ST. MARY'S UNIVERSITY

BUSINESS FACULTY

DEPARTMENT OF ACCOUNTING

AN ASSESSMENT OF CREDIT MANAGEMENT IN THE CASE OF AWASH INTERNATIONAL BANK (HEAD QUARTER)

BY

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JUNE 2014

ADDIS ABABA

AN ASSESSMENT OF CREDIT MANAGEMENT IN THE CASE OF AWASH INTERNATIONAL BANK (HEAD QUARTER)

A SENIOR ESSAY SUBMITTED TO THE DEPARTMENT OF ACCOUNTING BUSINESS FACULTY ST. MARY'S UNIVERSITY

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DECLARATION

We the undersigned declare the senior project is our origins work prepare under the guidance of Ato Meseret Kinfe. All sources of materiel used for the manuscript have been dully acknowledges.

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CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

Banking, the business of providing financial services to consumers and businesses. The basic services a bank provides are checking accounts, which can be used like money to make payments and purchase goods and services; savings accounts and time deposits that can be used to save money for future use; loans that consumers and businesses can use to purchase goods and services; and basic cash management services such as check cashing and foreign currency exchange.

The early development of banking and credit according to Rose (1999:59) was closely associated with three elements: merchants, moneylenders and smiths.

Credit management is the policies and processes that allow customer and clients to defer payment for goods and services. The management and control of credit is a vital component in the process of controlling cash flow and many organizations failed because management did not distinguish between profitability and cash flow. Effective credit management ensures that the total amount of credit extended and the period for which it is extended are not consistent with the organizations financial policies. It means ensuring that credit is granted on a consistent basis, the cost of credit are understood the client payment process is effectively administered, and a debt recovery policy is in place (Linder,1993:226).

1.2. Background of the organization

Awash International Bank S.C. (AIB) was established as the first private commercial bank on November 10, 1994 by 486 founder shareholders with a paid-up capital of Birr 24.2 million and started banking operations on February 13, 1995.Over the past twelve years, the numbers of shareholders and the amount of capital and reserves have increased to 2397 and Birr 342 million, respectively. It was named after the popular river "Awash" which is the most utilized river in the country especially for irrigation and hydroelectric power. Awash River plays a pivotal role in the economic development of the country (www.awash-bank-et.com).

Awash International Bank S.C is the first private bank to build its own headquarters located on the Ras Abebe Aregay street, will host AIB and AIC. The twins building named "Awash Towers" built at a cost of more than Birr 217 million in collaboration with its sister company, Awash Insurance Company S.C (ibid).

According to the Brochure of Awash International Bank, that was published in 2012, the Bank has 80 branches spread throughout the country in 2012, thus boosting the wider branch network next only to the state owned, Commercial Bank of Ethiopia. All city branches and almost half of the outlying branches are providing on-line services.

The Bank is working on a project aimed at replacing the existing CORE Banking system with a new one in order to improve its services and promote efficiency. Similarly, the Bank, in cooperation with NIB International Bank S.C and United Bank S.C and has established a share company known as "Premiere Switch Solutions S.C." for the joint operation and management of Automatic Teller Machines (ATM) and Point of Sale (POS) terminals (ibid).

1.3. Statement of the Problem

Credit management is one of the activities of banks which require a lot of time and effort for granting loans and collecting receivables. While collection of receivables and granting loans, banks possess a problem that results from inadequate customer's guidance and advisor service, which affects the bank's credit collection performance and minimize its liquidity.

Some of the indicator of the problem is, the bank announcement by different Medias to sell the collaterals of customers, for those who defaulted and loan associated with sell of collaterals.

As the secondary data indicates, the non performing loan of awash international bank is 125,698,770 as of 2011 data. Awash international bank provide a total loan of 3,880,696,323. The total percentage of nonperforming loan is 3.23%. In 2012 the non performing loan increased to 146,232,055 from a total loan of 3,986,464,776.The total percentage of nonperforming loan is also increased to 3.6%. The researcher wants to study the reason why the non performing loan increases in 2012.The study has assessed the bank's lending procedures and evaluates the problems related with customer's inability to return loan.

1.4. Research Questions

The researchers are interested to find answers for the following basic research questions;

- What are the mechanisms used by the bank to follow-up the loan repayment?
- How does the bank reduce non-performing loan?
- What are the major causes for non performing loan?
- How does the non-performing loan affect the profitability of the bank?

1.5. Objectives of the Study

1.5.1. General Objective

The research paper is used to explore alternative solutions to a root cause for non performing loan in awash international bank.

1.5.2. Specific Objective

Based on the above benchmarks there are also some other specific objectives:

- To assess the mechanisms used by the bank to follow-up the loan repayment
- To assess the method that the bank apply to reduce non performing loan
- To identify the major causes for non performing loan
- To assess the non-performing loan affect the profitability of the bank

1.6. Significance of the Study

The major benefits of the study are the following;

- In doing the research, the researchers are developed the research skill.
- It uses a secondary data for other researchers who are interested to carry out on further study.
- This research also useful as reference material for readers who are studying this subject matter.

1.7. Scope of the Study

The study is confined assessing the credit management practices of Awash International Bank. Under this, the researchers are tried to present the Banks performance toward credit management system. The scope of the study is limited to head office because, similarity of lending procedures for all branches of the bank. The scope of the study is also limited to the selected period of one year (January 1, 2012-December 31, 2012).

