

ST.MARYS UNIVERSITY
BUSINESS FACULTY
DEPARTMENT OF ACCOUNTING

AN ASSESSMENT OF CREDIT MANAGEMENT PRACTICE
IN DASHEN BANK

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JUNE 2014
ADDIS ABABA

AN ASSESSMENT OF CREDIT MANAGEMENT PRACTICE IN DASHEN BANK

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

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FOR THE DEGREE OF BACHELOR OF ARTS IN
ACCOUNTING***

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ABSTRACT

The study examined the Credit Practice and Management of Dashen bank. It is one of private banks in Ethiopia playing an important role in the country's economy and social life.

Among the various services provided by the bank, lending has been the primary activity. Lending activities require banks to make judgment related to the credit worthiness of a borrower. However, the judgment is not always proved to be accurate and the credit worthiness of a borrower may decline overtime due to various factors. Consequently, banks face credit risks that the borrower may fail to meet the terms of the underlining loan agreement.

Due to improving its service and increasing its branch networking, Dashen Bank performing well in deposit mobilizing and loan disbursement over the last decade. In the lending front, through the balance of outstanding loan has been increasing at increasing growth rate during this period.

The researcher investigated the major factors which exposed the bank to risk. The research has preliminary importance to reduce the causes and problems associated with the non performing loans, and enrich and update the knowledge of the reader on the loan and advance process of Dashen Bank.

The researcher used both primary and secondary data gathering method. The secondary data was obtained from different manuals, literatures & internal reports. The primary data was collected through questionnaires and interview of Credit Officials of the bank. Based on the questionnaire the primary data was gathered, analyzed and interpreted, by using explanatory types of table, graphs and percentages.

Finally, it was concluded that the major problem should be solved and credit risk of the bank should be minimized. Precaution should be exercised by all credit processing and approving personnel in dealing with financial analysis. At last some viable solutions are recommended.

Declaration

We the undersigned, declare that this senior essay/project is our original work, prepared under the guidance of **Belayneh Hailegeorgis**. All sources of materials used for the manuscript have been dually acknowledged.

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CHAPTER ONE

1. Introduction

1.1 Background of the study

Credit management is the process for controlling and collecting payments from your customers. A good credit management system will help you reduce the amount of capital tied up with debtors (people who owe you money) and minimize your exposure to bad debts.

Good credit management is vital to your cash flow. It is possible to be profitable on paper and but lack the cash to continue operating your business.

Economic activities such as the Production process, Marketing, Agricultural activities, Trade transactions and Services etc, had played greater role in the development of banking system through the use of money.

One of the important factors of economic growth is the establishment of strong financial sector. In this regard, one of the main objectives of financial institutions is mobilizing resources and channeling them to investors and generate a profit out of it.

Loans are the most important assets held by banks, and bank lending provides the bulk of bank income. It is equally true that bank loans, as they are profitable, are equally risky. Among other things, Bank loans fluctuate and influenced by the changes in economic policy and the economy in general. Therefore, it is very important for the banks to formulate their loan policies in order to minimize the risk associated with them. Besides, sound and complete loan policy has great advantage to the banks. It helps the officials to handle loan issues uniformly, avoid confusion and misunderstanding and ease management. Transparency in lending practices emanates from sound loan policy. (Temesegen Zeleke, 2007, City University College,)

In the world of competition, the survival of any organization is directly dependent on the strategy how the firm maximizes profit and minimizes cost. Effective and efficient use of resources in general and of finance in particular in any organization is paramount importance for the improvement of productivity of the organization and for the country's economic growth and development. The effect of good loans and advances process has contributed a lot to the growth of the bank and has an effect in extending itself into the

economy at large. Hence the bank is concerned about the quality of its credit procedure and techniques. (Dashen Bank Credit Training Material, 2001, Addis Ababa)

Banks are mainly concerned with accepting deposits for the purpose of lending or investment. In any country economy, there will be people and institutions with surplus funds which they do not require for their immediate use, and wished to place these surplus funds in an institution both for security and also to gain some income by way of interest. This institution would then lend the money to the borrowers at an interest ultimate best rate higher than what they pay to their depositors. (Mengistu G/hiwot, 2007, Addis Ababa)

Banks are the most important intermediaries in the financial world One of these financing institutions is bank. With this respect, banks pay a major role in the overall economic development of a country.

