ST. MARY'S UNIVERSITY COLLEGE
BUSINESS FACALTY
DEPARTMENT OF MANAGEMENT

AN ASSESSMENT ON LOAN PERFORMANCE IN AWASH INTERNATIONAL BANK S.C. (AIB)

BY
MISGANA EMIRU

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SMUC
ADDIS ABABA

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Company

It was the year 1905 G.C. that demarcated the beginning of banking service in Ethiopia with the establishment of the first bank, Bank of Abyssinia. The British owned the bank. The Ethiopian Government, under Emperor Haile Silassie, closed Bank of Abyssinia and established the Bank of Ethiopia which was fully owned by Ethiopians. But, during the Italian occupation (1936-1941), the operation of Bank of Ethiopia ceased and other Italian Banks came to existence. With the departure of Italians and the restoration of Emperor Haile Silassie's government, the State Bank of Ethiopia was established in 1943 G.C. In the year 1963 G.C., the bank splits in to the National Bank of Ethiopia and Commercial Bank of Ethiopia. Thus, until the end of 1974, there were state owned, foreign owned and Ethiopian owned banks in the country.

In 1975 G.C., Dergue came in to power and monopolize all private and public enterprises. This economic policy of the government has hindered the development of banking industry at its infant stage.

It was the new economic policy of the Transitional Government of Ethiopia that allows privatization and became a historical event for establishment of the first private bank in Ethiopia of the post-socialism era – Awash International Bank s.c.

Awash International Bank S.C. (AIB) was established on November 10, 1994 G.C. by 486 founding shareholders with a paid-up capital Birr 24.2 million and started banking operation on February 13, 1995 G.C.. Over the past 14 years the number of shareholders and the amount of capital and reserves has increased to 3,163 and Birr 445.5 million, respectively, (10th Anniversary, *1995-2005*).

1.2 Background of the Study

The major services that the bank provides to its customers are the following:

- Mobilizing all types of deposits (savings, demand and time) and pay interest on interest-bearing accounts.
- Providing loans and advances to its customers, including long term investment/project financing.
- Providing domestic and international money transfer services.
- Providing international banking services for importers and exporters.

By providing the above major services, the bank has never sustain loss and there is a general trend of increasing profit. This demonstrates the strong public and customer confidence and trust in AIB.

Beginning from its establishment, the bank has 300,547 customers through its 61 branches situated in Addis Ababa and various regions. As number of customers (depositors) and branches increased, there will be strong deposit mobilizations which in turn help the bank's capacity to meet the credit demand of its customers.

The bank's loan portfolio is composed of different sectors of the economy among which Domestic Trade & Service (DTS) took the highest portion followed by Import and Manufacturing. The bank has made a huge effort to increase the amount of the total loan portfolio and as a result the bank is at its success story. Therefore, since loan portfolio is the largest asset and predominant source of revenue, effective management of credit function through different risk management techniques is fundamental to the bank's safety and soundness.

Currently, managers need reliable risk measures to direct capital to activities with the best risk/reward ratio. They need mechanisms to monitor positions and create incentives for prudent risk-taking by divisions and individuals.

As the lending activity is considered by the banking industry as the most important function for the utilization of funds and contributes the highest gross profit of the bank, it is needless to mention that bank should strengthen its risk management capacity. Some of the risks that banks encounter are:

i. **Credit risks**: is the change in net asset value due to changes the perceived ability of counter parties to meet their contractual obligations.

ii. **Market risks**: is the change in net asset value due to changes in underlying economic factors such as interest rate, exchange rate, etc.

iii. **Operational risks**: results from costs incurred through mistakes made in carrying out transactions such as settlement failure and failure to meet regulatory requirement.

iv. **Liquidity risk**: is the risk to earnings or capital arising from a bank's ability to meet is obligation when they came due. (*http:// Berkeley-edu/finance/ wp/ rpflist.html*)

Therefore, despite the fact that the bank has made a huge effort, the load to growth has not been smooth particularly in a situation where the National Bank of Ethiopia has established a credit ceiling since last year. Having this problem as it is, the most pressing problem for the bank was the problem that constrains the enhancement of the bank's loan portfolio (*NBE Directive no. SSB/ 102/2009-2010*)

1.3 Statement of the Problem

Performance of banks can be viewed from different perspective, i.e. operational results, dividend payments, deposit mobilization, international activities, branch expansion, HR development and loan activities. For the purpose of this research, the performance of bank loan was selected because it constitutes the bank's major income generating source and incorporates different risks. Thus, analyzing the performance of bank loans helps the bank to gain more profit than before.

The loan performance could be measured in terms of rules & policies, repayment collection mechanism, collateral valuation techniques, credit risk management ability and methods set to decline non-performing loans.

1.4 Research Questions

- What is the current status of loan performance of AIB?
- What is the bank's repayment collection mechanism?
- What methods are adopted to decline non-performing loans?
- What is the sufficiency of collaterals to cover the loan granted?
- What credit risk management technique does the bank employ?

1.5 Objectives of the Study

- Assess the current loan performance of the bank and give recommendations how to perform better.
- To show methods of decline for non-performing loans.
- To emphasis the need of credit risk management and show its impact on the bank's profitability.
- To make them revise their rules and regulations regarding lending practice of the bank, when the need arises.

1.6 Significance of the Study

Accepting of money and lending to borrowers are the main functions of mainly commercial banks. Banks, if they do not lend the amount they have received from depositors, there might be the risk of not covering interest paid for customers. Moreover, as lending itself incorporates different risks; it has to be managed properly. Thus, I believe that the research paper would help in minimizing the above risks and would have the following significances.

- Aware the bank its loan performance and help it to take action accordingly.
- The finding of this paper might be used as a source idea for further in depth study to come up with better credit function for securing higher profit.

