fixed deposit. The bank also renders international banking services providing services like; opening letters of credit for importers, handling of incoming letters of credit for exporters, purchase of outward bills purchasing and selling of foreign currency denominated notes, receiving and transferring foreign currency payment by swift and handling incoming and outgoing international letters of guarantee.

Oromia International bank generates revenue from different sources, mainly from interest collected from loans and advances granted to customers. Considering the amount of income generated by forwarding loans & advances and collecting interest, the process of allowing loans and advances is one of the major operations of the bank which needs due professional care, high level of trust and professional ethics.

2.10. Summary and literature gap

In this section the researcher summarizes more of studies done in our countries because of more specifying the case was important for this study. As can seen above Girma, (2011) shows the bank with good or sound credit risk management policy have lower loan default rate and higher interest income. He also suggests Possible Causes of Loan like defaults fund diversion, loss of a job & failed of business. This is what the researcher of this study agrees. And also according to Abay Zembelachew, (2015), the bank must considered and develop a strong credit assessment and follow up to facilitate the control of NPL status of loan and improve its service delivery.

Factors such as associated with lack of obtaining potential creditors, estimating and checking appropriate values of collateral and loan documentation of creditors, preparing customer's disbursement instruction and follow up their periodic loan repayments was not looked by both researchers. Therefore, this study was find out the loan recovery performance and investigates the major factors affecting loan recovery performance of the bank specifically the case of OIB.

CHAPTER THREE

RESEARCH METHODOLOGY

This chapter deals with the research design and methodology of the study. Research design and approach, sources of data, sample size and sampling techniques, data collection instruments, research methodology, and data analysis are discussed as follows:-

3.1 Research Design and Approach

In order to answer the basic research question raised the researcher was used descriptive type of research method. The major purpose of descriptive research is to describe the state of affairs as it exists. It gives a brief description of the statistical units under the investigation. To present a profile of group of people and relevant events and to identify the event, characteristics of the phenomenon and this type of study is an appropriate and measure the attitudes of employees and department management towards loan recovery performance and also for collecting original data from target population. The obtained data were qualitative and quantitative in nature.

3.2 Sample Size and Sampling Techniques

The researcher was collect data by using simple random sampling technique which gives every eligible respondent in each enumeration area of employees an equal chance of being selected. It is the most popular method for choosing a sample among population for a wide range of purposes. In simple random sampling each member of population is equally likely to be chosen as part of the sample.

In this study, the target population was employees of OIB's at deferent level of credit process (loan officers, credit analyst, branch managers& loan recovery/NPL follow up managers). There are 82 total employees in selected department and by using Taro Yamane (1967) simplified formula, the total sample size became 68.

Taro Yamane (1967), simplified formula

n = $\boldsymbol{N}/\mathbf{1}$+N $(\boldsymbol{e})^2$

Where: N = the total target population

e = the level of precision (sampling error)

n = the sample size.

3.3 Sources of Data and data Collection Instruments

Both primary and secondary data were used in this study. The primary data was collected from Questionnaire prepared for OIB S.C city branch managers, loan officers and head office credit department credit analysts. Secondary data was collected from National Bank of Ethiopia (NBE) and Oromia International Bank s.c annual reports.

Employing multiple data collection instruments was favored by the researcher in order to improve the quality of data. As a result; three methods were employed, namely: questionnaire, interviews and review of secondary data were used to collect the relevant data.

a) Questionnaire: A questionnaire consisting of closed and open-ended questions for the survey was prepared. The questionnaires were distributed for all the sample population. In general, the questions revolved around the trend of loan recovery performance of OIB s.c.

b) Interview: Un-structured and semi-structured questions were prepared for the in-depth interview. The questions highlight on various areas such as problems related to NPL and etc.

3.4 Procedures in developing Instruments

Research papers with similar areas of this study were reviewed. With the help of hints from the studies and other related literatures, both the questionnaires and interview questions were developed in English language. The questionnaires and interview questions were given to the advisor of the researcher in order to take constructive corrections.

3.5 Methods of Data Analysis

An attempt was made to employ relevant data analysis tools which are in compliance with the very nature of the data at hand. Tables were also employed to analyze the gathered data. In addition, notes were taken during the interview and the information obtained from secondary data was used to carry out findings of the informants and written materials. Furthermore, the data analysis is presented by compiling the information gathered from both the interviews and questionnaires.

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND INTERPRETATION

This chapter will contain presentation and interpretation of data collection on the credit recovery performance of banking industry of three years, from 2015 to 2017.

4.1 The trend of Loan recovery performance of Banking Industry

4.1.1 Trend of loan disbursement by banks

Table 4.1 Loan Disbursement of OIB S.Co.

Year	2013/14	2014/15	2015/16	2016/17
Loan disbursed	787.3	1,266.2	1,572.4	1,817.2
Growth rate	-	60.8	24.2	15.6

Source: National bank of Ethiopia Annual Report (2014-2017)

• Loan Disbursement (in millions of Birr)

• Growth Rate (in %)

From the data presented in the above table, it can be seen that the loan disbursed by OIB during the three years trend has a decreasing trend from 60.8% during the base year (2014/2015) to 24.2% to the recent period. During 2015/2016 the loan disbursed by OIB s.co decreased by 36.6% when compared with the preceding period. This decreasing trend (from 60.8% to 24.2%) in amount of loan disbursed is because of loan disbursed to domestic trade and service has declined in the same period which covers the lion's share (50%) of OIB loan disbursement. This is also because of the company's customer demand has decreased. In effect, these would increase the level of risk that the company would face (since the biggest part of profit of the bank is generated from loan, this has a negative effect on the profit of the bank).

