# ASSESSMENT OF BANK LOAN REPAYMENT

# (CASE STUDY DEVELOPMENT BANK OF ETHIOPIA)

**IN THE PARTIAL FULFILLMENT OF THE REQUIREMENTS THE DEGREE OF ACCOUNTING IN BUSSINESS AND ECONOMICS FACULTY**


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## ABBREVATION

AIDB= Agricultural, Industrial and Development Bank

CBE= Commercial Bank of Ethiopia

DBE= development Bank of Ethiopia

IRR= internal Rate of return

EPDRF= Ethiopian People Democratic and Republic Front

# CHAPTER ONE

## INTRODUCTION

### 1.1 Back ground of the study

A loan is a liability for the borrowing individual or corporation received it (borrower) but an asset for the bank (lender). For each lender, a loan is an investment that brings a return in the form of interest income and for each borrower; it is a debt, an obligation to pay the borrowed money plus an interest.

Loan is essential to both lender and borrower, lender benefits from issuing loans to generate profit in the form interest income. Borrower on the other hand, benefits from getting loans in order to expand and diversify their scale of business, to cover temporary shortage of money in their day to day business activities and to increase their scale of operations.

Loans are less liquid with higher probability of default than other firm's assets. Thus credit is a risky business operation unless proper and close monitoring takes place in expanding it. In general, banks and other financial institution like insurances, saving and credit institution involves in credit facility. However banks remain the major factors as credit granting as credit granting is the major activity of the bank and loans and advances represent the largest portion of the total asset of the banks. Therefore, banks should set policies and procedures in relation to credit maintain efficient management of credit and minimize risk that may possible involved, the study deals with how development bank of

Ethiopia Gondar branch manages its loans by giving special emphasis on assessment of lending policies, procedures and follow up measures.

## 1.2 Back ground of the Bank

As many reliable historical sources indicates, the first people to have began the concept of banking operation were believe to be the gold smiths, since the gold smiths strong boxes to keep their gold, they kept in trust money, ornament, made of sliver gold and other valuable articles. Through time, these gold smiths come to aware that among the depositors of money, only a few of them came to withdraw their money, thus they used to money not needed by the depositors to lend to people who were in need of it on interest bases. Later, they abandoned the practice of charging money for the one kept by them and by giving law interest to depositors they attracted a lot of deposits of money.

Depositing money with a trusted organization and at the same time repaying profit from such savings encouraged the numbers of depositors to increase. Thus, the business of gold smiths expanded from time to time. Hence, modern banking began in this way more than 500 years ago, and the same system is still used even now. The present day banking was developed in Greece and Italy in the $15^{th}$ century, the word "Bank" is perhaps derived from the Italian word "banco" which means bench, counter, or place of business on which the money chargers of lenders (the early bankers) used to sit in market places to advance money (Federick Miskin P)

When we come to the case of our country, Ethiopia modern banking began in 1905, when the bank of Abyssinia was established in Addis Ababa under a

50- years franchise agreement with then the British owned national bank Egypt. Later on, this modern bank was accused of in efficiencies and purely profit motivates activities, and a decision to liquidate the bank and replace it with an indigenous one was taken by the Ethiopian government. The government decides to offer shares to the public and buy the British owned bank of Abyssinia, which was working under contract. The new set up was named bank of Ethiopia. This bank operated till 1935 and ceased to function during the fascist invasion. During and after the 5 years of enemy occupation, many banks have been established and dissolved resulting in the present days state and private banks.

Prior to the establishment of the present DBE. There were other financial institutions which were established to provide loan to the development of agriculture, industry and other relevant projects, there was the Agricultural bank which was established, in 1945 and later replaced by the DBE in 1951. To enhance industrial development, the investment bank of Ethiopia was established in 1963 and 1965. The name of the bank was changed to the Ethiopian investment corporation share company. Later the AIDB took the activities of the former DBE and Ethiopian Investment Corporation. The AIDB operated until the fall of the derg and the coming of EPDRF to power. This bank was restructured and changes its name to DBE because of inefficient in operation.

The present DBE is established under the national bank of Ethiopia with the following objectives.

- To mobilized funds from sources within or outside the country and provide medium and long term investment credits.

- To provide short term credit, which include working capital for investment
- To buy and sell negotiable instrument and securities
- To participate in equity investment
- To draw, accept, discount, buy and sell bills of exchange, drafts and promissory notes payable within and outside of Ethiopia
- To act as a trustee
- To administer managed fund that could be available from various sources
- To participate in syndicate financing and other development promoting activities
- To open and operate bank accounts with banks and banking correspondent in Ethiopia and or abroad: and
- To engage in such other activities which are customary to development banks?

To realize the aforementioned objectives, the bank operates throughout the country with its 33 branches including the head office located at economically strategic places, DBE Gondar branch is one of these branches. And this paper deals more specifically with impact assessment of bank loan repayment of this branch.

Source (organization manual, pamphlet paper)

## 1.3 . Statement of the problem

One of the means by which organizations meet their overall purposes mission and strategies is issuing the existence of enough available funds effectively and efficiency utilized for different viable project (i.e. agricultural, industrial and other service sectors).

So we can understand that DBE Gondar branch pay a vital rule in putting the idle money in to investment by transferring it to the needy through the lending process, and this function contributes much of the growth of borrowers, the bank and in general to the development of the country economy.