1.7 Scope of the Study

The scope of this study was confined only to investigation of the loan performance of the bank. The bank's loan portfolio was composed of different sectors of the economy among which Domestic Trade & Service (DTS) took the highest portion. Because of this, the research would concern on this type of loan. And for the purpose of this research and due to the fact that the number of creditors is large: Head Office, Merkato, Sidamo Tera and Tekle-Haimanot branches were selected. The research covered the year from 2005 – 2009 G.C. mainly because of the files this period is active.

1.8 Research Design and Methodology

1.8.1 Research Design

Since the research is an in-depth one, where different variables are analyzed, descriptive research design was used.

1.8.2 Population and Sampling Technique

The population of the study comprised credit department manager, branch managers, loan officers and customers. The study has two-population group: customers & employees. The population size of the customers was

100 people. From those customers 20 people were selected. Population size of employees was 20. From the customers all 20 people were filled questionnaire and from the staff 15 were filled questionnaire and 5 were interviewed. A simple random sampling method was selected for the research.

1.8.3 Types of Data Collected

Data to be collected are row data, which can able to define loan performance of Awash International Bank S.C. like:

- the bank's lending procedure
- collection mechanism
- progress in loan volume in past five years

1.8.4 Methods of Data Collection

Data was collected from primary and secondary source. The primary data was collected through questionnaire and interview. Moreover, secondary data composed of books, annual reports, directives, brochures, magazines, manuals, procedures and other local and international financial institutions documents including their websites, internet and other documents that are related to the stated topic were used.

1.8.5 Data Analysis Methods

The collected data were analyzed and conclusions were drawn using the simple statistical method such as mean, percentages, and ratios and through tabulation process.

1.9 Organization of the Study

The research is comprised of four chapters. The first chapter deals with general background of the study, statement of the problem, objective and significance of the study, scope of the study and the research design and methodology. Chapter two discuss about literature review. The data presentation analysis and interpretation part of the research is discussed on chapter three. Finally, the research will brought to an end by summary, conclusion and recommendation in chapter four.

CHAPTER TWO

REVIEW OF LITERATURE

2.1 General background

Banking service involve mobilization of funds in the form of saving deposits, checking accounts, and time deposits that are payable on demand and lending these to business organizations and individual trades. Lending is the principal business activity for most commercial banks. The loan is typically the largest asset and the predominant source of revenue for the bank. It is also one of the greatest source of risk to a bank's safety and soundness; that may be due to weakness in the economy, poor credit standards, side loans and others, which they have been historically the major courses of bank losses and failures, (*Bacha, 2008*)

Thus, effective management of the loan portfolio and the credit function is fundamental to a bank's safety and soundness. Loan portfolio management (LPM) is the process by which risks that are inherent in the credit process are managed and controlled. Because review of the LPM process is so important, it is a primary supervisory activity.

For decades, good loan portfolio managers have concentrated most of their effort on prudently approving loans and carefully monitoring loan performance. Although these activities continue to be mainstays of loan portfolio management, analysis of past credit problems, has made it clear that portfolio managers should do more. Traditional practices rely too much or trailing indicators of credit quality such as delinquency, no accrual and risk rating trend. Banks have found that these indicators do not provide sufficient lead-time for corrective action where there is systematic increase in risk.

Effective loan portfolio management begins with oversight of the risk in individual loans. Prudent risk selection is vital to maintain favorable loan quality. Therefore, the historical emphasis on controlling the quality of individual loan approval and managing the performance of loan continues to be essential. To manage their portfolios, banks must understand not only the risk posted by each credit but also how the risk of individual loans and portfolios are interrelated.

Currently, banks are encouraged to view risk management in terms of the entire loan portfolio by identifying nine elements that should be part of a LPM process. These are:

- Assessment of the credit culture
- Portfolio objectives and risk tolerance limit
- Management information system /MIS/
- Portfolio segmentation and risk diversification objective
- Analysis of loan originated by other lenders
- Aggregate policy and underwriting exception system
- Stress testing
- Independent and effective control functions
- Analysis of portfolio risk (*http://www.occ.treas.gov/hand book/Ipm .Pdf*).

2.2 Risks associated with Lending

According to Occ's supervision by risk philosophy, risk is the potential that events, expected or unexpected, may have an adverse impact on the bank's earning or capital (*http://www.occ. Tears. Gov*).

Banks are subject to a wide array of risks in the course of their operation. In general banking risks fall into four categories.

These are: -

1. Financial risk
2. Operational risk
3. Business risk
4. Event risk

1. **Financial Risk**: - is inturn comprises of two types of risks.
   a. Pure risk: includes liquidity, credit and solvency risks, which can result in a loss for a bank if they are not properly managed.

b. Speculative risks: are based on financial arbitration and can result in a profit, if the arbitrage's current or a loss if it is in current. The main categories of speculative risks are interest rate, currency and market price risks.

2. **Operational Risks**: are related to a bank's overall business strategy, organization, functioning of internal systems, compliance with bank policies and procedures and measures against mis-management and fraud. Fraud, operational error and system related and/or informational problems are the main aspects of operational risks.

3. **Business Risks**: are associated with a bank's business environment, including macroeconomic and policy concern, legal and regulatory factors, the financial sector infrastructure and payment system, and the overall systematic risk for operations.

4. **Event Risks**: include all types of exogenous risks which could jeopardize a bank's operation or undermine its financial condition and capital adequacy (*Greuning, H.V Bratanvic, S, 2000: 3*)

In spite of the presence of other risk categories like liquidity, market, interest risk and solvency risks in the literature, a supreme importance is given to credit risks. This is due to the fact that credits represent the major assets hold by banks and sources from which banks generate their income (*Jole Besis, 2002*).