On the other hand, when we consider Lion International Bank (LIB), which is relatively in the same peer group with the aforementioned bank, it had an increment in loan disbursement during 2014/2015 and a decreasing trend in the following year(184.3%, 42.8% and 15.7%) respectively. For Lion International Bank, though there is a decrease, it is not serious as that of Oromia International Bank s.co. Similarly, Commercial Bank of Ethiopia that has lion share of loan disbursement in the market, the fluctuation is different from that of private banks as there is an increase in the period 2015/16 and decrease in the next period(2016/17) (4.8%, 25.7% and -1.1%) in the amount of loan disbursed during the period under consideration.

Furthermore, the market share of Oromia International Bank and the loan disbursed during the periods under consideration are nearly equal for the first three years. On the other hand, the share of Commercial Bank of Ethiopia during the same period rose from 44.6% to 48.1%.It indicates that more or less half of the total market share is dominated by this bank during the last period. This can be because CBE has the biggest lending capacity than other banks. The market share of OIB is even by far less than that of peer groups in the industry such as Lion International Bank and Zemen Bank. Therefore, it would be implied that both the amount of loan disbursed and market share of Oromia International Bank have declined because of the above mentioned reasons. Commercial bank of Ethiopia's role has in the market might also have significant impact on the shares of other banks including OIB in general.

4.1.2 The trend of loan collection by banks

Table 4.2 Loan Collection of OIB S.Co.

Year	2013/14	2014/15	2015/16	2016/17
Loan collected	1,075.1	1,241.3	1,744.7	2,103.4
Growth rate	-	15.5	40.6	20.6

Source: NBE Annual Report (2014-2017)

• Loan Collection (in millions of Birr)

• Growth (Rate in %)

As indicated in the above table that the loan collected by Oromia international Bank during the period under study (2014/2015 to 2016/2017) fluctuated from15.5 to 40.6and to 20.6% respectively. On the other hand, in the same period the loan disbursement raised by 60.8% indicating that the rate of collection is not fair when compared with loan disbursed. This implies that the company was inefficient in collection of its loan for 2014/2015 fiscal year.

During the following period (2015/2016-2016/2017), loan collected decreased from 40.6% to 20.6%.This indicates that the customers' profitability decreased which hampered their paying back ability. This in return had a negative effect up on the amount of loan collection and the bank was not efficient in collecting the loans during the stated period. But, during 2014/2015-2015/2016, the growth rate of loan collection increased from 15.5%-40.6% this because during this period the customers are in a good position in paying back their debt because of their profitability.

On the other hand, foreseeing the loan collection of Commercial Bank of Ethiopia, that has lion share in the market, its loan collection rate increased from 2% during the base period to 27.3% and 28.7% respectively during the periods under consideration. Lion International Bank, which is in the same peer group with Oromia International Bank, scores an increase in loan collection by rates of 57.1% to 64.2% and decreased to 35.8% in the preceding year respectively. From these it could be deduced that their loan collection fluctuation rate is minimal when compared with that of Oromia International bank s.c.

4.1.3 Trend of loan recovery rate by banks

In determining the loan recovery performance of the period, the technique used is to determine the proportion of loan recovery rate. This is arrived at by dividing recovery against demand (total loan collection) to total demand (total loan outstanding) and then multiplying by hundred. Total demand is the amount of due loans both the principal and interest of the bank expected to be recovered at a particular period (it is the summation of beginning arrears and current demand).Loan recovery against demand is the portion of loan recovery during the period under consideration and overdue is the amount of loan repayment period that has matured but not realized.

Table 4.3 Trend of loan recovery rate by banks (Recovery rate by %)

Bank's name	Trend of loan recovery		
	2014/15	**2015/16**	**2016/17**
Commercial bank of Ethiopia	0.20	0.21	0.25
Development bank of Ethiopia	0.15	0.13	0.14
Awash bank	0.32	0.35	0.31
Dashen bank	0.51	0.53	0.44
Bank of Abisinia	0.41	0.28	0.20
Wegagen Bank	0.53	0.64	0.54
United Bank	0.60	0.61	0.50
Nib International Bank	0.50	0.48	0.42
Cooperative Bank of Oromia	0.41	0.49	0.46
Lion International Bank	0.39	0.42	0.45
Oromia international Bank	0.49	0.51	0.50
Zemen Bank	0.35	0.43	0.40
BirihanInternational Bank	0.41	0.50	0.50
Buna International Bank	0.33	0.36	0.29
Abay Bank	0.52	0.50	0.40
Addis International Bank	0.42	0.41	0.35
Debub Global Bank	0.71	0.80	0.78
Enat Bank	0.50	0.40	0.48
Industry Average	**0.43**	**0.45**	**0.41**

Source: NBE report & own calculation

Based on the above table, OIB's loan recovery rate for the year under considerations is more than industry average; This shows that OIB's loan recovery performance was efficient or satisfactory that means OIB's loan collection turn over or the rate at which the bank collects its outstanding loan from its customer is more than the industry average, which shows good performance of loan collection.

4.2The trend of Credit Recovery Performance of Oromia International Bank S.Co, by sector

The performance of the bank with respect to its credit operations should be assessed in order to measure the effectiveness of the bank in achieving major objective of providing financial facilities to development projects through providing loans. Loan is one of the essential activities of the bank which contributes the major profit of the bank. So, loan recovery performance of the bank should be evaluated in order to measure the effectiveness of the bank.

To understand the recovery performance of OIB S.C, it is advisable to thoroughly look at its loan recovery rate by sector.