1.8. Limitation of the Study

The major limitations of the study are the following:

- Lack of resources and experience
- Unable to get customers of the bank
- Unwillingness of one employee for response
- Unwillingness of the bank to give secondary sources

1.9. Research Design and Methodology

1.9.1. Research Design

A descriptive study was used to employees with an assumption that it will help to generate adequate information about the major challenges in the credit management department.

1.9.2. Population and Sampling Technique

The population for these studies includes all employees working in credit department of the bank. To conduct the study the researchers uses a total of 18 employees as population size in the credit department. The sampling method used by the researchers is census method. Census method is the procedure of systematically acquiring and recording information about the members of a given population. It is a regularly and official count of a

particular population. A census is often constructed as the opposite of a sample as everyone is surveyed rather than a fraction. The researcher select this type of method because of, the researcher can select a more representative sample that can bring more accurate results than by using other probability sampling techniques.

1.9.3. Types of Data to be Collected

To conduct this study the researchers were used both primary and secondary data. Primary data was collected through first hand information from employees working at the credit management department the secondary data was collected from annual reports, books, brochure, and internet for the appropriate and successful completion of the study.

1.9.4. Methods of Data Collection

The researchers were used both questionnaire and interview to collect the data. Open ended and close ended questions was used by the researchers. And semi-structural interview was used by the researchers. Distributing 17 questionnaires to employees at the credit management department and interviewing the manager of the credit department.

1.9.5. Data Analysis Methods

The data analysis method that was used by the researchers includes tables includes percentages. The data collected interpreted accordingly.

1.10. Organization of the Study

The study contains four chapters. The first chapter deals with introduction, that consists of background of the study, background of the organization, statement of the problem, research questions, objective of the study, significance of the study, scope of the study, limitation of the study, research design and methodology, organization of the study, the second chapter contains review of related literature, the third chapter contains about data presentation, analysis and interpretations and the forth chapter contains about summary, conclusions and recommendations.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1. Banking

2.1.1. An Overview of Banks and their Services

Banks are among the most important financial institutions in the economy. They are principal source of credit (loan able funds) for millions of households (individuals and families) and for most local units of government (school districts, cities, countries etc). Moreover, for small local business ranging from grocery stores to automobile dealers, banks are often the major sources of credit to stock the shelves with merchandise or to fill dealer's show room with new cars.

World-wide, banks grant more installment loans to consumers than any other financial institution. In most years, they are among the leading buyers of bonds and notes issued by government to finance public facilities, ranging from auditoriums and among the most important source of short-term working capital for business and have became increasingly active in recent years in making long term business loans for new business loans for new plant equipment (Ross 2006:89).

2.1.2. History of Banking in Ethiopia

The agreement that was reached in 1905 between Emperor Minilik II and Mr. Ma Gillivray, representative of the British owned National Bank of Egypt marked the introduction of modern banking in Ethiopia. Following the agreement, the first bank called Bank of Abyssinia was inaugurated in Feb.16, 1906 by the Emperor (www.nbe.gov.et).

After many revolution and challenges, the new bank called the state bank of Ethiopia acts as the central bank of Ethiopia and as the principal commercial bank activities until cases to exist by proclamation issued on December 1963. The national bank of Ethiopia (the country's central bank and financial advisor), the commercial bank of Ethiopia (which handed commercial operations), the agricultural and industrial development bank (established largely to finance state-owned enterprises), the saving and mortgage corporation of Ethiopia and the imperial saving and home ownership public association (which provide saving and services) where the major state-owned banks (ibid).

In January and February 1975, the government nationalized and subsequently recognized private and insurance companies. By the early 1980's, the country's banking system included NBE, the Addis Ababa bank, which was formed by merging the three commercial banks that existed prior to the revolution; the Ethiopian insurance corporations, which incorporated all the nationalized insurance companies, and the new housing and saving bank, which was responsible for making loans for new housing and home improvement. The pre 1994 Ethiopian banking industry was characterized by relatively less competition, low deposit mobilization, relatively high government intervention on their management and more loan access to state owned sector (ibid).

Following the change in the economic policy, financial sector reform also took place. Monetary and banking proclamation of the 1994 established the national bank of Ethiopia as judiciary entity, separated from the government. The banking proclamation of the 1994 has brought some changes in the credit policy of state commercial banks so to react to completion forces from new entrant and at the same time to retain and enhances their market share industry (ibid).

2.2. Credit

The word "CREDIT" is derived from Latin word creditum, which means to believe or trust. In economics the term credit refers to a promise by one party to pay another for money borrowed or goods or services receive. It is a medium of exchange to receive money or good or demand at some future date. It is the right to receive payments or the obligation to make payment on demand at some future time on account at the immediate transfer of goods (Jhinon, 2002:165)

2.2.1. Credit Management

Credit management is a term used to identify accounting functions usually conducted under the umbrella of Accounts Receivables. Essentially, this collection of processes involves qualifying the extension of credit to a customer, monitors the reception and logging of payments on outstanding invoices, the initiation of collection procedures, and the resolution of disputes or queries regarding charges on a customer invoice. When functioning efficiently, credit management serves as an excellent way for the business to remain financially stable (www.wisegeek.com).