Credit risk is one of the financial risks that a bank might face in its operation. Credit risk defined as the chance that a debtor will not be able to pay interest or repay the principal according to the terms specified in a credit agreement. This type of risk is an inherent part of banking that means payments may be delayed or ultimately not paid at all, which in turn can cause cash flow problems and affect a bank's liquidity (*Greuning, H.V Bratanovic & S, 2000:3*)

Some of the principles for managing credit risks are:

1. Establishing for managing credit risk environment.
2. Operating under a sound credit granting process.
3. Maintaining an appropriate credit administration, measurement and monitoring process.
4. Ensuring adequate control over credit risk.
5. The role of supervisors (*http://www.bis.org*)

The overall essence of analyzing credit risks is to assess the performance of bank loans with regard to risk minimization and repayment collection performance of bank loans can be positive or negative and non-performing loan is the adverse effect of poor performance. Therefore, one can clearly see that addressing the problem of non-performing loan is directly or indirectly addressing the problem of credit risk and overall performance of bank loans.

2.3 What are Non Performing Loans?

Non-performing loans are loans that are in default or close to being in default (*Investopdedia. Inc.2000*).

Non-performing loans are loans or advances whose credit quality has deteriorated such that full collection of principal and /or interest in accordance with the contractual repayment term of the loan or advance is in question (*NBE, 2007*).

A. Criteria for Non-Performing Loans in the International Statistics Manuals

The system of national accounts 1993(1993 SNA) does not provide criteria to decide what should be classified, as non-performing loans & other international statistics manual are also silent on the subject. Concerning NPLs, the bottom line in the international manuals seems to be that loans are good unless there is certainty that loans is not going to be repaid under existing arrangements.

B. **Criteria for Non-Performing Loans recommended by Banking & Institutions**

The extents to which authorities have been involved in developing criteria to distinguish between good and bad loans differs substantially between countries & as mentioned banking & financial institution have come into provide guidance on this issue.

Some counties use quantitative criteria (E.g. number of days of overdue schedule payments), while other countries exclusively rely on qualitative norms (such as availability of information about the clients financials status, management judgment about future payments), some counties (including Germany &U.K) do not give standard criteria at all. Furthermore, it cannot be said that a loan is either good or bad as there is a sliding scale in credit quality from risk free loans to these that do not give any hope for recovery (*Adrian, M & Ciornelis, N undated:3*).

To improve the ability to make comparison between banks across countries, the institute of international finance (IIF) report that for worldwide external reporting the following categories be used:

Standard: - credit is sound and all principal and interest payments are current. Repayment difficulties are not foreseen under current circumstances and full repayment is expected.

Watch: - assets subject to conditions that, if left an corrected, could raise concerns about full repayment. These require more than normal attention by credit officers.

Substandard: - full repayment is in doubt due to inadequate protection (E.g. obligor net worth or collateral) and/or interest or principal or both are more than 90 days overdue. These assets show underling, well-defined weaknesses that could lead to probable loss if not corrected and thus risk becoming impaired assets.

Doubtful: - assets for which collection/liquidation in full is determined by bank management to be improbable due to current conditions and/or interest or principal or both are overdue more than 180days. Assets in this category are considered impaired but are not yet considered total losses because some pending factors may strengthen the assets quality (merger, new financing, or capital injection.)

Loss: - an assets is downgraded to loss when management considers the facility to be virtually uncollectible &/or when interest or principal or both are overdue more than one year.

This classification may indicate that there are two cases that have to be addressed:

i. Loans that are a complete loss &

ii. Loans whose quality is significantly impaired (substandard or doubtful) and for which taken as a group experience source that a considerable portion of the future interest &/or installment payment will never be made (Ibid).

According to the international accounting standard board (IASB) a financial asset is impaired if it's carrying amount is greater than its estimated recoverable amount (*Adrian M.Bloem*)

C. Criteria for NPL per Directives of National Bank of Ethiopia (NBE)

As per the NBE's directives issued in relation to classification of loans are advances, banks shall classify loans and advances, whether such loans and advances have pre-established repayment programs or not, in to the following five classification categories using the criteria described below:

1. **Pass**

   Loans and advances in this category are fully protected by current financial and paying capacity of the borrower and are not subject to criticism.

2. Special Mention

The following loans and advances at a minimum shall be classified special mention:

a. Loan or advances with pre-established repayment programs past due 30 days or more, but less than 90 days.

b. Overdraft loans and advances if:

   i. The debt remains outstanding for 30 consecutive days but less than 90 days.

   ii. The debt exceeds the borrower's approved limit for 30 consecutive days but less than 90 days.

3. Sub-Standard

Non-performing loans and advances with or with out pre-established repayment programs past due for 90 days and more, but less than 180 days.

4. Doubtful

Loans and advances with pre-establishment program past due 180 days and more, but less than 360 days.

5. Loss

Non-performing loans and advances past due 360 days and more. (NBE, 2002)

2.4 Causes of Non-Performing Loans

Most bank failures are caused by non-performing loans, (*Brown Bridge, M, 1998:1*). It is therefore vital to see the causes of non-performing loans in order to avoid the failures and crisis that will follow.

Different researchers have indicated different causes for non-performing loans and have separated these causes into two.

1. A more or less predictable level of non-performing 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 non-performance in the form of bad loan provision, or they may spread the risk by taking our insurance. Enterprises may well be able to pass a large portion of theses costs to customers in the form of their prices. For instance, the interest margin applied by financial institutions will include a premium for the risks of non-performance on granted loans.

2. The amounts involved in non-performing loans may rise considerably as a result of less predictable incidents. Such as exchange rates or interest rates change abruptly. A similar effect may be caused by the sudden failure of a major company in an overly optimistic financials market (in this context the term irrational exuberance has been used). If the resulting loss of confidence begins to snowball toward a crisis, at least three effects tend to further aggravate situation:

    - A fall in the prices of loan collaterals (often real estate) may cause more loans to become classified as doubtful;

    - Large bad loan portfolios will affect the ability of banks to provide credit, and the resulting liquidity crunch may suffocate otherwise good creditors;

    - Depositors and foreign investors may start a run on the banks, pushing them into bankruptcy.

2.5 Types of Loan made by Banks

To address the credit need of the business society banks have different categories of loans. The major credit facilities are:

1. **Term Loans**

   These have been the primary sources of finance for private and public firms. Generally term loans are divided in to three based on their period of maturity i.e. short, medium and long term loans.