4.2.1 Credit Recovery Performance of industry sector

Oromia International Bank s.c provides loans for financing the establishment and expansion of industrial sector of the national economy. The following table indicates the recovery performance of the industrial sector within the OIB S.C.

Table 4.4 Credit recovery performance of the Industry sector

Amount in millions of birr & rate in %

Description	2015	2016	2017	Total
Total Demand(P+I)	155,144	302,270	275,871	733,285
Recovery against demand	69,815	115,087	85,520	278,648
Recovery Rate	0.45	0.38	0.31	0.38

Source: OIB annual report (2015-2017) and own calculations

As indicated in the table above the total demand for industrial sector was Birr 733 million of which only Birr 278 million was recovered (only 38% of the total demand was recovered) for the year under consideration. The total demand increased from 155,144 to 302,270 in the year 2016 but it decreased to 275,871 on the year 2017.

On the other hand, the recovery rate of the industry sector has decreased (45% to 38%). This shows the industry sector bears some risks because recovery rate is decreasing compared to the base year. The reason behind low recovery rate of the industrial sector is there are some industries which are not profitable and hence weak in paying back their debt in time because these industries are not studied on the side of the borrowers about the profitability of the industry and the same problem is even the bank does not make the necessary industry study before granting the loan.

4.2.2 Credit recovery performance of Import & Export sector

Table 4.5 Credit recovery of performance of Import sector

Amount in millions of birr & rate in %

Description	**2015**	**2016**	**2017**	**Total**
Total Demand(P+I)	168,676	349,682	376,005	894,363
Recovery against demand	128,194	244,777	308,324	679,716
Recovery Rate	0.76	0.70	0.82	0.76

Source: OIB annual report (2015-2017) and own calculations

As can be observed from the above table, total loan demand for import sector increased for the period under consideration. From the total demand of birr 894 million; 679 million birr was recovered from this sector. That means almost 76% loan was recovered from this sector for the period stated. Generally, this is because, most importers import consumer goods which are widely consumed in the domestic economy. Borrowers of this loan sector are also in a better position to pay back their loans.

Table 4.6 Credit recovery of performance of Export sector

Amount in millions of birr & rate in %

Description	**2015**	**2016**	**2017**	**Total**

Total Demand(P+I)	402,462	941,903	1,060,405	2,404,770
Recovery against demand	305,871	734,684	837,720	1,867,704
Recovery Rate	0.76	0.78	0.79	0.78

Source: OIB annual report (2015-2017) and own calculations

As can be seen from the above table, total demand for export sector has shown an increasing trend. The reason for this increase in total loan demand of export sector is because of governmental foreign policy which encourages private sector participation in export sector. On the other hand, recovery against demand of the export sector also has shown increasing trend for the period under consideration. This is because of high exchange rate of dollar in terms of birr which is advantageous for exporter in order to pay back its debt in time. The recovery rate for the export sector shows an increasing trend and also in the year 2017 this sector showed the highest pick (79%).Generally, this sector's recovery performance can be characterized by a good loan recovery performance; 78% on average during the period under consideration.

4.2.3 Credit recovery performance of Domestic trade & service sector

The domestic trade and service sector constitute a major part from total loan outstanding of all sectors. According to the information gathered from Credit Follow up Division of OIB s.c,this sector contains almost 50% of total demand.

Table 4.7 Credit recovery of performance of Domestic trade & service sector

Amount in millions of birr & rate in %

Description	**2015**	**2016**	**2017**	**Total**
Total Demand(P+I)	861,223	1,648,891	1,632,238	4,142,352
Recovery against demand	215,306	626,579	685,540	1,449,823

Recovery Rate	0.25	0.38	0.42	0.35

Source: OIB annual report (2015-2017) and own calculations

As can be observed from the above table, domestic trade and service sector recovered 25%, 38% & 42% from total loan demand of domestic trade and service sector for the years under considerations. Since this sector covers lion share of the total loan demand, loan recovery performance of this sector should be looked in to carefully. The total demand for the domestic trade & service for the period under consideration (2015-2017) was about Birr 4.1 billion of which only Birr 1.4 billion was recovered from the sector(only 35%). The total demand of the sector for the period shows an increasing trend, even though, recovery rate shows an increasing trend as of recovery against demand, and it is difficult to deduce that this sector's performance is satisfactory. From this it is possible to infer that there is a weak but increasing recovery trend because most of the product traded by these borrowers is more demanded by consumers, the products are day to day lives of consumers and mostly during the inflationary period borrowers are in a better position to pay back their debts.

4.2.4 Credit recovery performance of Transport & Communication Sector

Table 4.8 Credit recovery performance of transport & communication sector

Amount in millions of birr & rate in %

Description	**2015**	**2016**	**2017**	**Total**
Total Demand(P+I)	188,886	330,512	378,602	898,000
Recovery against demand	66,110	142,120	215,803	404,100
Recovery Rate	0.35	0.43	0.57	0.45

Source: OIB annual report (2015-2017) and own calculations

As per table depicted above, total loan demand for transportation sector increased from year to year. The amount recovered against demand was also increasing from year to year. This yearly increment in the amount of loan recovered from this sector is because the economy is a growing economy which has a high demand of transportation (passengers and cargo) and hence high profit earning. This in return has a positive effect up on repayment ability of the borrowers. That is why the bank's loan recovery performance had increased for this sector. Out of the total loan demand, only 45% was recovered showing low recovery performance of the sector.