Therefore, in extending loans to the public, banks have to be certain about efficient and effective performance of loans and advances. Thus, this research focuses on assessing the credit management and practice and its impact on the bank's performance.

When we come to the study area, the history of banking in Ethiopia goes as far back as 1905, when the first bank – The bank of Abyssinia was established under the arrangement between the emperor Menelik II and European banking group which was behind the National Bank of Egypt. The establishment of financial institution in Ethiopia, designed to collect and channel savings to productive investment, dates back to 1942, when the State Bank of Ethiopia was created by the imperial charter. The bank combined the function of central bank and commercial bank until December 1963, when it was split into the National Bank and Commercial Bank of Ethiopia. The central banking function was thus taken over by the National Bank of Ethiopia. This period was also characterized by emergent of specialized banks like Agricultural Bank of Ethiopia and Investment Bank of Ethiopia and private banks like Banco De Roma (Ethiopia) and Banco De Napoli (operate in Asmara for many years). (Belay Gidey, 1994)

In the post revolution period, financial sector institutions were nationalized and consolidate into specialized banks. At that period the country was followed the socialist economic system. Hence, all banks including National Bank of Ethiopia were thought to function as

government to favor and promote the development and sustenance of the socialized sectors (cooperatives).

In the reform period, after 1991, the Ethiopian financial sector structures adjusted in the form of re-establishing the already existing banks in new form and allow privatization of financial institutions. Along with this reform all private banks began operating on the objective of making profit as other business. And National Bank of Ethiopia, as sole regulator and supervisory organ, set rules and regulations in order to maintain the operation of all banks should be to the aim of integrating the economic growth of the country.

Dashen bank is a privately owned company established in 1995 in accordance with the “Licensing and Supervision of Banking Business proclamation no.84/1994” of National Bank of Ethiopia to undertake commercial banking activities. The Bank obtained its license from the National Bank of Ethiopia on 20 September 1995 and started normal business activities on the first of January 1996. Presently, it operates through its head office in Addis Ababa and branches established within and outside Addis Ababa.

1.2 Statement of the Problem

Bank credit can be defined as money provided by the banks for eligible customers to support execution of legally formed profitable business or investment activities that have economic importance, with an agreement to pay back the principal with interest within the period specified in the loan contract.

Loans are the most important resources held by banks. Lending activities require banks to make judgment related to the credit worthiness of a borrower.

However, the judgments do not always prove to be accurate and the credit worthiness of a borrower may decline due to various factors. Consequently, banks face credit risks. Credit risk is the risk that obligations will not be repaid on time and fully as expected or contracted, resulting in a financial loss or non performing loans. The borrower may fail to meet the terms of the underlining loan agreement. (Lulseged Teferi, 2002, Addis Ababa)

Therefore, Dashen Bank is one of private banks in Ethiopia playing an important role in country’s economy and social life. Among the various services provided by the bank, lending has been the primary activity for over a decade. It advances a large sum of its income to borrowers. It is equally true that bank loans, as they are profitable, equally risky.

Bank loans fluctuate and influenced by the changes in the economic policy and the economy in general. It is very important for the banks to formulate and update their loan policies in order to minimize risk associated with them. (Ibid)

This research investigates the credit approval procedure and credit management of Dashen Bank to find out:

- The efforts that credit department extended to assure the repayment of the loans and advances.
- Moreover the action that Dashen Bank has taken so far in the past to control or minimize the bank's NPL.
- The effect of Non-Performing Loans (NPL) on the bank.
- The threat being encountered in terms of implementing the credit policies and manuals.

1.3 Basic research question

- What follow up mechanism of the bank uses after granting the loan?
- What measures did Dashen Bank taken in the past to control or minimize the bank's NPL?
- What are the effects of NPL on the bank?
- What problems associated with implementing policy manual of the bank as desired?