2. **Overdraft Facilities**

   - Overdraft facilities are provided by banks to allow customers to overdraw their current account up to an agreed maximum amount.

   - Overdraft facilities have advantages of getting ideal facility for day-to-day working capital need and as interest rates are calculated on daily outstanding debit balance, interest costs for the borrower will be minimum.

3. **Merchandise Loans**

   - It is a kind of loan facility granted against pledge of stock of merchandise items in secured promises.
   - It helps to reduce short-term working capital constraints of customers.

4. **Advance against Import/Export Letter of Credit**

   The letter of credit is a formal letter issued for a bank's customer and authorizes an individual or company to draw draft on banks under certain condition. Banks made such advances by taking margins on letter of credit.

5. **Export Credit Guarantee Scheme**

   Such facilities are designed by NBE, to provide financial guarantee to funding institutions with the aim of covering against loses that could result from financing non-coffee agricultural exports.

6. **Personal Loans**

- As the name indicates, a personal loan is a lump sum advance for a borrower to meet his/her personal requirements.

- Usually source of repayment for such credit facility is from salary, rent income and others, (*Bacha, 2008*)

2.6 Valuation of Collaterals

Collateral is the protection against loss in the ability and willingness of the customer to repay borrowing (*Bacha, 2008).*

The valuation of collateral provided by the credit applicant is an essential element in the credit approval process and thus has an impact on the overall assessment of the credit risk involved in a possible exposure. The main features of a collateralized credit is not only the borrower's personal credit standing, which basically determines the probability of default, but the collateral which the lender realize in case the customer defaults and which this determines the bank's loss.

Collateral in general is dividend in to personal and physical collateral. In the case of personal collateral, the provider is basically liable with his entire fortunes. Examples of personal collateral are:

a. Surety ship
b. Guarantee and letter of support
c. Collateral promise

In the case of physical collateral, the bank receives a specific security interest in certain assets of the borrower or the collateral provider. Examples of physical collaterals are the following:

a. Mortgage
b. Pledge of movable assets (on securities, goods, bills of exchange)
c. Security assignment
d. Retention of title (*www, Oenb.at/en/img/credit_approval_process*)

Banks should take in to account the value of collaterals by assessing:

- The quality of collateral
- Its obsolescence and physical deterioration characteristics
- Its liquidity and marketability
- Legal enforceability of the collateral in case of defaults
- Acceptable ratio of the market value of collaterals (*Bacha,2008*)

Specialized employees, often called Civil Engineers, through the following valuation techniques, carry out the valuations of collaterals. These are:

a. Comparable Method

Used for most types of properties where there is good evidence of previous sale.

b. Investment/Income Method

This valuation model is used for most commercial and residential property that is producing, or has the potential to produce, future cash flows through the letting of the property.

c. Account/Profit Method

This model values trading properties, other than normal shops, where evidence of rents is slight, as they tend not to hold as investment. The account method determines an appropriate rent, which is then used in the investment method.

d. Cost Method

Used for those properties not bought and sold on the market and for technical purposes only (*Nick French, undated*)

2.7 Lending Procedures in the case of AIB

Lending is the process of making an advance to business on the basis of certain rules, regulations and under prearranged set of conditions entered between the parties concerned; the bank and the borrower. Procedures are a series of steps followed in a regular defined order. Lending has its own disciplines that are strictly followed by all who deal with bank credit matters.

Properly implemented procedures in a bank credits are good indicators for the performance of loans to be repaid without any problems. If wrong procedures are applied or irregularly implemented, repayments turnout to be default, resulting in non-performing loans.

Thus, the following are lending procedures in the case of AIB.

1. Contact with the Customer

Either the bank will go to the customer and initiate the customer to borrow money or borrower will came to the bank seeking for a loan. Hence, establishing a good relationship between the customer and the bank is the first step in the lending process.

2. Discussion with Customer

- Help the bank to assess the borrower's credit needs;
- During the discussion the bank may get information regarding the customer's credit history with banks, the purpose of loan request, previous repayment habits and many more.

3. Loan Application

After getting a go-ahead result from the discussion, the loan application is starting document for a loan request.

Some of the information's contained in the loan application form are:

- Loan amount required
- Duration and type of loan
- The purpose for which the finance is required
- Brief history of borrower to date.
- Details of main product and markets
- Audited financial reports
- Projected profit and loss accounts and cash flows
- Details of collaterals offered.

Loan officers evaluate the loan application such as:

- To check whether the cash flow is adequate to cover principal repayment or not;
- Whether the business is viable or not
- The nature of collateral offered
- Whether securities offered are acceptable to bank or not, etc

4. Getting Credit Information

The National Bank of Ethiopia provides information relating the borrower credit history, his spouse, mortgager, company and its general manager and major shareholders. Such information may relate to customer's honesty, operational efficiency and repayment capacity.

5. Credit Processing

After an in-depth analysis of the credit worthiness of the borrower and approval of loan is made by the credit committee, the final step in lending process is credit processing. (*Bacha, 2008*)

CHAPTER THREE

DATA PRESENTATION, ANALYSIS & INTERPRETATION

In this chapter, the data analysis, presentation and interpretation is given by comparing the data collected from borrowers and employees of Awash International Bank s.c. A total of 35 questionnaires were distributed to borrowers and employees of the bank at selected four branches and all are filled and returned. Moreover, an interview was made with four branch managers and one credit department manager.

The results of the questionnaires and interviews are presented for analysis as pr the following scenario:

3.1 Background Characteristics of Respondents

Item	Borrowers	
	Frequency of Response	Percentage
1) Age		
20-30	6	30
31-40	8	40
41-50	3	15
51-60	-	-
>61	3	15
2) Occupation		
Business Organization	16	80
Individual Businessman	4	20
Others	-	-

Table 1 Borrower's Bio Data

As shown in the above table, item no. 1, 40% of the respondents fall under the age of 30-40 years whereas 30% of the respondents are in between the age of 20-30 years. There is no respondent with the age group of 50-60 years. This indicates that majority of the borrowers age is between 30-40 years.