The process of credit management begins with accurately assessing the credit-worthiness of the customer base. This is particularly important if the company chooses to extend some type of credit line or revolving credit to certain customers. Proper credit management calls for setting specific criteria that a customer must meet before receiving this type of credit arrangement. As part of the evaluation process, credit management also calls for determining the total credit line that will be extended to a given customer (Maurietal, 1996:87).

Several factors are used as part of the credit management process to evaluate and qualify a customer for the receipt of some form of commercial. This includes gathering data on the potential customer's current financial condition, including the current credit score. The current ratio between income and outstanding financial obligations will also be taken into consideration. Competent credit management seeks to not only protect the vendor from possible losses, but also protect the customer from creating more debt obligations that cannot be settled in a timely manner.

After establishing the credit limit for a customer, credit management focuses on providing the client with accurate and timely statements or invoices. The invoices must be delivered to the customer in a reasonable amount of time before the due date, thus providing the customer with a reasonable period to comply with the purchase terms. The period between delivery of the invoice and the due date should also allow enough time for the customer to review the invoice and contact the vendor if there are any questions or concerns about a line item on the invoice. This allows all parties concerned time to review the question and come to some type of resolution (www.wisegeek.com).

2.2.2. Credit Risk

Credit risk is the risk loss due to debtor's non-payment of loan or other line of credit. It is the potential variation in the net income and market value of equity resulting from this non-payment or delayed payment. Most lenders employee their own model potential and existing customers according to risk, and then apply appropriate strategies with products such as un secured personal loans or mortgages lenders charge price for higher risk customers and vice versa. Loans typically the exhibit the greater credit risk. Changes in general economic conditions and a firm's operating environment alter the cash flow available for debts service. These conditions are difficult to predict .similarly; an individual's ability to repay debts varies with changes in employment and personal net

worth. For this reason, banks perform a credit analysis on each loan request to assess a borrower's capacity to repay (Koch, 1995:185).

Credit risk is associated with the quality of assets and the likelihood of default. It is extremely difficult to assess asset quality because limited information is available. Credit risk measures focus predominantly on loan experience because loans exhibit the highest default rates. Most nations examine either net loan losses or non-performing loans. Growth loan losses (charge-off) equal the dollar value of loan actually written off as uncollectable during a period (Koch, 1995:187).

2.2.3. Types of Credit

As described by Encarta (2009:26), the principal classes of credit are as follows:

1. **Commercial credit**- in which merchants extend to one another to finance production and distribution of goods.
2. **Investment credit**- used by business firms to finance the acquisition of plant and equipment and represented by corporate bonds, long-term notes, and other proofs of indebtedness.
3. **Bank credit**- consisting of the deposits, loans, and discounts of depository institutions.
4. **Consumer or personal credit**- which comprises advances made to individuals to enable them to meet expenses or to purchase, on a deferred-payment basis, goods or service for personal consumption.
5. **Real-estate credit-** composed of loans secured by land and buildings.
6. **Public or government credit**- represented by the bond issues of national, state, and municipal governments.
7. **International credit-** which is extended to particular governments by other governments, by the nationals of foreign countries, or by international

banking institutions, such as the International Bank for Reconstruction and Development.

2.2.4. Credit Analysis

The objectives of consumer credit analysis to assess the risk associated with lending to individuals. Not surprisingly these risks different substantial from those of commercial loans. Most consumer loans are quit small, average around and $6,500 in 1993. Because the fixed cost of servicing consumer loans is high, bands must generate substantial loan volume to reduce unit costs. When evaluating loans, banks cite the cost of credit: character, capital, capacity, condition and collateral (Koch, 1995:201).

Credit standards influence the quality of firm's customers. The average collection period (ACP) determines number of days for which credit sales remain outstanding. The longer the average collection period, the higher the firm investment in account receivable. A loan officer essentially must determine the customers drive to repay a loan. The only quantitative information available is the borrower's application and credit record. If the borrower is a bank customer, the officer can examine internal information regarding the customer historical account relationship (CBE, 2006:56).

As stated by Ross (2006:36), once a firm decides to grant credit to its customers, it must then establish guidelines for determining who will and who will not be allowed to buy on credit. Credit analysis is important because potential losses on receivable can be substantial.

2.2.5. Components of Credit Policy

After a firm decides to grant credit to its customers, then it must establish procedures form extending credit and collecting. In particular as stated by Ross (2006:38), the firm will have to deal with the following component of credit policy;

1. **Term of sales-** In the term of sales establish how the firm propose to sale its goods and services**.** A basic decision is whether the firm will regular cash or will extend credit. If the firm does grant credit to customer, to term of sales will specify (perhaps simplicity) the credit period, the cash discount and discount period and the type of credit instrument.
2. **Credit analysis-** In general credit firm determines how much effort to extend trying to distinguish between customer who will pay and who will not pay. Firms use the number of devices and procedures to determine to probably that customer who will not pay, and put together, these are called credit analyses.
3. **Collection policy-** After credit has been granted, the firm has potential problem of collecting the cash, for which it must establish a collection policy.

2.2.6. Elements of an Effective Credit and Collection Policy

According to (www.credit-to-cash-advisor.com), there are six elements of an effective credit and collection policy, these are the following;

1. Mission Statement- A thoughtfully designed mission statement is basic to a functional credit and collection policy. The mission statement should define the purpose of the credit department and express the long-range focus of the policy within the framework of the organization's mission as a whole.