4.2.5 Credit recovery performance of Hotel & Tourism Sector

Table 4.9 Credit recovery performance of Hotel & Tourism sector

Amount in millions of birr & rate in %

Description	2015	2016	2017	Total
Total Demand(P+I)	241,504	365,037	485,744	1,092,285
Recovery against demand	101,432	135,064	150,581	393,223
Recovery Rate	0.42	0.37	0.31	0.36

Source: OIB annual report (2015-2017) and own calculations

As shown in the above table the total demand for the period under consideration was birr 1.09 billion of which only birr 393 million was recovered. Total demand for Hotel & Tourism loan indicates increasing trend in all years. But the recovery rate shows decreasing trend on the year under consideration and generally only 36% of the total demand was recovered. This indicates that the loan recovery performance of the bank in the Hotel & Tourism sector is declining or no improvement was seen in the repayment of the loan.

4.2.6 Credit recovery performance of Agriculture Sector

Table 4.10 Credit recovery performance of Agricultural sector

Amount in millions of birr & rate in %

Description	2015	2016	2017	Total
Total Demand(P+I)	75,790	92,597	140,009	308,396
Recovery against demand	24,253	15,741	29,402	71,959
Recovery Rate	0.32	0.17	0.21	0.23

Source: OIB annual report (2015-2017) and own calculations

As shown in the above table the total demand for the period under consideration was birr 308 million of which only birr 71 million was recovered. Total demand for agricultural loan indicates increasing trend in all years. But the recovery rate shows decreasing trend on year 2016 and generally only 23% of the total demand was recovered. This indicates that the loan recovery performance of the bank in the agricultural sector is declining or no improvement was seen in the repayment of the loan. This is because agricultural loan is a type loan with high level of risk of return which depends up on weather condition (rain feed agriculture) Agricultural sector in developing countries is weather dependent especially in Ethiopia. So, this could most probably affect loan recovery performance of the bank.

4.2.7 Credit recovery performance of Mortgage sector

Table 4.11 Credit recovery of performance of Mortgage sector

Amount in millions of birr & rate in %

Description	2015	2016	2017	Total
Total Demand(P+I)	81,567	199,504	253,331	534,402
Recovery against demand	57,097	131,673	172,625	354,487
Recovery Rate	0.70	0.66	0.63	0.66

Source: OIB annual report (2015-2017) and own calculations

As indicated in the above table, the total loan demand of mortgage sector and recovery against demand of the same sector has an increasing trend. As can be seen total demand dramatically increased from Birr 81 million to 199 million Birr for the year 2015 to 2016. This is because of the bank lends mortgage loan to its staff without additional collateral. This also indicates that there is an increased demand of mortgage for both residential and commercial buildings in the country as a whole. In addition, the reason behind for an increasing trend of loan recovery against demand is that there is an increased income level of the citizens which increased their paying ability of the loan.

Even though the amount of recovered amount increased for the year under consideration, it doesn't mean that this sector is performing well because recovery rate of this sector is small compared to total demand.

4.2.8 Credit recovery performance of personal or consumer loan sector

Table 4.12 Credit recovery of performance of personal or consumer loan sector

Amount in millions of birr & rate in %

Description	2015	2016	2017	Total
Total Demand(P+I)	241,504	365,037	485,744	1,092,285
Recovery against demand	125,582	229,973	276,874	626,243
Recovery Rate	0.52	0.63	0.57	0.57

Source: OIB annual report (2015-2017) and own calculations

As shown in the above table, the total loan demand for personal loan sector had an increasing trend. This was because of an increased expenditure of households up on necessity goods such as residential building, furniture, cars etc in relation with increased population and also to offset the effect of inflation up on their income level. On the other hand, the recovery against the demand had fluctuated for the period under consideration. This was because of the decrease in repayment ability of the borrowers due to inflation. The rate of loan recovery of personal loan sector was increased for the year 2016 but declined from 63% to 57%. This was because of the inflation effect up on consumer goods.

4.2.9 Sectorial relationships and Comparison of Loan Recovery performance of OIB (2015-2017)

Table 4.13 Recovery Rate of OIB S.Co by sector (in %)

Description	2014/15	2015/16	2016/17
Industry	0.45	0.38	0.31
Import	0.76	0.70	0.82
Export	0.76	0.78	0.79
Domestic trade & service	0.25	0.38	0.42
Transportation & communication	0.35	0.43	0.57
Hotel & Tourism	0.42	0.37	0.31
Agriculture	0.32	0.17	0.23
Mortgage	0.70	0.66	0.63
Personal or consumer loan	0.52	0.63	0.57

Source: OIB S.Co Annual Report (2015-2017) and own calculation

In general, the loan demand of OIB for all the sectors had an increasing trend.But for industrial sector it had a decreasing trend except for year 2017.

The loan recovery against demand for the sectors such as Import & Export, domestic trade and service, transport, hotel & tourism, mortgage &Personal had an increasing trend while Industry &agriculture sectors had a fluctuation in their loan recovery trend during the period under consideration.

Furthermore, the recovery rate of export, domestic trade & services and transportation &communication sectors had an increasing trend. In contrast, the recovery rate of Industry, mortgage, hotel & tourism sector had a decreasing trend.

But the recovery rate of import, agriculture & personal loan sectors had a fluctuating trend.

Finally, in more general terms, the recovery performance of the sectors can be summarized as follows:

Table 4.14 Average Loan recovery Rate of OIB (2015-2017) of sectors

Sectors	Percentage recovered
Industry	38
Import	76
Export	78
Domestic trade & service	35
Transport & communication	45
Hotel & Tourism	36
Agriculture	23
Mortgage	66
Personal loan	57

As a summary, from the above table we can rank loan recovery performance of the sectors of OIB as follows: Export, Import, Mortgage, Personal, Transportation, Industry, Hotel & tourism, Domestic trade & service& Agricultural sector depending up on recovery performance.