Beside their age composition, the above table also depicts that 80% of the respondents are business organizations followed by individual businessman, which is 20% of the borrowers. As the need for financing is high for business organizations than individual businessman, the bank should exert utmost effort to provide a better loan processing scheme.

3.2 Analysis of Data Obtained

3.2.1 Timely Payment of Loans

The mere fact that most loans are converted to non-performing loans is because customers fail to pay their repayment amount regularly.

As borrower of the bank, do you pay your repayments regularly?	Frequency of Respondents	Percentage
Yes	7	35
No	13	65
Total	**20**	**100**

Table 2 Regular Repayment Schedule

The repayment amount for a single loan that is disbursed to an individual businessman or other business organizations are structured based on their profit, projected cash flow statements, the interest rate applied, the period of loan and its frequency of repayments.

In any ways, the borrower should regularly pay what is expected from him/her. But on table 2 above, it is clearly shown that 65% of borrowers did not pay their repayment amount regularly while 35% of respondents did pay their repayments regularly.

Furthermore, based on the information gather through interview all branch managers agreed that there is no such strong mechanism that the bank follows to collect repayments from borrowers regularly. Thus, as there is no pre defined and strong mechanism adopted by the bank for collections and as borrowers did not pay their debts regularly, the risk of uncollectable is high and so does non-performing loan switch in turn contributes to the loss of a bank.

Most of the respondents agreed that the following are some of the reasons why they did not pay their repayments regularly. These are:

1. For most business organizations, their profit may decline and unable to pay the loan regularly.
2. High repayment structure of the bank due to the short life of loan.
3. Weak follow up by the bank.

Therefore, it would be more appropriate if the bank creates awareness to borrowers about the consequence of not paying the debt regularly. This may decline the belief that the bank did not give due follow up for the repayments.

3.2.2 Communication between Borrowers and the Bank

Item	Frequency of Respondent	Percentage
1) Have you ever discussed your problems, if any, regarding the loan that you take from the bank?		
Many times	9	45
Some times	3	15
Not at all	6	30
I have no problem	2	10
TOTAL	**20**	**100%**
2) How fast is the bank in responding your enquires?		
Very fast	5	25
Fast	5	25
No response	10	50
TOTAL	**20**	**100%**

Table 3 Complain Presentation and Response Time

In service giving organizations like banks, it is needless to mention that receiving feedbacks and act accordingly is important to create good relationship between customers. In one or another way customers may complain about the service provided by the bank or may present their problems in a belief that the bank will respond as quickly as possible. If they get a response according to their expectation, they will be delighted and strengthen their attachments better than before.

Item no. 1 shows that 45% of respondents presented their problems to the bank regarding the loan they have taken from the bank. 30% an1530% of borrowers reply that though they have problem with respect to the loan that the bank has disbursed, they did not discussed their issues at all and some times to some extent respectively. Only 10% of respondents did not have any problem regarding their loan.

Beside the frequency of complaints presented to the bank, the above table also depicts the time that the bank took to respond for borrowers enquire. To this end, the lion share of respondents, i.e. 60%, said that the bank gives no response for their complaints while 25% and 15% of respondents reply that the bank did rely response for their enquires fast and very fast respectively.

This really indicates that, even though majority of borrowers have presented their problems to the bank expecting that the bank will give them a solution so that they may have a capacity to pay their debts without any problem, the bank did not to give responses to their needs accordingly.

Therefore, resolving complaints to some extent mean decreasing the tendency of non-performing loans and hence better to review its response time.

3.2.3 Loan Processing Time

Loans are another source of finance for individual borrowers, business organizations, investors and others. From banks perspective, loans are the major sources of income and should be properly managed since lending by its nature is risky. As borrowers request loan for their urgent need and lending is a profit for the bank, the time that loan processing should be minimized since it gives a win-win opportunity for both parties. The time that the bank took to process given loan is presented hereunder in table 4.

Item	Frequency of respondent	Percentage
The time that the bank took to grant a loan is:		
Very quick	1	5
Quick	2	10
Took longer time	17	85
Total	**20**	**100**

Table 4 The time that the bank took to process a loan

The above table shows that 85% of the respondents confirm that the bank took longer time to process a given loan application. Meanwhile, 10% of the respondents that said the processing time is quick followed by 5% of the respondents said that the time the bank took to grant a loan is very quick.

Borrowers have been asked to give their own justification about the reasons why the bank took longer time in processing a loan and many of the respondents give their opinion by saying:

1. the bank may not have enough personnel
2. that the bank should review its credit policy
3. it should give some give some authority to each branch

The implication of those facts is that borrowers did not get their financial needs as quick as they demanded to be and the bank is not in a position to excel a win-win opportunity. This scenario may lead customers to switch to other banks in need for financial assistance.

3.2.4 Credit Policy of the Bank

How do you rate the bank's credit policy?	Frequency of Respondents	Percentage
Very satisfactory	1	5
Satisfactory	3	15
Moderate	4	20
Dissatisfactory	10	50
Very dissatisfactory	2	10
Total	**20**	**100**

Table 5 Credit Policy of the Bank

The above table depicts that 15% are satisfied and 5% of respondents are very satisfied with the bank's credit policy. It is also shown that the majority 50% of respondents' replies that they are dissatisfied by its policy, 20% of respondents rate bank's credit policy as moderate and the remaining 10% are very dissatisfied. If borrowers are not satisfied with the policies, rule and regulations of the bank regarding loan disbursements, it is clear that they will shift to other banks. If the switching rates gets higher and higher, realizing interest income from loans & advances may decline and could influence the overall performance of loan in general.

Most of the respondents suggest that as they are dissatisfied, the bank should:

1. evaluate and review its credit practices
2. check other banks practice
3. Set procedures and policies in collaboration with borrowers, if possible.