The major income generation activity of DBE Gondar branch is to provide loans for those who apply for and full fill the bank criteria, therefore banks that have effective policies and procedures can reduce the risk that credit is scarce resource. It should be optimally utilized under all circumstances.

Though we can generalized that the lending function has a great importance to the success of the bank, borrower and the country at large it also has a disastrous effect to all before mentioned parties unless the loan is portfolio is critical, and basic requirement of bank maintaining clean loan. Which are free of any arrears and possibility of default, some of the problems which occur during repayment of bank loans can be the following.

- The costumer may not understand the credit policies, rules and regulations.
- Interest rate can have positive or negative impact on loan repayment
- The borrowed money (loan) may not be invested the viable project effective
- The customer collateral may not cover the loan
- The bank customer may not repay the money they borrowed on time
- The loan repayment period may not be enough for the customer to pay the borrowed money.

## 1.4. Objective of the study

### 1.4.1 General objective

**The general objectives are:-**

- To review the assessment of bank loan repayment on the basis of loan terms and conditions.
- To assess perceptions and attitudes of the branches' customers.
- To assess the effect of bad debt (uncollected loan )

### 1.4.2 Specific objective

**The specific objectives are:-**

- To assure weather the costumers made to understand the credit policies, rules and regulations.
- To identify the impact of interest rate the payment of the loan
- To observe weather the borrowed loans invested on the viable projects effectively or not.
- To assure that bank expertise gives services to the clients
- To investigate the fairness of collateral requirements for the loan.
- To review loan repayment period.

## 1.5. Scope of the study

The study focuses only on assessment of bank loan repayment of DBE at Gondar branch.

## 1.6.Significance of the study

The paper is used for further research and investigation assessment on bank loan repayment. It can be used as secondary data and documentary for the institution development bank of Ethiopia.

## 1.7 Methodology

- The researcher use both primary and secondary data. Primary data collected through questionnaires and secondary data collected from credit policy manuals.
- Out of the 21 bank employees 9 were selected by using simple random sampling besides simple statically use (table ratio percentage) were applied analyze the data

| Population and selection | Population | Sample office | Sample size |
|---|---|---|---|
| Bank employee | 21 | 9 | 9 |
| Customer | 127 | 15 | 15 |

## 1.8. Limitation of the study

During the preparation of the paper, different problems were faced i.e. shortage of time, financial and not available some important data are the major one.

## 1.9. Organization of the paper

The research paper is organized in such a way that, the first chapter deals with the introduction of the topic. The second chapter presented the review of the related literature about the bank repayments. The third chapter was contained discussion and analysis assessment on bank loan repayment. The last but not the least chapter presents the conclusion and recommendations about the result obtained.

# CHAPTER TWO

## 2. REVIEW OF RELATED LITRATURE

### 2.1 Definition of Banks

Are the financial institutions that accept deposits and make loan included under the term banks such as commercial banks, saving and loan association, mutual saving banks and credit unions (Fredrick Mishkin P.8)

### 2.2 General Principles of Bank Management

Now that you have same idea of how a bank operates let’s look a bank manages its asset and liability in order to earn the highest possible profit, the bank manager has four primary concerns, the first is to make sure that the bank has enough ready cash to pay its depositors when there are deposit out flows. That is when deposits are lost because depositors make withdrawals and demand payment, to keep enough cash on hand, the bank must engage in liquidity management, the acquisition of sufficiently liquid assets to meet the bank obligation to depositors. Second the bank manager pursues an acceptable low level of risk by acquiring assets that have a low rate of default and by diversifying assets holdings (asset management). The third concern is to acquire funds at low cost (liability management). Finally the manager must decide the amount of capital the bank should maintain and then acquire the need capital (capital adequacy management) (Miskin P.8.)

## 2.3 Definition and Characteristics of loan

A loan is a liability for the individual or corporation it but an asset for a bank for each lender a loan is an investment comparable to fund, stock or other assets. For each borrower a loan is a debt an obligation to repay the borrowed and interest. (Smith, 1991 P. 299) loan is typically less liquid than other assets because they cannot be changed into cash until it matures. If the bank makes a one year loan, it cannot get its funds back until the loan become due in one year. Loans also have highest probability of default than other assets: because of lack of liquidity and higher default rise the bank earns its higher return on loans. (miskin 1997)

## 2.4 Kinds of bank loan

1. **A simple loan**

It provides the borrower with an amount of funds (principal) that must be repaid to the lender at the maturity date along with an additional amount known as an interest payment. (Law vences litter)

2. **A fixed payment loan**

According to (law vences rifer) a fixed payment loan provides the borrower with an amount of funds that is to be repaid by making the same payment every month consisting of part of the principal and interest for a set number of years. Installment loans such as out of loans and mortgages are frequently of fixed payment type.

3. **Secured loans**

Banks often ask firm to provide security for loans. Since the bank is lending on a short-term basis, the security generally consists of liquid assets such as account receivables, inventories and securities. Sometimes the bank will accept a “floating lien” against receivable and inventory. These gives it sets few restriction on what the company can do with the asset, more commonly banks will require specific collateral. (Richard and Stewart P. 899)

4. **Unsecured loan**

The loans that described as self-liquidating, in the other word the sales of the goods provides the cash to repay the loan. Many companies rely on unsecured bank loan to finance temporary increase in inventories.