4.3 Analysis and Interpretation of Primary data

In addition to information collected from secondary data, this research paper was carried out using the structured questionnaire with the objective of evaluating the performance of loan recovery in Oromia International Bank s.c. The respondents are branch managers, loan officers, credit analysts and NPL follow up staffs &managers and credit monitoring officers and the respondents have an educational background of B.A and MA in Business related area with a banking experience that ranges from two to seven years.

Table 4.15 Respondents' Qualification

Qualification	Degree		Masters	
	Frequency	%	Frequency	%
Accounting	14	21	1	1
Management	22	32	4	6
Economics	10	15	3	4
Business administration	12	18	2	3

Source: primary data

According to the above table, some 21% of the respondents have first degree in Accounting. Slightly 32% of the informants had first degree in Management &fifteen (15%) of the respondents has degree in Economics. As can also be seen from the above table, 18% of the respondents have first degree in Business Administration.

Also there are second degree graduates within the respondents. As can be observed from the above table, 1% of the respondents have second degree in Accounting. Some 6% of the respondents have second degree in management. 4% of the respondents have also second degree in Economics and 3% of the respondent have second degree in Business administration. Majority of the respondents are (26 in number) are graduate of Management (First degree& Second degree) and fifteens are Accounting (First degree& Second degree) graduates are assigned in area of loan activities.

Table 4.16 Respondents' experience

Service year of the respondent	Frequency	%
1-5	43	63
>5	25	37

Source: Primary data

The above table depicts that (63%) of the respondents service years falls under the category of 1-5 years of service. Also 37% of the respondents have served more than five(5) years. In order to get relevant data, employees those have more than 5 years experienced are preferable by the researcher. Because those respondents have more know how about the credit policy of the bank and the level of NPL.

4.4 Summary of respondents

OIB may have policy and procedure. In the way of answering the first question, the respondents were asked to confirm whether the credit police of OIB are flexible or not. The respondent's replies are given below.

Table 4.17. Respondents with value of the credit policies of the Bank

Answer	Frequency	%
Rigid	-	0
Somehow rigid	29	43
Somehow flexible	29	43
Flexible	10	14

Source: primary data

From the analysis tabulated above, none of the respondents replied as to whether the policy of OIB is rigid or not. 43% reply that the OIB policy is "Somehow rigid". 43% of respondents have responded that, OIB policy is "Somehow flexible". As the collected data shows, 14% of the respondent says OIB' credit policy and procedure is flexible.

Table 4.18 Summary of respondents

Questions	Number of respondents			
	Yes		No	
	Freq	%	Freq	%
1. Do you think that OIB's lending procedure manual has got a defect?	39	57	29	43
2. Do you consider the following five C's credit analysis factors, when you analyze the loan request?				
➢ Collateral	68	100		
➢ Condition	68	100		
➢ Capital	68	100		
➢ Character	68	100		
➢ Capacity	68	100		
3. Which of the following credit facilities are entertained by OIB S.C?				
➢ Industry	68	100		
➢ Import & Export Trade	68	100		
➢ Domestic Trade & service	68	100		
➢ Transport & Communication				
➢ Hotel &Tourism	68	100		
➢ Agriculture	68	100		
➢ Mortgage	68	100		
➢ Personal or Consumer loan	68	100		
4. Which of the following factors cause non-performing loan to accumulate in OIB s.c				
➢ Inadequate loan assessment	68	100		
➢ Political influence	42	62	26	38
➢ Lack of monitoring	57	84	11	16
➢ Inadequate regulation	14	21	54	79
➢ Length of the legal system	28	41	40	59

➢ Corruption	0	0	0	0
➢ Lack of follow up	68	100		
5. Do borrowers disclose every data that the bank demands during loan request?	54	79	14	21
6. Do you think the relationship between your bank and default borrowers is weak?	54	79	14	21
7. Is there any situation in which NPLs are recovered fully?	68	100		
8. Do you think that the directive of National Bank of Ethiopia is strictly adhered by your bank regarding non-performing loan management?	68	100		

Source: primary data

As illustrated by respondents, OIB's lending procedure has some problems. Around fifty seven (57%) of the respondents claimed that the lending procedure lack details and completeness. The respondents also indicated that the lending procedure accommodate the existing business practice. Others indicated that it lacks revision of credit manual to reflect existing objective reality. This is especially common in the loan recovery and collection part and the procedure of legal measures i.e. it should allow to make prompt action as soon as possible. On the other hand, 43% of the respondents indicated that OIB's credit procedure manual is adequate to make credit risk assessment.

Pertaining to five C's of credit analysis factors, as indicated by respondents, all informants replied that the bank considers all the five C's in order to analyze the loan request.

As indicated in the above table, all of the respondents disclosed that the bank has various loan facilities availed to its borrowers. Apart from the above description, the respondents noted that the bank has other facilities that include overdrafts, pre-shipment, temporary OD & mining too. Many factors are considered by bank's Credit Department in analyzing a loan request. They are the ingredients which determine the lending officers' faith in the debtor's ability and willingness to pay the obligations.