Contrary, with an interview held with the credit department manager, he has said that the current rules, regulations, policies and procedures of credit processing allow creditors to get a better facility in the bank for this; he replies that the bank adopts the following credit management techniques:

1. implement credit risk strategy
2. create clear and sound granting criteria
3. clear procedures of loan approval
4. check and manage on and off balance sheet item

Moreover, in the interview made with the selected four branch managers 75% of them give their response that the bank's rules and regulations encourage customers to borrow money from the bank.

Hence, this implies that though the above techniques are good enough to give a better credit facility, these techniques were not implemented in to practical situation. Had it been practiced, the satisfaction level of borrowers with respect to credit policy of the bank will be increased so that the performance of loan will be improved thereafter.

3.2.5 Performance of loan in Awash International Bank

How do you observe the bank's loan performance for the last 5 years?	Frequency of respondent	Percentage
Satisfactory	6	40
Dissatisfactory	9	60
Total	**15**	**10**

Table 6 Employees view towards Awash International Bank's loan performance

From the selected 4 branches 15 loan officers have been taken and 60% of them reply that they are dissatisfied by the current performance of the bank in line with its credit activities. Not only the loan officers but also the credit department manager response that he is not satisfied with the loan performance of the bank in general. This shows that there is poor management of loans in the bank.

The loan officers reason out some of the points that contribute to the poor performance of loan in the bank. These are:

1. Bureaucratic procedures availed in the bank
2. Non-performing loan not declined
3. Non qualified personnel

The implication is that the bank should hire qualified loan officers and should struggle to decline non-performing loans and bureaucratic procedures, if any.

3.2.6 Benefit of collecting repayments regularly

One means of measuring loan performance could be the ability to collect repayments regularly from borrowers. As banks receive loan payments regularly, there would be no interest and principal arrears that accrue on main loan balance. This will possibly minimize the risk of default. Loans become default then become non performing loan and later transferred to loss when borrowers did not pay their repayments as per the agreed schedule and become outstanding for greater than 180 days (NBE Directive).

For this, loan officers have been asked to give their response whether collecting repayments regularly would benefit the bank or not, and there response are presented here in table 7.

Do you think that collecting repayments regularly would benefit the bank?	Frequency of respondents	Percentage
Yes	15	100
No	-	-
Total	15	100

Table 7 Collecting Repayments Regularly

All of the respondents noticed that collecting repayments regularly benefits the bank with no doubt. Since repayments highly determine the performance of loan, the bank deploys some mechanism to collect loan repayments, based on respondents amongst which the basic is providing grace periods.

3.2.7 Existence of Non-Performing Loans

Loan, if not properly supervised and controlled, it may weaken the bank asset quality. Moreover it might be changed to non-performing loan category. The following table depicts the existence of non-performing loan in the bank.

Is there any Non-Performing Loan?	Frequency of respondent	Percentage
Yes	10	66.67
No	5	33.33
Total	15	100

Table 8 Existence of Non-Performing Loans

Table 8 shows that 66.67% of the respondents reply that there is Non-performing loans in the bank while the remaining 33.33% denies its existence. The interview made with the branch managers and credit department manager also reveals the existence of Non-performing loans in the bank, i.e., 80% of branch managers' reply that there are Non-performing loans in their branches.

Non-performing loans are best indicators of loan performance in banks. They have adverse effect to the overall performance of the bank since they are contra asset account. Therefore unless they are controlled, they will create a big mess to the overall performance of a given bank.

According to the response made by loan officers, branch managers and credit department manager, currently the bank deploys some mechanisms to decline NPL's. The major ones are:

1. risk assessment
2. motivating borrowers to pay regularly
3. collateral management
4. monitoring methods
5. chose supervision of loans
6. monitor overall composition and quality of credit portfolio

This implies that when these methods of declining NPL exercised practically, the percentage of NPL will decline and the overall loan performance will be improved.

3.2.8 Loan Collaterals

Does the bank held sufficient collateral for the loan?	Frequency of Respondents	Percentage
Yes	11	73.33
No	4	26.67
Total	15	100

Table 9 Collateralized Loans

Sufficient collaterals are also one good indicators of performance of loan. Collaterals are those items like building, machinery, vehicles and the like that is used as a backup for the loan as security. Therefore banks usually accept collaterals whose values exceed the total amount of loan granted to the borrower. This helps banks in case the loan defaults they will sale the property at a higher price than the outstanding loan balance. This in turn helps not to take losses up on default.

Taking this fact into account, the above table shows that 73.33% of loan officers reply that the bank gives loan by taking sufficient collaterals whereas 26.67% of respondents said that there are some loans granted without presenting sufficient collateral to the bank.

By the same token, 80% of branch manager said that their branch secured loans against sufficient collateral values while the remaining 25% of respondents said that the branch gives clean-unsecured loans. In addition to the branch managers, the credit department manager also said few loans are not collateralized while many are. But both branch managers and credit department managers agreed that the risk of clean loan is high, especially when the loan defaults.

All in all, this implies that the bank leaves some room from granting loans without requesting sufficient collaterals. This in other word indicates that there is some level of risk associated with clean loans, which later may affect the performance of loans. Furthermore, it entails that there is no defined policy and procedure about collateralized loan processing.

3.2.9 Risk Management

Loans become problem credits as a result of controllable and uncontrollable factors. Controllable factors are those that reflect overall bank credit policy as well as inadequate credit analysis, loan structuring and loan documentation. Uncontrollable factors typically reflect adverse economic conditions, change in regulations, environmental changer around borrower’s operations and other catastrophic events. While there is little that can be done to prevent uncontrollable problems, effective risk management technique can reduce other sources of losses.

In view of the above, the table depicted hereunder shows the risk management technique of the bank, if any.

Does the bank employ credit risk management techniques?	Frequency of respondents	Percentage
Yes	12	80
No	3	20
Total	15	100

Table 10 Risk Management Techniques

According to the response made by loan officers and credit department manager, the bank has some risk management techniques. These are:

1. Monitor the condition of individual credits, including the adequacy of provision and reserves
2. Establish appropriate credit risk environment
3. Credit limit should be set

This show that the bank is good at deploying risk management techniques so that the risk associated with loans can be minimized.