A key point to consider when developing the Mission Statement: the primary purpose of every credit department should be to maximize sales within the framework of the organization's "appetite for risk".

2. Statement of Goals- Goals should track with current market conditions and the strategic direction of your organization. In addition, they should

function as drivers to improve receivable management. Therefore, goals must be linked to targets and monitored and measured against established metrics.

Many credit departments utilize the following metrics in establishing goals:

- DSO – Days Sales Outstanding
- CEI – Collection Effectiveness Index
- Aging Bucket Performance
- Percent Current
- Bad Debt Write-off Percentage

3. Credit Department Organization- Including a section in the policy that spells out specific roles, responsibilities and especially levels of authority of the various credit and collections staff streamlines operations, prevents redundancy and improves productivity.

4. Credit Evaluation and Approval Process-The most important function of this section of the policy should be to:

1. Define what your company considers an "acceptable" credit risk.
2. Outline a credit evaluation process that allows for quick, consistent and objective decision making and, thus, delays as few orders as possible.
3. Assign credit limits to every acceptable account to minimize the need for manual intervention to release orders. Items that should be covered:

    - **Credit terms-** Your terms may differ by product line and location of the customer (domestic or international, country by country). However, keep exceptions to the minimum and ensure they are based on competitive practices and generate a satisfactory return on investment.

- **Credit evaluation process.**
  - Do you require a signed credit application?
  - When do you require financials? What types of financial statements are acceptable? What ratios are used to analyze financial information?
  - What third-party sources do you utilize: credit bureau reports, credit references, bank references, public records, industry credit group?
  - Do you use a credit scoring system? What and how?

- **Credit limits-** How are credit limits calculated and assigned?
- **Substandard and unacceptable credit risks-** Saying "no" to credit should not negate the sale. Have a plan in place to: (1) notify the customer **and the sales department**; (2) outline acceptable forms of security or collateral; (3) offer alternative methods of payment; and especially, (4) describe when you will reevaluate the account, and how the customer can become creditworthy.

5. Credit Continuation Procedures- Granting, or withholding credit facilities should never be considered a one-time decision. Today's business climate is erratic, to say the least. Companies that appeared secure six months ago may now be on the verge of collapse. It's essential to continually monitor your receivables portfolio to ensure you are maintaining an overall appropriate level of risk. Items to cover in this section:

- **Incentives for prompt payment-** If you find your DSO (days sales outstanding) isn't tracking where you'd like, you might consider discounting invoices for early payment, or charging interest on late payment.
- **Frequency of and procedures for credit re-evaluation-** It's good practice to schedule all or a portion of your larger accounts (using

the 80:20 rule) for routine review, so you can quickly revise limits based on changing levels of creditworthiness.

- **Procedures for approving orders when a customer has reached its credit limit.**

6. Collection- Uncollected dollars nibble away at your company's cash flow and profitability, and can ultimately threaten its very survival. A survey by the Commercial Law League of America revealed that after three months, the probability of collecting delinquent accounts drops to 73%. After 6 months, collectability drops to 50%. And after 1 year, collectability is just 25%. It's essential that you have a plan in place to follow up on *every* past due account.

- **When and how to contact a delinquent debtor-** You'll be best served by developing a treatment plan matrix (sample below), which can be customized by account size, or product, etc. Phone scripts, collection letters, escalation plans for each level should also be included.

2.2.7. Steps in the Lending Procedures

According to National bank of Ethiopia (2002:12), in order to quality loan the following steps are important;

1. The applicant should submit the basic documentary requirements, which include;

- Application letters
- Valid business license
- Articles and Memorandum of association
- Auditing financial statements for all share company
- Powers of attorney
- Performa invoice
- Sales agreement

- Concluded contracts
- Land holding certificate and Vehicle ownership booklet
- Testimonial letters
- Bank statement

2. The purpose of the request should be clearly stated

3. Evidence should be submitted that would show the profitability of the business

4. In the investment of project, financial and economic rates of returns should be stand tested against national parameters for their acceptability

5. The business should have at least one year of operational expense

6. Unless treated exceptional, sufficient collateral acceptable to bank is offered

2.2.8. Parts of a Typical Loan Agreement

As stated by Rose (1999:142), the following are parts of a typical loan agreement:

The Note- When a bank grants a loan to one of its customers, such as an extension of credit is always accompanied by a written contract with several different parts. First, there is a note, signed by the borrower, which specifies the principal amount of the loan. The face of the knot will also indicate the interest rate attached to the principal amount and the terms under which repayment must take place (including the dates on which any installment payments are due).

Loan commitment agreement- In addition, large business loans and home mortgage loans often are accompanied by loan commitment agreements, in which the bank promises to make credit available to the borrower over a

designated future period up to a maximum amount in return for a commitment fee (usually expressed as a percentage-such as 0.5 percent-of the maximum amount of credit available).

Collateral- Bank loans may be either secured or unsecured. Secured loans have a pledge of some of the borrower's property behind them (such as a home or an automobile as collateral that may have to be sold if the borrower has no other way to repay the bank. Unsecured loans have no specific borrow assets pledged behind them; these loans rest largely on their reputation and estimated earning power of the borrower.

Covenants- Most formal loan agreements also contain restrictive covenants, which are usually one of two types: affirmative or negative.