5. **Seasonal loans**

Seasonal loans are short term loans. It is granted for periods of less than one year, usually up to 180 days. Borrowers use this loan to purchase inventory and to finance account receivables during their peaks sale season. The loan is repaid as receivable and inventories are converted in to cash. Under seasonal lending arrangement, the bank is repaid in a few months and the bank partially depends up on repayments to meet the needs of the borrowers or to repay depositors. Edmister, (1994)

6. **Real Estate loans**

When compared to other types of loans, real estate loans are less liquid. Because of its less liquidity commercial banks have traditionally restrict themselves to offer the real estate most loan, but in recent year commercial bank have highly participating in the field. Miller, et al (1993).

7. **Consumer loans**

This is when many people or organization purchase consumer goods either borrow from bank or buy on credit form dealer whose loans are financed by bank, since there are many types of purchase, maturity and conditions of this loan vary widely with the type of purchase. Maturities can be as short as one month as long as five years. S.kid well, Pitorson, (1990)

## 2.5 The essence of credit

### 2.5.1 What is credit

It is the sale of goods, services money claims in the present in exchange for a promise to pay (usually in money) in the future. The debtor and creditor can agree, of course to settle their transaction in something else of value. Herbert, (1983 P.53).

### 2.5.2 Credit policy

Credit policy is often referred to as a standing decision made in advance to cover a prescribed set of condition. It provides guide lines for determining whether to extend credit to customers and how much credit to extend. A bank adopts either liberal of fight credit policy. Liberal credit policy involves giving credit to more risky classes whose credit worthiness loans extended to customers but incurs high risks of bad debt losses and faces the problem of liquidity. Light credit policy involves extending credit to those who have proven credit worthiness. This policy is very selective in extending credit and results a low profit but it has minimum cost and chance of bad debt losses relatively too liberal credit policy. (Soldafsky and olive p 459).

#### 2.5.2.1 credit standard

As very measurement has its own standards, credit has its own standards, which are standard below.

Credit standard is a minimum criterion for giving credit to customers it helps the credit manager to decide whether to accept or reject clients. He or she accept the desirable clients and rejects the undesirable ones. Setting credit standards implicitly requires a management of credit quality. Which are defined in terms of the probability of a given borrower to pay the loan, it is subjective judgment. But system of credit standard enhance the ability of credit manager to make the correct decision is use fairly and consistently. (J.fred Waston, p 341-342).

#### 2.5.2.2. Credit term

Credit term holds two very important things i.e. length of the credit period and the discount given. Credit period is means by which a firm may be able to affect product demand. Expecting to increase demand by extending the credit period. Discount given involves attempt to speed up the payment receivable. (J.Gitman; P. 787).

### 2.5.3. Credit information

To do something the first and most important thing is having information about what you are going to do. In cases of extending credit having information about borrower is crucial.

Credit information is means of gathering information about the borrower's credit worthiness and general back ground. When business is approached by a customer desiring credit terms, the credit department typically begins the evaluation process by requiring the applicants to fill out various forms that requires financial and credit information and references such as the purpose of the advances, the source of repayment, the profitability transaction and the security offers if any, it is also important to obtain customer statement of his asset and liability.

Often it will be found that qualified account annually. If not it should be prepaid by asking clients the necessary information regarding what he/she is having in the business, which is your own, how much it with others. If the firm given credit to applicants previously, the firm will not need further to search for information it will have its own information on applicants history (J. Gitman,p 544-555).

### 2.5.4 Credit process

W.Koch (1995) explains that fundamental objective of commercial bank consumer lending is to make profitable loans with minimal risk management should target specific industries of markets in which lending officers have expective, the twin goal of loan volume and loan faulty should be balanced with the banks liquidity requirement, capital constraint and rate of return objectives, the credit process relies on each banks systems and controls to allow management and credit officers to evaluate risk and return trade office, management credits philosophy determines how much risk will take and in what form under the label credit culture, banks evidence large differences in how they make loans, this term refers to the fundamental analyze risk, this credit culture is set and enforced by the chief executive officer, most of the elements address the systematic approach to risk taking that forces loan officers to concentrate to long term performance, consider a wide range of possible outcomes and be accountable for actual earning and loss performance.

### 2.5.4.1 Credit analysis

Once customer requests loan bank officers analyze all available information to determine whether the loan meets the bank risk-return objective credit analysis is essentially default risk analysis in which a loan officers attempt to evaluate a borrower ability and willingness repay. Traditionally, key risk factors have been classified according to the five Cs of credit such as character, capital, capacity, condition and collateral.

- **Character: -** is defined as an intangible sum of personal attribute and these attribute are revealed indirectly rather than directly. it can be personal habit, attitude and virtue the applicants record of meeting past obligations of financial, contractual and moral; past payment history as well as any pending or resolved legal judgments against the applicants would be used to evaluate its character. In some respect good character may be result of never having faced adversely.
- **Capacity:** is a credit quality that rest on a widely diverse group of specific conditions, it is the ability to pay specific dollar obligations when it is due but in much wider sense, it measures the source of the ability to pay such as in come, employment, earning power, etc. financial statement analyst with particular emphasis on liquidity and debt rations is typically used to assess the applicants capacity.
- **Capital**:- means the financial strength of the risk in case the applicant is unable (because of decrease in capacity or newly unwilling because of certain traits of character) to pay obligations when due. It is the financially strength of the applicants as reflected by its ownership

position. Analysis of the applicant's debt relative to equity and its probability ratio are frequently used to assess its capital

- **Condition:** the current economic and business climate as well as any unique circumstances affecting either party to the credit transaction. Analysis of general economic and business condition as well as special circumstance that may affect the applicant or firm is performed to assess conditions. While credit analysts today can obtain fairly reliable picture of an individual through a series of specific cautions, they always face the problem of interpreting this information in forms of the current environment. Knowledge of the economic environment must be part of the analyst's general knowledge.
- **Collateral:** the amount of assets the applicants available for use in securing the credit. The linger the amount of available assets, the greater the chance that a firm will receive its funds if the applicants default a review of applicants balance sheet. Fred, F (1981).