As can be seen from Table 3.18, inadequate loan assessment & Lack of follow up are the major contributing factor for NPL to accumulate. This means it got direct negative effect on performance of loan repayment. All respondents (100%) declared that the accumulation of NPL in OIB is caused primarily as a result of inadequate loan assessment and lack of follow up. According to the respondents, problem in loan recovery performance of the bank starts with loan assessment problems and then after the loan is disbursed there is lack of follow up. Most respondents also argued lack of monitoring, political influence, length of the legal system &inadequate regulation are reasons for the accumulation of NPL or poor loan recovery. Respondent also mentioned some reasons not mentioned under those questionnaires for the accumulation of NPL in OIB like diversion of funds, exaggerated property estimation or over and under estimation of property, economic crisis in some sectors, business diversification and deteriorating in business are also reasons.

Table 4.19 problems faced during recovering of nonperforming loan.

Answers	Frequency	%
Unavailability of additional collateral	24	35
Collateral value depreciation	19	28
Complicated legal procedure	15	22
Complicated bank procedure	10	15

Source: primary data

According to the above table, most of the respondents (35%) have given responses on the unavailability of additional attachable borrower property or collateral. This is the major problem to recover the nonperforming loan. 28% of the respondents declare collateral value depreciation, 22% says complicated legal procedure and (15%) of respondents have given response on the complicated bank procedure. Respondent also suggested that willingness of customers on the proposed resolution mechanisms on time and fulfillment of preconditions stated by the banks are problems faced during recovering of non-performing loan.

As per the respondents' suggestion, NPL affect the ability to generate adequate profit, customer satisfaction, market share & liquidity of the bank. NPL affects the profitability of the bank since provision is held for every category of NPL. Liquidity and lending capacity of the bank could also be affected. This makes customers dissatisfied & affects asset quality of the bank as well.

According to the respondent, the standard set by national bank of Ethiopia to categorize loan as NPL is stated on NBE directive No.SBB 52/2012. Loan beyond 3 months from the installment date of agreed between the bank & the customers during the loan dispersed. If one loan passes 90 days from the agreed repayment date, the loan is categorized as substandard, more than 180 days, doubtful and more than 360 days, as loss.

As indicated in the Table 3.18, some respondents replied that some borrowers are not willing to disclose necessary information that is crucial for loan risk analysis. Around twenty one (21%) of the respondents revealed that borrowers are not willing to disclose necessary information to assess credit risk. This resulted in delay in loan processing and poor lending decision that entails poor recovery performance such as raise in NPL.

From the types of business entertained by OIB, according to the respondents, the rate of NPL is high on domestic trade & service sector. The second one is hotel & tourism. Import Export Trade has also high rate of NPL because it relates with pre-reshipment.

The study observed that in addition to internal factors, external factors also affect the loan recovery performance of the bank. Internal factors that increase the occurrence of NPL that were mentioned by the respondents were poor customer requirement, poor analysis, poor follow up, poor monitoring and poor recovering, too much reliance on collaterals are some. On the other hand major external factors that increase the occurrence of NPL were social instability, market problem, environmental factors, macro problems specially regarding international market are factors mentioned by respondents.

The respondents also suggest that the available loan resolution strategies to change the status of NPL to normal condition. Some of the responses were restructuring, rescheduling, refinancing/ injection of fresh money to the business, transferring to other potential customer are some strategies to change the status of NPL.

As per the information inferred from respondents, majority of the respondents about (79%) denoted that OIB's relationship with defaulters is weak. This could be the major reason for weak loan collection performance. The bank and the borrower should have strong relationship in order to tackle problems attached with NPL.

On the other hand, 100%of the respondents indicated that there are situations in which NPLs are recovered fully. They suggested that NPL could be recovered fully through contacting the customers, or discussion, through sale of proposed collateral, by consent of borrowers, by identifying other attachable properties (legal actions to take over other properties which are not pledged as collateral from the sale of the collateral) and by allowing additional working capital that could reverse NPL to the right truck.

As per the summary of response, the challenge faced by OIB to manage increase in NPL was lack of willingness by the defaulter/ difficult to engage in negotiation, management reluctance to make decision on time, collateral market value and actuation procedure.

As per summary of responses, all of the respondents, about 100% also indicated that the Directive of National Bank of Ethiopia is strictly adhered by OIB to manage non-performing loan management. With regard to the way NPL affect the general growth condition of the bank, all of respondents reflected similar idea.

The bank should give due attention at the time of loan request by customer, during process of loan and proper follow up and monitoring are some points that were given by the respondent in order to control the problems faced by non-performing loan.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

In this research, the intention was to investigate the trend of loan recovery performance of banking industry in general and a case study of Oromia International Bank S.Co in particular. In the course of dealing with this very issue, various loan recovery sectoral issues were thoroughly examined. This means, loan recovery performance of OIB S.Co.by sector and the banking industry in general was assessed.

Generally, with regard to the loan disbursement by Oromia International Bank s.co it had an increasing trend and in comparison with the banking industry it showed a low share of loan disbursed for the period under consideration. This means the amount of fund that is being lent by the bank is being increased which has a positive impact up on its profit. And the trend of loan collection of OIB s.co has exhibited fluctuating trend during the period under consideration in comparison with the industry average; it had a low loan collection trend but its peer groups such as Lion International Bank had an increasing trend in their loan collection. This implies that there are problems of loan follow-up and supervision. On the other hand, the loan recovery rate of Oromia International Bank s.co during the period under consideration showed a good loan recovery rate and also the recovery rate was more than the industry recovery rate.

For the agricultural sector the loan recovery rate was decreasing and out of the total loan demand during the period only 23% was recovered showing a poor loan recovery performance. This can be because of unpredictable bad weather condition.