1.4 Objective of the Study

It is important to conduct critical assessment of the viable factors, which determine approval of credit mechanisms and evaluation of acceptability of loan request presented using appropriate standards. The objectives of the study are described as follows.

General Objectives

General objective of the study is to assess the credit management practice of Dashen Bank.

Specific Objective

- o To examine the effort that the credit department of the bank extends to assure the repayment of loans.
- o To assess the procedures that the bank has used to reduce the amount of non-performing loans in the past.

- o To identify the effect associated with the non-performing loans (NPLS) in DB.
- o To assess the problems associated with implementing policy Manual of the bank.
- o To explore the essence of credit follow up and reviewing the follow up systems and timely settlement of loans.

1.5 Significance of the Study

The researcher strongly believes that this research helps to minimize the causes and problems associated with non-performing loans. In addition, it helps as a preliminary study for others who are more interested in this area. Moreover, it enables the bank to take any remedial action based on the findings of the study.

The result of this study:

- It is intended to enrich and update the knowledge of the reader on the loan and advance process of Dashen Bank and to see how the process they develop is used as a measure of their success.
- It would help the officers and analysts to be aware of what is expected from them as professional in managing the loan and advance process, which is a very important part of the Bank.
- It could provide the basis for planning and using efficient and effective loan and advance program in the organization.
- It would enable the concerned government body to see the loan and advance of the bank and its legal implications.

1.6 Scope & Delimitation of the Study

Credit Management and Practice is a broad area which needs due consideration in meeting the objectives of the bank. Thus, it should be studied in depth. However, our scope between 2011 up to 2013 G.C, the study is delimited to selected area of Credit Department at H.O and Main Area Bank.

1.7 Research Methodology

In conducting this study, both primary and secondary sources of data are used. Regarding the primary data source, the researcher tried to obtain information in distributing questionnaire, through direct personal interview with concerned officials of Dashen Bank

Sh. Co. & observation. Regarding the secondary data sources, the researcher gathered data from company manuals & annual reports of the bank.

1.7.1 Research design

In attempting to assess the credit management, the data is designed to use descriptive method.

1.7.2 Population and Sampling Technique

From a target population of 250 employees at head office and Main Area bank, 40 employees are randomly selected using purposive sampling technique to distribute questioners and conduct interview with the credit manager of Dashen bank based on judgmental sampling technique.

1.7.3 Method of data collection

As it is indicated above, both primary and secondary data are used. The primary data are obtained through distributing questioners and through conducting interview with the credit manager. Regarding the secondary data source we use company manual and annual report of the bank.

1.7.4 Data Analysis methodology

In attempting to assess the credit management practice of the bank, the study used a descriptive approach in addition to representing the collected data in terms of tabulation and percentage.

1.8 Limitation of the Study

Getting well organized information is the major limitation of this study. Anxiety and lack of confidence of respondents to give detail information in the questionnaires are became an additional problem for the study. Since banks are profit making organizations and most information are held secret, assessing information as needed became difficult.

1.9 Organization of the Paper

This study is organized in four chapters. The first chapter deals with the Introduction. The second chapter focuses on the literature review and it is followed by the third chapter i.e; data presentation and analysis. The last chapter presents summary, conclusion and recommendation part of the study.

CHAPTER TWO

2. Literature Review

2.1 Theoretical Review

The purpose of this chapter is to describe and document what has been written and recorded in different manuals, literatures and authors about Bank Credit Management and Practices. For this particular study, the researcher has documented the views, concepts and definitions forwarded from selected manuals and authors on “Credit Management and Practice”. In short it summarizes the conceptual framework for this study.