### 2.5.5 Advantage of credit

The credit system benefits both society and individual forms:-

1. Idle goods and services are transfer from creditors to debtors and put to make increasing business and national income.

2. Specialization and division of labor are stimulated by already flow of goods and services from creditor to debtor.

3. Consumptive credit broadens industry's market increases production and so helps reduce costs and raise the general living standard.

### 2.5.6 Who wants credit and Why?

Business organizations seek credit for long term fixed investment capital purpose, like the expansion of plant and equipment or for short term working commercial capital purpose, for example to increase the volume of current productive operation. Neither investment nor commercial would be sought and granted unless the borrowers and lender believed productive credit which it would be repaid and would have yielded the profit to all parties.

### 2.5.7 Credit maturity

Short term credit runs usually for less than one year; intermediate credit is granted ordinarily for from one to five years and long term credit matures in more than five years.

### 2.5.8 Credit risk

Credit risk arises because someone bank borrowers may not be able to pay back their loans moreover, many of these loans are made to borrowers wholes risk is difficult to assess and whose performance is difficult to monitor. That is they are loans characterized by the systematic information problems of adverse selection and moral hazard, success in making these loans depends on a bank's ability to produce information about these borrowers and structure their loans appropriately, in particular, the riskier loan should be changed a higher interest rate face higher collateral requirement. (Lawrence and William).

### 2.5.9 Financial analysis as an aid to decision making.

Review appraisals and follow up are these basic elements in credit management and decision making. At the time of considering fresh proposals or enhancement proposals, the banker reviews the past operations with a view of judge the health status of the client. Review if for the past. It should in able to banker to find out whether it is safe to lend a particular client. In order to arrive at this decision, the bankers have to satisfy himself about the risk and viability of the unit.

Credit appraisal implies conditions of fresh or enhancement proposal on the basis of futuristic data while apprising proposals bankers tries to find out.

- Financial needs of the client
- End use of the funds
- Viability of operations and risk involved appraisal of term loan proposal requires information about the project. In such cases, a complete project report may be needed giving detailed of technical knowhow techniques of production, availability of infrastructure facilities and other imputes, total cost of the project, market prospects, elements of computation, managerial competence etc, follow up may be defined as a continues activity aimed at assuring observation of stipulations, laid down by the bank. Picking up signals on the health status of clients position, remedial action and ensuring result of action on a continuous basis, safety need bases financial and end-use are the key assumptions of lending. Sing et al, (1983).

### 2.5.10 .Loans and advances

A number of problems faced by borrowers also are in regard to deposits, remittance, collections etc, and have already been dealt with.

Basically, the problems peculiar for borrowers arise due to difficulties in attitudinal adjustment of bank staff to the new client, new environments and inadequate job knowledge couple with inexperience, it will obviously take some time overcome these problems in their entirety the recommendations that follow would nevertheless bring about a measure of improvement.

Each bank should immediately uncertain take a simple study of the information and data sought for examination of small loan proposal form client in the priority sectors for a ascertaining whether the demands made by the bank are excessive and /or unrealistic, with a view to initiating corrective action.

The task of implication and consolidation of documents and bringing them out in regional languages for loans in the priority sector, especially for smaller units and agriculturist, should be taken upon an urgent basis. Loan documents should be so designed as to take care of as far as possible, additional facilitates subsequently granted obviating the necessity of obtaining entire set of fresh documents on each occasion.

Banks must enjoin on their operating staff to call for information data, etc, for examination of loan applications, as far as possible, in only one or two entrepreneurs and small businessmen.

In considering loan applications for small amounts in priority sectors, especially from small agriculturists, artisans, etc, loans officers should be encouraged to adapt flexible approach sophisticated appraisal techniques, usual in industrial landings, are out of place in considering the small requirements of small man, her. What is important is an overall appraisal backed by a good knowledge of local market prices, applicant and hiss background and familiarity with the nature of operations of applicant loan officers should be able to comprehend the total situation and determine whether;

- Applicant seems honest
- Applicant's proposal seems reasonable
- Information given by applicant makes sense
- Applicant can accomplish the purpose of the loan
- Has necessary know how and /or experience
- Purpose the loan is legitimate and productive
- Applicant with have capacity to repay the loan according schedule under normal circumstances and
- There is margin of safety if thins just do not of right

Bank staff should perform and additional duty of consulting these applicants, wherever require; with a view to converting seemingly nebulous and unattractive proposals in to reasonable bank able propositions.