CHAPTER FOUR

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter deals with the summarized highlights of the assessment, conclusions drawn and recommendations made on the basis of the findings. The study attempted to address the basic research questions posed in chapter one.

4.1 Summary

The main objective of the paper is to assess the overall performance of loan in Awash International Bank S.C. Thus, the following are some of the summarized highlights of the research based on the findings presented in chapter three.

- Majority of the bank's borrowers are between the age of 30-40 and none of the respondents are fall under the age of 50-60.
- 80% of the borrowers are business organizations while the remaining 20% are individual businessmen.
- With regard to customer's habit of paying their debts regularly, 65% of borrowers do not have a practice of paying their debts regularly but 35% of respondents said that they are paying their debts per the schedule set forth.
- Many of borrowers said that they did not pay their debts regularly because one, their profit may decline and another repayment structure of the bank is high.
- 45% of borrowers presented their problem regarding the loan they took from the bank many times. Contrary, 30% of respondents do not present their problems for discussion at all. Besides, only 10% of respondents do not have any problem about their loan.

- Borrowers were in a position to evaluate the bank's response time for the complaints forwarded by creditors. The data analyzed in chapter three reviled that 15% and 25% of the respondents said that the bank's response for complaints very fastly and fastly respectively. Whereas, majority of the respondent borrowers, i.e. 60%, said that the bank did not give any response for the problem raised by borrowers.
- The time that the bank took to grant a loan was evaluated and the response depicts that the bank took longer time to process a given loan.
- In the interview held with credit department manager and 4 branch managers, it is pointed that the current rules & regulations of the bank allow customers to get better facility in the bank. Nevertheless, 50% of the borrowers are not satisfied with the current credit policy of the bank.
- 60% of loan officers agreed that the performance of loan in Awash International Bank S.C is dissatisfactory.
- All respondents of loan officers show the importance of collecting repayments from borrowers according to the predefined schedule.
- With an interview made between branch managers and credit manager, there are non-performing loans in the bank. Besides, 66.67% of loan officers respond that there exists non-performing loans in the bank.
- Based on the response of loan officers, 73.33% of the loan are collateralized while the remaining response that there are clean loans. Similarly, the interview result depicts that majority of the respondents agreed that the bank gives collateralized loans to borrowers.
- The bank adopts credit management techniques and 80% of the respondents agreed that the bank employ these technique

4.2 Conclusions

The following conclusions are drawn based on the primary and secondary data findings.

- Referring to borrower's bio data, it could be said that the bank has a work force borrower whose age falls between 30-40 years.
- Many of the bank's loan products are consumed by business organizations than individual businessmen.
- Borrowers do not pay their repayments accordingly.
- There exists complaints by borrowers regarding the loan they took from the bank and the bank's response time is dissatisfactory.
- Based on the response made by borrowers, the bank took longer time for processing a given loan product.
- Though employees of the bank respond that the current credit policy allows creditors to get a better loan facility in the bank, majority of the borrowers respond that the credit policy, procedure, rules & regulations of the bank are dissatisfactory.
- The performance of loan in Awash International Bank S.C is poor.
- There is non-performing loan in the bank.
- The bank grants loans without holding sufficient collateral in exceptional cases.
- Finally, there are some credit management techniques in the bank.

4.3 Recommendations

Today, the trend of business environment is changing drastically. This makes the assessment of risks difficult. As loan in its nature involves risks it should be managed properly otherwise it will affect the bank's loan performance in general.

Loans are the major source of income in many commercial banks. Poor performance in loans may mean poor performance in the overall operation of the bank. The performance of loans can be viewed from different perspective. One of the parameter for evaluating the performance of a given loan in banks is that the existence of mechanisms to collect repayments according to the predefined repayment schedules. Another may be the existence of non-performing loans and methods of decline in the bank. Furthermore, the amount and type of collateral that the bank holds upon disbursing the loan may also be one indicator of the performance of loan in the bank.

The following recommendations are made based on the findings observed in chapter three and the conclusions drawn herein this chapter.

- As many of the borrowers are business organizations, it would be more appropriate and favorable if the bank gives many loans that fit business organization requirements better than before.

- For one or another reason borrowers could not pay their repayments regularly, and one of the reasons was the fact that the bank's repayment structure is very high. Thus, as paying repayments regularly will minimize the tendency of having non-performing loans in the bank, which they are good measurements of loan performance, the bank should look at its repayment scheduling structures and switch its policies accordingly for instance decreasing the interest rate may reduce the repayment amount so that borrowers can pay their debt without any problem.

- In service organizations handling of complaints and customer problems in good manner is very vital. If customers present their problems regarding the loan they took from the bank, the bank should discuss and resolve situations before they get worse. For instance, if the borrowers forward his problems regarding repayment schedules we have to talk with him/her so that we will extend and wave the repayment time and amount. By doing so the risk of changing the status of loan from normal to non-performing loan could be minimized.

- To get as many as possible borrowers and to excel profit in the long run, the bank should minimize the time that it took to grant a loan. One possible solution for this may be the bank should decentralize approval authority to each branches so that the time may be minimized. In the current scenario, branches received all loan requests then forward to Credit Department at Head office level and credit department go through the requests and make decisions either approve or decline and finally returned to respective branches. This lengthens the process so that if the bank gives authority to each branch there will not be such time lost during the process. Furthermore, the bank should hire enough personnel at each branches and credit department.

- If the following proposed credit management techniques are implemented and exercised there is no doubt that the performance of loan becomes better than before. These are:

    - Implementing credit risk strategy
    - Creating clear and sound granting criteria
    - Creating clear procedures of loan approvals
    - Checking and managing on and off balance sheet items.

All these will help the bank in providing defined loan products and also help to assess the risks associated with loans in general. This in turn helps the bank for improving its loans.