1. Affirmative Covenants- require the borrower to take certain actions. Such as periodically filing financial statements with the bank, maintaining insurance coverage on the loan and on any collateral pledged, and maintains specified levels of liquidity and equity.

2. Negative Covenants-restrict the borrower from doing certain things without the bank's approval, such as taking on new debt, acquiring additional fixed assets, participating in mergers, selling assets, or paying excessive dividends to stockholders.

2.2.9. Non-Performing Loan

In the Ethiopian context, NBE directive No.SBB/32/2002 define non-performing loans as loans whose credit quality has deteriorated, full collection of principal and/or interest in accordance with the contractual terms of the loan is in question.

Non-performing loans are those in which borrowers are experiencing some repayment problems. Past–due loans represent loans for which counteracted

interest and principal payments have not been made within 90 days after the due date. Classified loans are those that bank regulators have forced management to set aside as reserves for clearly recognized losses.

Loans are designated as non-performing when they are placed on nonaccrual status or when the terms are substantially altered in a restructuring. Nonaccrual means that banks deduct all interest on the loans that was recorded but not actually collected. Banks have traditionally stopped accruing interest t when dept payments were more than 90 days past due. However, the interpretation of when loans qualified as past due varied widely. Many banks did not place loans on nonaccrual if they were brought under 90 days past due by the end of the reporting period. This permitted to make late partial payments and the banks to report all interest as accrued, even when it was not collected. On occasion, would lend the borrower the funds that were used to make the late payment (Koch, 1995:234).

The impact of this practice on financial statements is twofold. First, non-performing loans are understood on the balance sheet, so credit risk is actually higher than it appears. Second, interest accrued but not collected increases net interest income, thus overstating Net interest Margins, Return on Assets, and Return on Equity (Koch, 1995:235).

CHAPTER THREE

DATA PRESENTATION, ANALYSIS AND INTERPRETATIONS

This chapter deals with the presentation and analysis of major finding of the research. The findings are based on the data collected through questionnaires distributed and interviews conducted during the data collection phase of the research. The collected questionnaires from the employees and their responses are presented and analysis by using descriptive technique in the form of tables and percentages.

The researcher have distributed 18 questionnaires to employees of Credit Management Department, among them 17 questionnaires were returned. This shows 94% of the distributed questionnaires were returned. The collected questionnaires from the employees and their response are presented in this section.

Table 3.1. Respondent Background Information

No	Items	Options	No.	%
1	Age	Below 25 years	3	18
		25 - 35 years	6	35
		35 – 45 years	7	41
		Above 45 years	1	6
		Total	**17**	**100**
2	Sex	Female	7	41
		Male	10	59
		Total	**17**	**100**
3	Education background	Certificate/diploma	3	18
		1st degree	9	53
		2nd degree	5	29
		Total	**17**	**100**
4	Work experience	Below 5 years	9	53
		5 – 10 years	7	41
		10 – 15 years	1	6
		Above 15 years	0	0
		Total	**17**	**100**

As shown in item 1 of table 3.1, 3(18%) respondent were below 25 years, 6(35%) respondents were 25 - 35 years, 7(41%) respondents were 35 – 45 years and 1(6%) respondent were above 45 years. This indicates that most of the respondents are capable of doing their work properly because it is energetic age to work.

As shown in item 2 of table 3.1, 7(41%) respondent were female and 10(59%) respondent were male. This shows that most of the respondents are male.

From table 3.1 item 3 shows that 3(18%) respondents have certificate / diploma, 9(53%) respondents have 1st degree and 5 (29%) respondents have 2nd degree. From this one can say that most of the employees are degree holder how can be provided to upgrade and develop their knowledge, skill and attitude in order to contribute extra effort to achieve the bank mission and vision.

From table 3.1 item 4 shows that the work experience of respondents, among the respondents 9(53%) were served below 5 years, 7(41%) were served 5 – 10 years, 1(6%) were served10-15 and no one is served above 15 years. This indicates that most of the respondents were served below 5 years so it helps to gather the current information for our study.

Table 3.2. Repay of Customers Obligation as Per the Scheduled Time

Item	Options	No.	%
Do you believe that your customers repay their obligation as per the scheduled time	Yes	6	35
	No	11	65
	Total	**17**	**100**

As shown in the table 3.2 concerning opinion the respondent about the repay of the customer's obligation as per the scheduled time, 6(35%) believe that the customer repay their obligation as per the scheduled time and 11(65%) believe that the customer doesn't repay their obligation as the scheduled time. This shows that most of the bank's customer doesn't repay their obligation as per

the scheduled time so the non-performing loan will be increased because of the customers' inability to repay their loan.

Table 3.3. The Probability for the Collection of Loan

Item	Options	No.	%
Probability of the collection of loan	Proper collection	7	41
	Improper collection	10	59
	Total	**17**	**100**

As shown in the table 3.3, 7(41%) of the respondents respond that collection is properly done while 10(59%) respond that there is improper collection of loan. This indicates that the bank has inability to collect the loan from customers. The respondent state that the reasons behind improper collection are, lack of credit analysis and over lending.