For the export, domestic trade & service and transport sectors, the loan recovery rate were increasing and out of the total loan demand of these sectors 78%, 35% & 45% respectively were recovered during the period under consideration. Nevertheless, for both domestic trade & service and transport sectors, the credit recovery rates were not satisfactory. Out of the total loan demand during the period under consideration, 35% & 45%were recovered respectively. This indicates poor loan recovery performance for domestic trade & service sector and transport but good loan recovery performance for export sector showing the biggest loan recovery rate in comparison with other sectors (78%).

And for import, agriculture & personal or consumer loan sectors the loan recovery rate showed fluctuation during the period under consideration. Out of the loan demand for each sector, 52% was recovered indicating good level of loan recovery performance. But for agriculture sector, during the period only 23%was recovered. This implies a very low performance and its impact on the profitability of the bank was very bad.

For the industry, hotel & tourism and mortgage sectors; the loan recovery rates were decreasing. Out of the total loan demand of these sectors, 45%was recovered showing a poor loan recovery performance. Industry sector, the loan recovery rate was decreasing and out of the total loan demand of this sector only 38% was recovered. And again the loan recovery rate of the hotel & tourism sector during the period under consideration was 36% which showed a poor recovery rate. The recovery rate of mortgage sector was also decreasing, but it recovered 57% of its total demand which showed slightly good recovery rate.

In general, out of nine loan sectors of OIB under study, five of sectors' recovery rates are less than 50%. Moreover, out of the total loan demand of OIB during the period, on average only 48% was recovered. This implies on average 52% of the total loan demand was not recovered.

5.2 Conclusion

Based up on the analysis from the primary &secondary data, the researcher has reached at the following conclusions.

The process of loan from application to approval is the normal and routine activity of the bank. But OIB process of loan is needs improvement because credit is the core activity of the bank.

In order to address the objectives stated, the need for gathering data revolving around the subject was felt. Thus, quantitative and qualitative research methods of data were employed. The sources of the data were both primary and secondary. In order to generate data from primary sources, various means including, questionnaire and key informant interview were used.

The study concludes that NPL affect the ability to generate adequate profit, customer satisfaction, market share & liquidity of the bank. NPL affects the profitability of the bank since provision is held for every category of NPL. Liquidity and lending capacity of the bank could also be affected. This makes customers dissatisfied & affects asset quality of the bank as well.

The study concluded inadequate loan assessment & Lack of follow up are the major contributing factor for NPL to accumulate. Diversion of funds, exaggerated property estimation or over and under estimation of property, economic crisis in some sectors, business diversification and deteriorating in business are also reasons.

This means it got direct negative effect on performance of loan repayment. All respondents declared that the accumulation of NPL in OIB is caused primarily as a result of inadequate loan assessment and lack of follow up.

The loan recovery for the sectors such as Import & Export, domestic trade and service, transport, hotel & tourism, mortgage &Personal had an increasing trend while Industry &agriculture sectors had a fluctuation in their loan recovery trend during the period under consideration.

Furthermore, the recovery rate of export, domestic trade & services and transportation &communication sectors had an increasing trend. In contrast, the recovery rate of Industry, mortgage, hotel & tourism sector had a decreasing trend. But the recovery rate of import, agriculture & personal loan sectors had a fluctuating trend.

The study also concludes that in addition to internal factors, external factors also affect the loan recovery performance of the bank. Internal factors that increase the occurrence of NPL that were mentioned by the respondents were poor customer requirement, poor analysis, poor follow up, poor monitoring and poor recovering, too much reliance on collaterals are some. On the other hand major external factors that increase the occurrence of NPL were social instability, market problem, environmental factors, macro problems specially regarding international market are factors.

Since most customers are not willing to disclose information to the bank needed for loan processing, it's affecting loan recovery performance of the bank. The result of study showed that the bank during recovery of nonperformance Loan faced issues such as unavailability of additional collateral; complicated Bank procedure, complicated Legal procedure and deprecation of collateral are the major problems for recovering nonperforming loan.

5.3 Recommendations

On the basis of the research findings, the researcher would like to suggest some points by which OIB's loan recovery performance will be improved:

1. To increase the amount of disbursement, the bank should attract more borrowers by giving a better quality loan service so as to share customers from other banks or potential customers.

2. To increase the amount of loan collection or the recovery rate, the bank should properly assess the five C's of the credit analysis factors before the loan is granted and also after the loan is disbursed the bank should follow up whether the loan disbursed is being expended for the intended purpose or not. Not only that, the bank should also give the proper specialist advice for the borrower how and where (investment sectors) to invest the fund so as to be profitable.

3. For the agricultural loan sector, OIB should reduce the amount of loan disbursement, because from all the loan sectors the biggest percentage (77%) of the loan demanded during the period under study was not recovered. The bank should recommend borrowers of this loan sector the use of irrigation to reduce the risk of bad weather condition (lack of rain fall).

4. In general, for the industry, domestic trade & service and hotel & tourism sectors, the bank should design an effective loan procedure which can help to assess the financial position of potential customers to screen out sound borrowers which are eligible for the above loan sectors. Furthermore, the bank should conduct research about the demand and profitability of products of the above sectors.

5. Since 52% of the total loan demand for sectors during the period under consideration was not recovered by OIB, it is advisable to pay attention up on loan collection by all concerned parties. i.e. Bank's Board, Management including Branch managers, loan officers, credit analysts and other related parties.

6. The bank should effectively use the potential of man power especially loan officers in order to make an effective credit assessment especially for those borrowers who don't want to disclose full information.

7. And finally, OIB should revise its credit procedure manual in order to reflect the existing reality that can reduce uncollectible loans of different sectors (I.e. loan procedure manual that can screen out potential defaulters in advance).