Repayment installment in regard to small loans in priority sectors should be fixed invariably not in relation to the size of loan or on the basis of willingness of applicants, but strictly in relation to applicant's paying capacity realistically assessed by bank, taking account also the minimum basic necessities of applicant and his dependant family members in this, if may, at times be necessary to relax the maximum repayment period generally stipulated in various schemes formulated by bank concerned, controlling offices of bank should advice their applicants, in each case, the reason for rejection, but this may not be possible always, Illustratively, when market report is adverse, business integrity of competence is doubtful, etc, banks would be justified in refusing to diverse reasons for rejection but, where every possible, customers should be advised of the reasons backed by counseling in appropriate cases.

At every office of each ban, a separate record, in appropriate form should be maintained of all loan application received their disposal and full reasons for delay in sanctions and for rejections, is should be periodically impressed up on all operating staff that loan proposals, especially from priority sector customers, must be dealt with expeditiously sand in time so that the loans could be meaningfully utilized.

The forgoing recommendations are intended to meet, to some extent, the more common complaints, in the field of lending particularity where the small man is concerned the compliments, by and large, pertain on irrelevant and excessive questioning at different times, delays in sanction, too many rejections by insistency on the letter of schemes while ignoring the spirit, summary rejections without assigning reasons, incomprehensible and lengthy documentation stiff and unrealistic attitude of disinterest and un concern to words customers. Shekakr, (1990).

### 2.5.10.1. Purpose of the advance

While in the practical bank environment, policy will from time to time affects the banks attitude to certain types of lending, from an examination view point this can be disregarded, however, the risk involved in an advance is obviously influenced by the purpose for which it is required, and the banker must be satisfied that the venture will succeed. Palfreman, (1998).

### 2.5.10.2. Amount of the advice

There is a tendency for customer to ask for the amount they think the bank will lend rather than the figure they consider realistically needed to see a project through. Therefore, it is essential for the banker to ensure than the amount required is adequate for all eventualities.

### 2.5.10.3. Period of the advance

Historically bankers have been regarded as short-term lenders, but in recent year there has been a much more flexible attitude towards medium–term loans for business purposes. For the smaller term loans, the letter merely states that a loan continues to be available for the period agreed provided monthly repayment of interest and capital are met. Sing et al, (1983).

### 2.5.11. Collection technique

This is firm's collection policy. It is the set of procedures for collection account receivables when they are due. A number of collection techniques are employed as an account becomes more and more ever due intense.

**The following are the popular techniques.**

**1. Letter** → This is a polite letter a firm sends to the customer to remain its obligation. Firm do this after an account receivable becomes over due. If the account is not paid within a certain period after the letter has been sent, a second more demanding letter is sent. Only this two letters is not enough if the customer still not respond another more letters will be followed.

Collections letters are the first step in the collection process forever the accounts.

**2. Telephone calls**→ this is applied if letter prove in unsuccessful. Telephone call may be made to customer to personally request immediate payment. Such a call is typically directed to the customer's account payable department where the responding employees act on instruction of his/her boss. If the customer has a reasonable excuse, arrangement may be made to extend the payment period. A call from the seller's attorney may be used if all other discussion seems to fail.

**3. Personal Visits**→ this technique much more common at the customer credit level, but it may also be effectively employed by industrial suppliers. Sending a local sales person or a collection person to comfort the customer can be a very effective collection procedure.

**4. Collection agencies**→ if the customer fails to pay though the above three steps the firm can turn no collectable account over a collection agency or an attorney for collection. The fees for this service are typically quite high, the firm may receive less than 50 cent on the dollar from account collected in this way.

**5. Legal action** → legal action is the most stringent step in the collection process. It is an alternative to the use of collection agency. Not only is direct legal action expensive, but it also may force the debtor into bankruptcy. There by reducing the possibility of futures business without granting the ultimate receipt of the overdue amount (J. Gitman p. 791-794).

### 2.5.12. Interest rate

The act saving and lending, borrowing and investing are untimely linked through the financial system, one factor that significantly influences and ties all of them together is the interest. The rate interest is the price a borrower must pay to secure scarce loan able funds from a lender for an agreed up on period, it is the price of credit. But unlike other price in the economy, the rate of interest is really a ratio of two quantities: the money cost of borrowing divided by the amount of money actually borrowed, usually expressed on percentage basic, interest rate send price signal to borrowers, lenders, savers and investors, the higher interest rates send price signal to borrowers, lenders, savers and investors, the higher interest rate generally brings forth a great volume of saving and stimulate lending of fund, lower rate of interest on the other hand, tend to damage the flow of saving and reducing lending activity. Higher interest rate tends to reduce volume of borrowing and capital investment and lower rates stimulus borrowing and investment spending (prefer S.rose 1997p.192).

#### 2.5.12.1 Loan rates

The major determinates of loan rates are the banks costs of funds the interest rate the bank can earn on other investments, and the risk of default, banks loan rates. Also depend on the interest rate available on treasury securities and other potential investments, the borrower the risk of default, the more attractive the loan and the lower the interest rate charged, the prime rate has traditionally been the interest rate on six month commercial loans to customers are charged a little above prime or a lot above prime or have their loan requests denied entirely, loans are less risky when they are secured by collateral  legal claims in the event of default to such assets as bonds, stock, real estate, or customer durables (gray smith p. 157).