Table 3.4. The Effectiveness of the Bank's Credit Analysis before Approve the Loan

Item	Options	No.	%
Effectiveness of the bank's credit analysis before approve the loan	Very good	3	18
	Good	5	29
	Neutral	7	41
	Poor	2	18
	Very poor	0	0
	Total	**17**	**100**

As shown in the table 3.4 the respondents responds about the effectiveness of the bank's credit analysis before approval of the loan, 3(18%) respondents said very good, 5(29%) said good, 7(41%) said neutral, 2(12%) said poor and no one is said the credit analysis is very poor. This indicates that the effectiveness of the bank's credit analysis before approve the loan is mostly neutral. That means the bank doesn't make enough credit analysis before approve the loan.

Table 3.5. The Adequacy of Loan Collection Effort of the Banks

Item	Options	No.	%
Adequacy of Loan Collection Effort	Very good	2	12
	Good	7	41
	Neutral	6	35
	Poor	2	12
	Very poor	0	0
	Total	**17**	**100**

As shown in the table 3.5, concerning about the adequacy of loan collection effort of the banks the respondent answered 2(18%) respond very good, 7(41%) respond good, 6(35%) respond neutral, and 2(18%) respond poor and there is no respondent who said the adequate of loan collection effort is very poor. This indicates that adequacy of collection of the bank is good. That means the bank have a good effort to collect the loan that grants to the customers.

Table 3.6. The Measure of the Bank's Follow up Method

Item	Options	No.	%
Bank's follow up method	Very strong	6	35
	Strong	7	41
	Medium	4	24
	Weak	0	0
	Very weak	0	0
	Total	**17**	**100**

As shown in the table 3.6, concerning about measure the bank's follow up method from the respondents 6(35%) said very strong, 7(41%) said strong, 4(24%) said medium and there is no respondent who said the follow up method is weak and very weak. The above data shows that majority of the respondent

7(41%) said that the bank's follow up method is strong. This indicates that the bank's follow up methods done in effective and efficient manner.

Table 3.7. The Effect of Non-Performing Loan on the Profitability of the Bank

Item	Options	No.	%
Non- performing loan affect the profitability of the bank	Strongly agree	6	35
	Agree	4	23
	Neutral	2	12
	Disagree	3	18
	Strongly disagree	2	12
	Total	**17**	**100**

As shown in the table 3.7, concerning about the effect of non-performing loan on the profitability of the bank's from those respondents 6(35%) were strongly agree, 4(23%) were agree, 2(12%) were neutral, 3(18%) were disagree and 2(12%) were strongly disagree. This shows that majority of the respondent strongly agree 6(35%) so, one can say that the non-performing loan have negative impact on the profitability the bank.

Table 3.8. The Techniques Used by the Bank to Reduce Non-Performing Loan

Item	Options	No.	%
Techniques used by the bank to reduce non-performing loan	Very good	1	6
	Good	5	29
	Neutral	5	29
	Poor	6	35
	Very poor	0	0
	Total	**17**	**100**

As shown in table 3.8 the respondent measure the techniques used by the bank to reduce non–performing loan. From those of the respondents 1(6%)

were said very good, 5(29%) were said good, 5(29%) were said neutral, 6(35%) were said poor and no one is said very poor. This shows that majority of the respondent 6(35%) said poor, that indicates the techniques used by the bank to reduce non-performing loan is not sufficient or the bank don't have well design and implemented techniques.

Note: 3, 2 and 1 point given for 1st, 2nd and 3rd rank respectively for table 3.9 up to 3.13.

Table 3.9. The Problem that the Bank Faces For the Proper Collection of Loan

Item	Options	Ranks			Value	Total	%
		1st x3	2nd x2	3rd x1			
The problem that the bank faces for the proper collection of loan	Lack of credit analysis	8	4	5	24+8+5	37	36
	Over lending	6	63	8	18+6+8	32	31
	Lack of proper follow up	3	10	4	9+20+4	33	33

As shown in the table 3.9, 36% of the respondents rank lack of credit analysis as a 1st problem, 31% of the respondents rank over lending as a 2nd problem and 32% of the respondents rank lack of proper follow-up as a 3rd problem that the bank faces for the proper collection of loan. This indicates that the main problem that the bank faces for the proper collection of loan is lack of credit analysis.

Table 3.10. The Effect of Non-Performing Loan to the Bank

Items	Options	Ranks			Value	Total	%
		1st x 3	2nd x2	3rd x1			
The effect of non-performing loan to the bank	Decreasing net income	4	5	8	12+10+8	30	29
	Increasing its expense for provisioning	7	6	4	21+12+4	37	36
	Affecting the earning capacity of the bank	6	6	5	18+12+5	35	35

As shown in the table 3.10, the respondents rank the effect of non-performing loan to the bank and 29% of the respondents rank decreasing net income as a 1st effect, 36% of the respondents rank increasing its experience for provisioning as a 2nd effect and affecting the earning capacity of the bank as a 3rd effect. This indicates that the non performing loan has greatest effect by increasing its expense for provisioning so it causes an additional cost to the bank.

Table 3.11. The Methods Used by the Bank to Reduce the Balance of Non-Performing Loan

Item	Options	Rank			value	Total	%
		1st x3	2nd x2	3rd x1			
The Methods Used by the Bank to Reduce The Balance of Non-Performing	By giving credit awareness	8	5	4	24+10+4	38	37
	By giving relevant training	4	6	7	12+12+7	31	30
	Deficient and proper follow up	5	6	6	15+12+6	33	32

As shown in the table 3.11 the respondents rank the methods used by the bank to reduce the balance of non- performing loan and 37% of the respondent rank giving credit awareness as a 1st method, 30% of the respondents rank giving relevant training as a 2nd method and 32% of the respondents rank deficient and proper follow up as a 3rd method. This indicates that mostly the bank gives credit awareness to reduce the balance of non-performing loan this is also indicates that giving credit awareness is not the best method to reduce the balance of non-performing loan because the percentage of non- performing loan was increase from 3.23% to 3.6%.