Prudent lending would help to prevent and minimize loan recovery problems. Prudent lending primarily involves effective processing of the entire loan transaction. Proper evaluation of the credit risk, accurate documentation of the loan and security agreements and systematic monitoring of the progress of the loans will help to minimize loan default.

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DECLARATION

I, the undersigned declare that, this thesis is my own work prepared under guidance of Simon Tareke (Ass. professor) and has not been presented in any other university. All sources of material used for this thesis have been duly acknowledged.

Declared by: Genet Kebede

Signature:________________________

Date: ___________________________

Ato: Simon Tareke

Saint Mary University

ENDORSMENT

This thesis has been submitted to St. Mary's University School of graduate Studies for examination with my approval as a University advisor.

____

Ato Simon Tareke

Advisor

School of Graduate Studies

Department of Accounting and Finance

(Questionnaire prepared for OIB Credit analysts, Loan Officers, Branch managers and NPL Follow-up Managers)

Genet Kebede

Post Graduate student

I am a post graduate student in St. Marry University carrying out a research under the topic "The trend of Loan Recovery Performance in Banking Industry: A case study of Oromia International Bank S.CO."

The principal purpose of this questionnaire is to obtain data for a study intended to investigate the trend of loan recovery performance in banking industry. Therefore, your cooperation in providing the data collections through the questionnaire and interview will be used strictly for academic purpose.

Thanks in Advance

- Position in the Bank ______________________________
- Years of service _______________________________
- Qualification (e.g. Diploma in Accounting)

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Study's related question

1. How did you rate the credit policy and procedure of Oromia international bank giving loan service to the customer?

Ridged ☐ Somehow ridged ☐ somehow flexible ☐ Flexible ☐

2. Do you think that the OIB's lending procedure manual has got a defect?

Yes ☐ No ☐

If yes, in what part? ____
____
____.

3. Do you consider the following five C's credit analysis factors, when you analyze the loan request? (Hint: Tick in the box)

5 C's credit analysis factors	**Yes**	**No**
Collateral		
Condition		
Capital		
Character		
Capacity		

4. Which of the following credit facilities are entertained by OIB S.C?

Types of loan by sector	**Tick in the box**				
	Yes	**No**	**Loan by maturity**		
			Short term	**Medium term**	**Long term**
Industry					
Import & export trade					
Domestic trade & service					
Transport & communication					
Hotel & tourism					
Agriculture					
Mortgage					
Personal or consumer loan					

If others please specify

____

____

5. Which of the following factors cause non-performing loans to accumulate in OIB S.CO? (Hint: Tick in the box)

Factors	Yes	No
Inadequate loan assessment		
Political influence		
Lack of monitoring		
Inadequate regulation		
Length of the legal system		
Corruption		
Lack of follow up		

If other, please specify

1.______________________________

2.______________________________

3.______________________________

6. What is the problem faced during recovering non-performing loans?

Unavailability additional collateral ☐ Collateral value depreciation ☐

Complicated legal procedure ☐ Complicated bank procedure ☐

If any others please______________________________

7. How does NPL, affect the general condition of the bank? (Hint: Profitability, customer satisfaction, market shares, liquidity problem …)

____

____

8. What is the standard set by NBE to categorize loans as NPL?

____

____

____.

9. Do borrowers disclose every data that the bank demands during loan request?

Yes ☐ No ☐

If No, what do you think of the effect?

____

____.

10. Please indicate in which type of business the rate of NPL is high? What are the reasons you mostly observed?

1. Industry
2. Import & Export Trade
3. Domestic Trade & Service
4. Transport & Communication
5. Hotel & Tourism
6. Agriculture
7. Mortgage
8. Personal or Consumer Loans

11. Mention the major internal factors that aggravate the occurrence of NPL?

1.____

2.____

3.____

4.____

5. ____

12. Mention the major external factors that increase the occurrence of NPL?

1.____

2.____

3.____

4.____

5.____

_

13. What are the available loan resolution strategies to change the status of NPL to normal condition (e.g. restructuring ---- etc methods being utilized by the bank? ____

____

____.

14. Do you think the relationship between your bank and default borrower is weak?

Yes ☐ No ☐

If yes why? ____

____

____.

If No, why? ____

____

____.

15. Is there any situation in which NPLs are recovered fully?

Yes ☐ No ☐

If No, why?

____

____

____

If yes, how, explain it.

____

____

____.

16. What are the challenges faced by your bank in order to manage the increase in non-performing loan?

____

____

____.

17. Do you think that the Directive of National Bank of Ethiopia is strictly adhered by your bank regarding non-performing loan management?

Yes ☐ No ☐

If No, why?

____

____

______

____.

18. State some points you consider may be important input for controlling the problems faced by non-performing loan?

____

____

____.

19. Please Give your suggestion or comment if you have any additional information that you may think can enrich this study.

____

____

____.

Thank you!!

Interview question for H.O Credit Dep`t Officers and Division Managers

Q1.What are the major requirements that OIB used for lending?

Q2. Which sector records high non-performing loans?

a. Which of the sectors of the bank's lending activities is associated with high non-performing Loan?

b. What is the factors cause NPL?

Q3. How can the occurrence of nonperforming i.e. bad loans be minimized?

Q4. Does the bank have a supervision program?

Yes ☐ No ☐

Q5. What is the frequency of supervising the borrowers?

Specify____

Q6. Does the supervision of clients support the bank to minimize the risk of default?

Q7. What are the major causes for repayment failures of borrowers?