### 2.5.13. loan evaluation

Personal and business loans are initiated with an application and an interview with a loan officers, who is sometimes given a moral congenial title, such as relationship manager the loan officers responsibility is to acquire information about the customer, the purpose of the loan, and the likely hood of its payments, those who have a long standing relationship with the bank involving deposits, previous loans, and other services naturally expect to have their loans approved more readily than applications from strangers.

The evaluation of personal loans involves an investigation of the applicant's employment and credit history. The loan officer looks for a record of stable employment at a wage adequate to repay the loan and meet other financial obligation and for evidence of the repayment of earlier credit obligation including a home mortgage car and education loan and credit purchase. Some banks quality an individual's credit worthiness using a credit scoring system based on the economic and demographic characteristics and default frequencies of past borrowers. (Garry smith p. 155).

## CHAPTER THREE

### 3. DATA PRESENTATION AND ANALYSIS

The main target of the study in the first place is to set down the relevant information that requires meeting the desired objective. The type of data source methods and procedures of data collection are basically specified under questionnaire method.

In order to full fill the information requirement of the study the focus is put on the presentation and discussion of data collected through questionnaires. There are questionnaires designed for the employees opinion and customer opinion the question is closed ended which is "yes" and "No" type. Thus the following analysis and discussion are made using the above mentioned methodology.

### 3.1 Result of questionnaires of employee section

**Table 1.1 (result of question** No **1.1)**

| No | Questions | No of respondents | | No of respondents in percentage | | Remark |
|---|---|---|---|---|---|---|
| | | Yes | No | Yes | No | |
| 1 | Do you follow that the project proposal was selected based on the stated criteria? | 9 | 0 | 100 | 0 | |

Source questionnaire result from employees

As the above table 1.1 shows all of the respondents 9 (100%) all of them have agreed that the bank strictly follow and evaluate the feasibility of the proposed project based on the stated criteria, the bank makes high effort to perform its operation based on the preset criteria in order to get a loan the client apply loan request and its investment project proposal attached to the concerned body. At the same time the bank experts also evaluated in different angle on the bases of stated criteria that are reported to the loan committee and then to discuss the issue decision and submitted to the branch manager. This stated criteria some of them are the project should be:-

- Attractiveness of cash flows
- The availability of strong collateral
- The past trained of repayment of loan was good
- Profitability of the business

In general assure that depending on the above information the bank follows the project proposal on the basis of the above mentioned stated criteria.

**Table 1.2 (result of question** No **1.2)**

| No | Question | No of respondents | | No of respondents in percentage | | Remark |
|---|---|---|---|---|---|---|
| | | Yes | No | Yes | No | |
| 2 | Is there any encouraging or rewarding system for the repayment of lean in the short period of time | 5 | 4 | 55.6 | 44.4 | |

Source questionnaire result from employees

As depicted in the above table 1.2. Out of 9 respondents 5(55.6%) of them said that when the customer paid the loan with in the short period of time, the bank also reward or encourage the customer. The loan officer told that when any clients completed his/her debt the bank provides him/her thank you letter although 4(44.4%) of them have stated that the bank does not provide any encouraging or rewarding system to facilitate payments of loan in the short period of time.

Generally form the result we can see that the bank provides thank you letter to the customer when they fully paid their debt.

**Table 1.3 (Results of question No 1.3)**

| No | Question | No of respondents | | No of respondents in percentage | | Remark |
|---|---|---|---|---|---|---|
| | | Yes | No | Yes | No | |
| 3 | Do you think that the loan repayment was affected by investing for not feasible project? | 6 | 3 | 66.6 | 33.4 | |

Source questionnaire result from employees

As depicted above table 1.3, out of 9 respondents 6(66.6%) of them agreed that loan repayment was affected by investing in not for feasible. However the remaining 3(33.4%) of them did not accept that the loan repayment was affected by investing in not for feasible project, since the loan is invested infeasible project often evaluated examined and assess based on scientifically accepted standard. Thus the target of the bank to approve loan and in order to maximize profit.

This implies that the loan will not pay on time it is invested for infeasible project.

Generally as the researcher observed the client file the learning officer studied and evaluated the project proposal based on operational guide line from the above information

**Table 1.4 (Result of question No 1.4)**

| No | Question | No Of respondents | | No of respondents in percentage | | Remark |
|---|---|---|---|---|---|---|
| | | Yes | No | Yes | No | |
| 4 | Is the bank after the loan disbursement properly follows up on the invested project? | 7 | 2 | 77.8 | 22.2 | |

**Source questionnaire result from employees**

As shown in the above table 1.4 (77.8%) of them have said that, the bank properly follow the invested project after the loan disbursement. The bank follows the loan disbursement weather it is properly invested or not in that particular project.

How over out of 9 respondents 2 (22.2%) of them disagreed that the bank does not follows up the loan disbursement whether it is properly invested or not in that particular project on one properly follows up, thus the branch bank to be expected maximum effort to control and follow up the project as well. From the above information we can see that the bank follower the loan disbursement properly whether it is invested in that particular project.

**Table 1.5 (result of question № 1.5)**

| No | Question | No Of respondents | | No of respondents in percentage | | Remark |
|---|---|---|---|---|---|---|
| | | Yes | No | Yes | No | |
| 5 | Do you release the loan that holding a balance security? | 9 | 0 | 100 | 0 | |

**Source questionnaire result from employees**

As shown the above table 1.5 out of 9 respondents that is 9 (100%) of them agreed that the bank does release the loan that holding the balance collateral security. The loan officer told that the bank requires that its loans be secured by mortgage on fixed assets. The projected financed under normal rate of interest and are located in urban areas will be required to present 125% of the loan a collateral including fixed asset of the project. In case of similar objects located in rural areas i.e. outside the municipally are the bank requires 75% of collateral to be presented form outside the project. The remaining 50% shall be covered by fixed assets of the project financed.