Table 3.12. The Signals for Non-performing Loan

Item	Options	Ranks			Value	Total	%
		1st x 3	2nd x 2	3rd x1			
Signals for non performing loan	Bad market report	2	5	10	6+10+10	26	25
	legal suit and notices by other creditors	5	6	6	15+12+6	33	32
	Request for rescheduling	10	6	1	30+12+1	43	42

As shown in the table 3.12, 25% of the respondents rank bad market report as a 1st signal, 32% of the respondents rank legal suit and notices by other creditors as a 2nd signal and 42% respondent rank request for rescheduling loan repayment as a 3rd signal. This indicates that most of the customer's request the bank to rescheduling the loan repayment when they are not capable of repaying their loan based on the schedule agreed with the bank.

Table 3.13. The Action taken by the bank if the customer unable to pay the loan

Item	Options	Ranks		Value	Total	%
		1st x 3	2nd x 2			
The action taken by the bank if the customers unable to pay the loan	Sale of collateral	6	11	18+22	40	47
	Give time to repay their loan	11	6	33+12	45	53

As shown in the table 3.13, the respondents rank the action taken by the bank if the customers unable to pay the loan from those of the respondents 47% of the respondents rank sale of collateral as a 1st action and 53% of the respondents rank give time to repay their loan as a 2nd action. This indicates that the bank gives time to the customer in order to repay their loan this is because as the manager of the credit management department said that the bank doesn't have interest to sale the collateral and sale the collateral affects the relationship of the bank and its customers.

According to the interview made with the concerned body the following data were collected.

The causes of the NPL- can be categorized in to two groups as internal and external factor as follows:

As Internal Factors:

- Lack of consolidation and communicating with defaulter
- Over stating the collateral at the time of estimation
- Lack of credit information
- Agency problem.

As External Factors:

- Diversion of borrowed fund to other purposes
- Unavailability of demand and price fluctuation on both local and international market
- Country economic and political condition
- Impact of change fiscal and monetary policy
- Insufficient credit awareness
- Unwilling customer to disclose the information required
- Willful default

With regard to methods applied to reduce NPL the following methods were given:

Compromise: is settlement of dispute reached by mutual concession, the following are detail guidelines for compromise settlements of non-performing loans.

Restructuring (rescheduling): It is the changing of the term and condition of loan with the aim of meeting the lending with the aim of maintains the landing with the borrower. As a workout strategy restructuring is done under modifies agreement that the existing outstanding loan is paid over additional period of time or within the existing period of time. It can be possible either through cash payments, offering of additional collateral or through the realization of collateral with the agreements of the borrower.

Regular training: The all levels of executives are compelling to intergrowth the regular training program on credit and non performance loan management. It is very useful and helpful to the executives for dealing the non-performance loan properly.

Write Offs: It is also one of the common management techniques of non-performance loans. If negotiation or legal action could not result in recovery of the loan and we are sure that there are no properties in the name of the borrower and same is substantiated by evidencing documents, the branch should recommend the loan balance for write- off from the account of the bank. The assets are treated as loss assets, when the bank writes off the balance. The ultimate aim of the write off is to clean the balance sheet.

Sport Visit: The bank officials should visit to the borrower's business place or borrowers field regularly or periodically. It is also help full to the bank control or reduce the non-performing loans limit.

Legal Remedies: The legal remedies are one of the methods of management of non-performance loans. The banks observed that the borrower is making willful default; no more time should be lost instituting appropriate recovery proceedings. The legal remedies are filling of civil suits.

Other methods may include: Persistent phone calls and Medias announcement.

Interview response with regard to the effect of NPL on the profitability of the bank is the following:

The increase in nonperforming loan has an adverse effect on the bank's profitability that means the amount of money the bank should allocate for provisioning will be increasing and making the banking the banks net income decrease. Despite the increase in total profitability of the bank year after year the increasing trend in the number and amount of non-performing loan has forced the bank to increase its expense for provisioning. Hence increase in the amount provisioning leads to decrease in the amount at that income to be declared.

Finally interviewee's response with regard to the mechanism used by the bank to follow up the loan repayment is the following:

Physical Follow-up. It helps to ensure existence and operation of business, status of collateral properties correctness of declared financial data, conformity of financial data with other records.

Financial Follow-up. It helps to verify whether the assumption on which lending decision was taken continues to hold good both in regard to borrower's operation and environment, and whether the end use is according to the purpose for which the loan was given.

Legal Follow-up. It helps to insure that the legal recourse available to the Bank is kept alive at all time. It consists of obtaining proper documentation and keeping them alive and registration. Specific issues pertaining to legal follow up include: ascertain whether contract are properly executed by appropriate person and documents are complete in all aspects, insuring loan contracts are updated timely and examining the regulatory directives, laws, third party claims among others.

CHAPTER FOUR

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This study was intended to assess the credit management of Awash International bank in the year 2012 and the basic research questions are: what are the major causes for NPL, how does the NPL affect the profitability of the bank, what are the mechanisms used by the bank to follow up the loan repayment and what are the techniques used by the bank to reduce NPL.