2.1.1 Definition and Meaning

The word credit is derived from the Latin word *credium*, 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 received. It is a medium of exchange to receive money or goods on demand at some future date. (ML JhiNGan, 2002, New Delhi)

Another definition of credit is that it has originated from the Latin word “Credo” which means ‘I believe’. Credit is a matter of faith in the person and no less than in the security offered. Credit is purchasing power not derived from income, but by financial institutions either as an offset to idle incomes held by depositors in the banks, or as a net addition to the total amount of purchasing power. In fact, no economy can function without credit, all economic transactions are settled by means of credit instruments today. It is the very life blood of modern business and commercial system.(G.D.H. Cole, 2000)

Loans and Advances

Loan - A lender granting temporary use of a sum of money to borrower, who must repay the money that, was borrowed over a fixed term, in addition to the interest on the loan or debt, that was incurred, defines loan. There is a stated due date to the borrower by the lender to repay the money back to the borrower, but if the borrower failed to repay the stated money back, the lender charges late fee from those persons who do not return the money on the due date. (Annual Report of DB, 2006)

Advance - are credit facilities in the form of written promises and should not necessarily be given on physical money like loans. (Ibid)

2.1.2 Types of Loans and Advances

Bank Loans and advances can be classified in a variety of ways, including the purpose, the type of security, the maturity and repayment period. (Annual Report of DB, 2006)

Term Loans

Term loan is debt originally scheduled for repayment in more than one year but generally less than ten years. Term loans are physical money lent to borrowers in expectation of periodic repayments. It is a method of financing, which is characterized by periodic repayments that can be monthly, quarterly semi-annually and. This loan can be categorized into three based on the duration: (Dashen Bank Manual and procedure, 2007, Addis Ababa)

Short-Term Loans

Short-term loans have duration not exceeding one year and are normally for working capital to meet financial requirements of customers. (Ibid)

Medium-Term Loans

Medium-term loans have duration not exceeding five years and are used for purchase of capital goods, light vehicles, public transport vehicles, completion of buildings, purchase of residential buildings, etc. (Ibid)

Long-Term Loans

Long -term loans have a duration exceeding five years; such loans are granted for the construction of residential houses, commercial and industrial buildings, large-scale investments, etc. (Ibid)

Overdraft Facilities

It is one method of financing by which customers are allowed to withdraw beyond the deposited amounts in their current accounts. Such facility is usually granted to well established customers with sizable businesses as a supplement to their working capital. In order to be eligible for overdraft facilities the applicant has to be a customer of bank with good current accounts operations. However, the facility granted to new customers is based on some criteria of banks. These criteria's are discussed later under Loan eligibility criteria. (Ibid)

Merchandise Loan

This is the type of facility by which customers are provided with credits against pledge of goods, commodities. Most of the time the duration of this loan is for three months. While valuing the merchandise pledged, bank verifies the existence and value of stored goods. (Dashen Bank Manual and procedure, 2007, Addis Ababa)

2.1.3 Characteristics of Loan

Time to Maturity – It is the length of the loan contract. Loans are classified according to their maturity into short term, intermediate – term debt and long-term debt. Revolving credit and perpetual debt have no fixed debt for retirement. Banks provide revolving credit through extension of a line of credit; brokerage firms supply margin credit for qualified customer on certain securities. In this case the borrower constantly turns over the line of credit by paying it down and re-borrowing the funds when needed. A perpetual loan requires only regular interest payment. The borrower who usually issued such debt through a registered offering determines the timing of the debt retirement. (Ibid)

Repayment Schedule -It is a schedule that shows two parts that are apportion of the outstanding principal and the interest costs. With the passage of time the principal amount of loan is reduced, or repaid little by little until it is completely retired. It is required at the end of the contract or on asserted interval, usually on a monthly or semi – annual basis. (Ibid)

Interest – It is a cost of borrowing. The interest rate charged by lending institutions must be sufficient to cover operation and administrative costs on acceptable rate of return. It may be fixed for the term of loan or adjusted to reflect the changing market condition; floating rates are tied to some market index and are adjusted regularly. (Ibid)

Security – Assets pledged as security against loan are known as mortgages. Unsecured debt relies on the earning as collaterals. Credit backed by collateral is secured debt. In many cases the assets purchased by the loan often serve as the only collateral, in other cases the borrower puts other assets including cash, aside as collateral. (Ibid)