**Table 1.6 (result question № 1.6)**

| No | Question | No Of respondents | | No of respondents in percentage | | Remark |
|---|---|---|---|---|---|---|
| | | Yes | No | Yes | No | |
| 6 | Is the loan collection fully handled by the respective lending units? | 9 | 0 | 100 | 0 | |

Source questionnaire result from employees

As shown the above table 1.6 out of the 9 respondents 9 (100%) of them have stated that the loan collection was fully handled by the respective lending units.

The loan officer hold that the loan is paid to respective lending units on the agreed time i.e. monthly, quarterly and annually based in loan position of each borrower.

### 3.2. Results of questionnaire of customer section

**Table 2.1 (results question No 2.1)**

| No | Question | No of respondents | | No of respondents in percentage | | Remark |
|---|---|---|---|---|---|---|
| | | Yes | No | Yes | No | |
| 1 | Have you been informed the loan policy and regulation of the bank? | 5 | 10 | 33.3 | 66.7 | |

Source questionnaire result from customers

Based on the above responses out of 15 respondents 5 (33.3%) of them explained that they have full information about the credit policies and regulations. If customers have informed about the operational guide lines as well as rules and regulations of the bank. If will create a good relationship between clients and bank. That helps to be paid the loan on time and also it minimize costs, on the other hand the relative huge number of customer i.e. 10 (66.7%) explained that they have not any information about the credit policies and regulations of the bank. This shows major clients of the bank are not informed about the operational guide line. Thus the clients cannot know their right and obligation in the process of approval loan the general guide lines.

It can be generalized that the bank does not inform about the bank guide lines and policies to its customers.

**Table 2.2. (Result of question** No **2.2**

| No | Questions | No of respondents | | No of respondents in percentage | | Remark |
|---|---|---|---|---|---|---|
| | | yes | No | yes | No | |
| 2 | Do you get the loan during 6 weeks after you have full filled the required criteria? | 2 | 13 | 13.3 | 86.7 | |

Source questionnaire from costumer result

As the above table shows question No 2 from the total of 15 respondents 2(13.3 ) of them agreed that the bank provides appropriate responses without dalliance to applicants who seek banking services, concerning with customer satisfaction on the bank release the loan on the plan and it saves unnecessary additional cost and time. Whereas 13 (86.7%) of the respondent indicate that the bank do not provide the loan with 6 weeks even though customers fulfillment the required criteria. In addition to this some of the customer explained to the researcher informally that the bank takes a long period of time, even more than 4 or 5 months to disburse loan to the customers. According to the above information, it is easy note that the bank is not providing loan within 6 weeks even though they fulfilled the stated criteria.

**Table 2.3 (result question No 2.3)**

| No | Questions | No of respondents | | No of respondents in percentage | | Remark |
|---|---|---|---|---|---|---|
| | | yes | No | yes | No | |
| 3 | Is there any encouraging or rewarding system practice by bank for the repayment of loan in a short period of time? | 5 | 10 | 33.3 | 66.7 | |

Source questionnaire from customer result

As the above table shows that from the total 15 respondents 5 (33.3%) of them said that the bank encourage or reward when the customers pay their loan within a short period of time. Regarding with customers believe that there is an incentive way of encouraging by the bank that help to the clients paid the loan fully. As the researcher observed the clients file when customers paid all their debts the bank provides a letter of acknowledgement. However 10 (66.7%) of them said that the bank does not encourage or reward even though they fully paid their loan within a short period of time.

Depending on the above information one can assure that if the customer had been paid their debt in short period of time, the banks does not encourage or reward the clients, thus it is a barrier to promote the collection of debt on time.

**Table 2.4 (result question No 2.4)**

| No | Questions | No of respondents | | No of respondents in percentage | | Remark |
|---|---|---|---|---|---|---|
| | | yes | No | yes | No | |
| 4 | Does the bank follow and control whether the loan is properly invested in a feasible project or not? | 15 | 0 | 100 | 0 | |

Source questionnaire from customer result

According to the respondents response for question 15 (100%) of them have replies that the bank follow and control whether the loan is properly invested in a feasible project or not.

From the above information one can draw that the bank follow and control the loan winner it is properly invested in a feasible project or not.

The bank provides loan to clients phase by phase based on agreement, when first phase is completed, and the loan officer will evaluated the project and report to the branch manager whether the loan is properly invested in the projects or not.

**Table 2.5 (result question No 2.5)**

| No | Questions | No of respondents | | No of respondents in percentage | | Remark |
|---|---|---|---|---|---|---|
| | | Yes | No | Yes | No | |
| 5 | Is there any follow up the bank? If you don't repay the loan during the contract period? | 0 | 15 | 0 | 100 | |

Source questionnaire from customer result

As shown in the above table that out of 15 respondents 15(100 %) of them have stated that the bank does not follow the borrowers when they are not repay on the loan with in the contract period. This shows that the bank focus only to repay the loan up to last second based on the agreed time. However the customer will not paid the loan with in contractual period. The bank should take necessary measures according to the stated policy.