- If the bank reduces its bureaucratic procedures availed in the bank and implement some methods of declining non-performing loans like:
    - risk assessment
    - collateral management
    - loan supervision and
    - Design some motivations to borrowers to pay their debts regularly; there is no doubt that the percentage of non-performing loan decline year after year and the performance of loan will be improved.

- Clean loans and loans that are granted without having sufficient collaterals are so risky, in such a way that the bank may incur lose at time of default, it would be more appropriate for the bank to grant loans that are fully backed up with sufficient collateral values. In addition to its value, the collateral type is also one factor that can affect the performance of loan. Thus, the bank should consider the marketability of the collateral before disbursement.

- Finally, the good side of the bank with regard to creating some techniques for credit management should be strengthened.

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APPENDIX

Sample Questionnaires and Interview Questions

St. Mary's University College

Faculty of Business

Department of Management

Questionnaire for Loan Officers

Introduction

This questionnaire aims at assessing the loan performance of Awash International Bank S.C.________________ Branch. It is intended for academic purpose to do term paper for the partial fulfillment of Bachelor's Degree in Management.

Your first hand information has a paramount value in this research. The respondent's answers and opinions are confidential & no harm to him/her.

With many thanks for sharing your experience & ideas as well as your time in advance.

N.B When you fill these questionnaires:

- ☞ You need not to write your name.
- ☞ Mark your answer by putting ✓ in the box and fill your personal suggestion in the space provided.

1. As a Loan Officer, how do you observe AIB's Loan performance for the last five years?

   A. Satisfactory ☐

   B. Un-satisfactory ☐

2. If your response for the above question is "unsatisfactory", what do you think is the reason behind?

   ____

   ____

   ____

   ____

3. Do you think that collecting repayments regularly would benefit the Bank?

   A. Yes ☐

   B. No ☐

4. What kind of mechanism does the Bank deploy to collect repayments from its borrowers, if any?

   ____

   ____

   ____

   ____

5. Is there any Non performing loan in the Branch?

   A. Yes ☐

   B. No ☐

6. If your answer for the above question is "Yes", what methods are employed to reduce NPLs in your Branch?

   ____

   ____

   ____

   ____

7. Does the Bank held sufficient collateral while granting loans?

   A. Yes ☐

   B. No ☐

8. If "No", what problem does it create on the performance of Loan?

   ____

   ____

   ____

   ____

9. Is there any credit risk management technique that the Bank employs?

A. Yes ☐

B. No ☐

10. If "Yes" what are these techniques?

____

____

____

____

Thank You!!!

St. Mary's University College

Faculty of Business

Department of Management

Interview Questions for Credit Department Manager

1. What is the performance of loan at AIB for the past five years?

2. Is there any Non-performing loan at your Bank?

3. If yes, how much is the Percentage of NPL?

4. What mechanisms should be deployed by the Bank so as to decrease non-performing loans?

5. What Credit Management Techniques does the bank employ?

6. Are all loans backed up with sufficient collateral?

7. What problem does it create to the performance of loans if the Bank holds collateral whose value is less than the amount granted to the borrower?

8. Do you think that the current lending practice, rules & regulations, of the Bank allow Creditors to get a better loan facility at your Bank?

9. How often do you evaluate & follow the repayment schedule of creditors, and how do you relate such scenario with loan performance?

St. Mary's University College

Department of Management

<u>Interview Questions for Branch Managers</u>

1. Does the rules and regulation of the Bank encourage customers to borrow money from the Bank?
2. Is t here any NPL in the branch?
3. What measures should be taken to decline non-performing Loans?
4. Is there any repayment collection mechanism?
5. Are all collaterals offered as Mortgage sufficient enough to back up the loan?
6. What is their adverse effect to the performance of loan?

St. Mary's University College

Faculty of Business

Department of Management

Questionnaire for Borrowers

Introduction

This questionnaire aims at assessing the loan performance of Awash International Bank S.C.________________ Branch. It is intended for academic purpose to do term paper for the partial fulfillment of Bachelor's Degree in Management.

Your first hand information has a paramount value in this research. The respondent's answers and opinions are confidential & no harm to him/her.

With many thanks for sharing your experience & ideas as well as your time in advance.

N.B When you fill these questionnaires:

- ☞ You need not to write your name.
- ☞ Mark your answer by putting ✓ in the box and fill your personal suggestion in the space provided.

1. Age

   A. 20-30 ☐

   B. 30-40 ☐

   C. 40-50 ☐

   D. 50-60 ☐

   E. Greater than 60 ☐

2. Occupation

   A. Business Organization ☐

   B. Individual Businessmen ☐

   C. Other ☐

3. As borrower of the Bank, do you pay your repayment regularly?

   A. Yes ☐

   B. No ☐

4. If "No", what is your reason?

   ____

   ____

   ____

   ____

5. Have you ever discussed your problems, if any, regarding the loan that you take from the Bank?

   A. Many Times ☐

   B. Some Times ☐

   C. Not at all ☐

   D. I have no Problem ☐

6. How fast is the Bank to response for your enquires?

   A. Very Fast ☐

   B. Fast ☐

   C. No response ☐

7. What is your view regarding the time that the Bank took to grant a loan for your request?

   A. Very Quick ☐

   B. Quick ☐

   C. Took longer time ☐

8. If it took longer time, what do you suggest?

____

____

____

____

9. How do you rate the Bank's Credit Policy?

   A. Very Satisfactory ☐

   B. Satisfactory ☐

   C. Moderate ☐

   D. Dissatisfactory ☐

   E. Very Dissatisfactory ☐

10. If it is dissatisfactory, what is your suggestion?

____

____

____

____

Thank You!!!

DECLARATION

I, the undersigned, declare that this senior essay/project is my original work, prepared under the guidance of Instructor Ephrem. All sources of materials used for the manuscript have been duly acknowledged.

Name: ________________________________

Signature: ______________________________

Place of Submission: ______________________

Date of Submission: ______________________