To conduct this study the student's researchers collected data through questionnaires and interview. The researchers have distributed 18 questionnaires to employees of credit management department, among them 17 questionnaires were returned. This shows that 94% of the distributed questionnaires were returned.

4.1. Summary

Based on the presentation, analysis and interpretation of the data shown in the chapter three the following are summary of the major finding:

- While 7(41%) are female and 10(59%) are male respondents.
- Regarding their age 3(18%), 6(35%), 7(41%), and 1(6%) are below 25 years, 25-35,35-45, above 45 year respectively.
- Regarding their educational background 3(18%), 9(53%), and 29(%) are the holder of certificate or diploma, 1st degree and 2nd degree respectively.
- About the work experience of the respondents 9(53%) are below 5 years, 7(41%) are 5-10 years and 1(6%) are 10-15 years.
- Regarding the response about repay of customer obligation as per the scheduled time 6(35%) were said yes and 11(65) were said no.
- While 7(41%) are said there is proper collection of loan and 10(59%) are said there is improper collection of loan.

- Concerning about the adequacy of loan collection effort of the bank 2(12%), 7(41%), 6(35%) and 2(12%) are said very good, good, neutral and poor respectively and no one is said very poor.
- Regarding the measure of the bank's follow up method 6(35%), 7(41%), 4(24%) of the respondents measure as very strong, strong and medium respectively and no one is measure it as weak and very weak.
- According to the finding about the effect of NPL on the profitability of the bank and from the responds 6(35%) were strongly agreed, 4(23%) were agreed, 2(12%) were neutral, 3(18%) were disagree and 2(12%) were strongly disagree.
- With regard to the finding about the techniques used by the bank to reduce NPL 1(6%), 5(29%), 5(29%) and 6(35%) of the respondents were said very good, good, neutral and poor respectively and no one is said very poor.
- Based on the finding about the problem that the bank faces for the proper collection of loan lack of credit analysis, proper follow up and over lending ranked by the respondents from 1st to 3rd respectively.
- Regarding the effect of NPL to the bank increasing its expense for provisioning, affecting the earning capacity of the bank and decreasing net income respectively ranked by the respondents from 1st to 3rd.
- According to the finding, responses concerning about the methods used by the bank to reduce the balance of NPL, giving credit awareness, deficient and proper follow up and by giving relevant training ranked by the respondents from 1st to 3rd respectively.
- Regarding the signals for NPL request for rescheduling loan repayment, legal suit and notices by other creditor and bad market report respectively ranked by the respondents from 1st to 3rd respectively.
- Regarding action taken by the bank, if the customer unable to pay the loan ranked first and second for giving additional to repay their loan and sale of collateral respectively.

- Internal and external factors are the causes for NPL, some of the methods used by the bank to reduce NPL are: compromise, regular training and spot visit.

4.2. Conclusions

Based on the above summary the following are conclusions are drawn:

- Most of the respondents are male.
- Almost all of the respondents are below 45 years age. Within this age group employees have willingness and power to create good image building and to satisfy customer service.
- Majority of the respondents are the holder of 1st degree and 2nd degree so most of the respondents are skilled and well trained and they are capable of responding reasonable responses.
- Most of the respondents have work experience of below 5 years. With year of experience employees have more initiation to work because most of them have fresh mind and interest to work.
- From the customers' majority of them are not repaid their loan as per the schedule time. With regard to this fact the amount of non-performing loan becomes more and more.
- NPL have an impact on the profitability of the bank. If the NPL increase their will be an adverse impact on the profitability of the bank because it leads the bank to additional expenses and additional cost for provisioning. The increasing in the amount provisioning leads to decreasing in the amount of income to be declared.
- The techniques that the bank uses in order to reduce the balance NPL are in a poor manner with its techniques the bank couldn't reduce NPL because they are not well design and implemented.
- The major problem of the bank that faces for the proper collection of loan is lack of credit analysis that means the bank doesn't made enough credit analysis when loans are granted to the customer.

- Request for rescheduling loan repayment is the major signal for the NPL to the bank. That means, when most of the customer are not capable to repay their obligation they goes to the bank and ask the bank to reschedule loan repayment.
- Most of the time the bank doesn't wants to sale of collateral of the customer rather the bank give time to repay their loan, in order to made smooth relation with its customer.
- The major causes for NPL in Awash International bank are internal and external factors. Internal factors are like: overstating the collateral at the time of estimation and lack of credit information to be gathered from another commercial bank. External factors include diversion of borrowed fund to another purpose, country economic and political condition and insufficient credit awareness.

4.3. Recommendations

Based on the findings and conclusions drawn the following recommendations are forwarded:

- The bank should provide loan advisory service because it helps to improve the loan collection performance.
- Training about credit analysis should be given by the bank to the employees because it is one of the important mechanisms to upgrade the performance and skill of employees. It also helps to minimize the balance of NPL.
- The bank should make efficient credit analysis by observing the financial performance of the borrower and the profitability rate of the loan applicant. This kind of analysis helps the bank to increase its income and profitability.
- The bank should make loan rescheduling to the customers based on the detail assessment, strong justification and convincing cases are presented to the bank.

- Management need to ensure that borrowed funds are being used for the intended purpose through enhanced credit monitoring.

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