**Table 2.6 (result question No 2.6)**

| No | Questions | No of respondents | | No of respondents in percentage | | Remark |
|---|---|---|---|---|---|---|
| | | Yes | No | Yes | No | |
| 6 | Do you get the bank technical and Guidance service? | 3 | 12 | 20 | 80 | |

Source questionnaire from customer result

The respondents answer for the question 6 out of 15 respondents 3(20%) of them agreed that the bank has giving technical and guidance service to the customers, the respondents answer indicate that the bank provides technical and guidance service to the customer, this leads to the customer acquired enough knowledge about their project, in General where as the relative large amounts of respondents i.e. 12(80%) of them stated that the bank does not giving technical and guidance service to customer.

In General at the above information stated that the large amount of customers has not enough knowledge about loan operations / Techniques and guide lines

**Table 2.7 (result question No 2.7)**

| No | Questions | No of respondents | | No of respondents in percentage | | Remark |
|---|---|---|---|---|---|---|
| | | Yes | No | Yes | No | |
| 7 | What is the reason for the proper unpaid of loan? Is it the case that infeasibility of the project? | 2 | 13 | 13.3 | 86.7 | |

Source questionnaire from customer result

As shown the above table out of 15 respondents 2(13.3%) of them has agreed that the problem of unpaid loan due to infeasible project.

It implies that the bank causes of loan is unpaid there is lack of properly evaluated project based on the stated criteria, that is why most customers were not paid their debt with the contractual arrangement. Whereas 13(86%) of them respondents that is not the case of default of loan repayment. As some of them have informed me most business other than the repayment of loan based on major respondents answered that the bank evaluate the project proposal of the clients based on the objective criteria used by the bank to evaluate the clients projects proposal includes.

- The analysis of the existing demand and supply of the market.
- The analysis of the IRR of the proposed project
- The analysis of the management capability to the owner
- The analysis of the production services capacity rate of the project
- The analysis of economic and social benefits of the project.

The reason that the bank provides a loan to the customer is?

1. Attractive cash flows □
2. Availability of strong collateral □
3. The post trend of repayment of loan was good □
4. Profitability of the business □
5. All points are equally important □

Choose no 1 □ choose no 3 □ choose no 5 □

Choose no 2 □ choose no 4 □

Question no 7 tells that about the total respondents. 15(100%) of them have agreed that the reason which the bank provides a loan to the customer is provides that equal important for availability of attractive cash flow, Availability of strong collateral, the past trend of repayment of loan was good, and the profit ability of the business. Thus the customer's point of view the above all points are equal important for the bank which provides a loan. This shows that the branch bank considered all points giving the same weight and not provides the loan until to fulfill the above stated points. Basically this implies that the bank focuses on adequate selection of customer, the profitability of project and other essential points are considered to take a moderate action to provide loan to the customers, unless the bank has a large idle available funds and it creates a great problem of investment and the development as well.

Therefore observing this situation the bank does not provide a loan to fulfill that is attractive cash flow, availability of strong collateral, the past trend of repayment of loan was good, and profitability of the business, this indicates that the bank carefully provides a loan to the clients and also shows that it credit regional development as well as the country as a whole

# CHAPTER FOUR

## 4. CONCLUSION AND RECOMMENDATION

In this part the paper the important finding are summarized and some recommendation that are supposed to be helpful for the bank are also forwarded.

### 4.1 CONCLUSION

As it is clearly indicated in the first chapter of this paper the main objective of the study was to find out problems associated with the provision of loan by development bank of Ethiopia Gondar branch.

- DBE is one of government owned bank it provide loan for agriculture, industry and other business sector apart from this it finances the firms working capital need.
- Most loan of DBE Gondar branch are secured against pledge of movable and immovable assets, which must be readily marketable and stable in value in order to minimize bad debt losses, the security to be pledge is estimate by DBE's expert as to the value and marketability.
- In order to be eligible for loan borrowers is required to present an application letter. A legal personal certificate the appraisal work is starting to propose a loan. After the application fulfilled the requirements the bank collects credit information about the applications his/her mortgage to ascertain whether they have a direct or indirect liability with other bank on the value of the collateral presented and the customers' payment history or past loan; the

branch bank recommends the applicant to be approved by the manager.

- To collect loans the bank uses different techniques. It writes letters, makes telephone call, gives personal warning and finally takes legal actions.

## 4.2 . RECOMMENDATION

Based on the finding of the paper the research would like to for word the following key recommendations

### 4.2.1. Recommend for organization

- The branch bank shows get technical support to customers in record keeping and also create awareness of the customers
- Some operational guide lines and policies of the bank are vague, therefore these guide lines and policies could be revised and make to be clear in order to implement effectively and efficiently by all concerned body of the bank.
- The bank provides thank you letter to the clients but it is not enough it make cash discount because the bank also collects their credit it incurred additional cost.
- In order to protect bad losses the bank should consider the following measures: - analyze future market perspective, considered depreciation cost and other important points.
- The branch should give an adviser services to customers.

### 4.2.2. Recommend for customers

- The customers before loan application first should understand the rules and regulation of the bank ,
- The customers should create close relationship with bank officer and ask some core and important points about loan procedures
- The customers should be repaid the loan plus interest on time
- The customers should follow rules and regulations of the bank
- The customer before proposed the project first should understand is the project feasible or not.