2.1.4 Loan Eligibility Criteria

In evaluation of loans, subjective judgments are to some extent unavoidable. But Dashen Bank set loan eligibility criteria to minimize the effect of individual perceptions in loan evaluation. On Dashen Bank's loan manual these eligibility criteria are stated broadly according to the purpose of the loan and type of the loan. But in general, the basic loan eligible criteria are: (Dashen Bank Manual and procedure, 2007, Addis Ababa)

- Proof of engagement in a licensed business.
- Presentation of financial statements or filling of financial credit report.
- Presentation of collateral to secure the loan (unless where clean loan is justifiably acceptable)
- Providing some legal documents in relation to legal status as the
- Situation requires; such as article and memorandum of association in the case of non – natural legal persons.
- Feasibility study in case of projects finance. (Ibid)

In order to qualify for a loan the following criteria are needed almost for all businesses.

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

- Application letter
- Valid business license
- Article and Memorandum of Association
- Audited financial statements for all share companies
- Power of attorney
- Performa invoice
- Sales agreements
- Concluded contracts
- Land holding certificate and vehicle ownership booklet
- Testimonial letters
- Banks statements

2. The purpose of the request should be clearly stated.(Ibid)

3. Evidence should be submitted that would show the profitability of the business, which is sufficient to provide the owner with adequate returns while meeting loan obligations with in a reasonable period of time. (Ibid)
4. In the investment of projects, financial and economic rates of returns should be set and tested against national parameters for their acceptability. (Ibid)
5. The business should have at least one year of operational experience. (Ibid)
6. Unless treated exceptionally, sufficient collateral acceptable to banks is offered. (Ibid)

2.1.5 Determining the Bank's willingness and Ability to Lend

A bank's ability to lend is restricted by banking regulations that limit the amount of loans that may be extended to any borrower. A bank may also establish an internal limit ("house limit") on the amount lend to a single borrower. What affect a bank's willingness to lend are its portfolio objectives and it's earning targets. To reduce exposure of risk, a bank will try to maintain diversification in its portfolio and investments. These objectives will shape a bank's loan origination and acquisition strategy. Thus a potential borrower must not only meet the lending institution's credit standards but also be within its target lending market and legal lending capacity. (Dashen Bank Manual and procedure, 2007, Addis Ababa)

2.1.6 Loan Processing

Banks succeed when the risks they assume are reasonable, controlled and commensurate their resources and credit competence. Lending officers must accurately identify measure and manage risk, if their banks are to succeed.

Before a bank agrees to commit its funds to a company, its loan officers analyze the prospective borrower to determine credit worthiness. Loan officers have responsibility to grasp the quantitative and qualitative details of each transaction thoroughly, analyze its variables and make adequate for their impact (P. Henry Muller, 1981)

According to the loan manual, the researcher tries to explain how the loan process starts, how a series of duties are performed at the various stages of the process i.e. initiation, evaluation and approval and how it is finalized, i.e. documentation. (Ibid)

Initiation: the basic document necessary to proceed on loan processing is the loan application. It is simply a letter lodged by a customer to a bank that explains his desire to have a bank loan. The loan application should be accompanied by valid and currently renewed trade licenses. This helps to prove the legal formation of the business organization and its existence. Once the loan application is found in order, and copy of relevant trade license are proved valid and genuine the next step to be followed would be evaluation. (P. Henry Muller, 1981)

Evaluation is a process through which applicant's actual need for bank loan is assessed, viability of the business he/she runs is studied, and repayment capacity is measured. However, handling this task is not as such simple. It requires analysis of financial statements of the borrower to check financial soundness, and gathering relevant information regarding character, credit worthiness of the applicant. (Ibid)

Assessment of financial soundness can be done by analyzing financial statements of the applicant (Balance Sheet and Income Statement), which could be audited or provisional. But, it is not always possible to base the analysis on financial statements, as most of the customers do not maintain accounting records. Therefore, the bank resort to fill in the information required for analysis in a format prepared to serve the purpose (Financial credit report). The next step is collecting credit information. (Ibid)

Documentation: All documents beginning from the loan application up to the last paper have to be properly filed in a loan file. Loan files have to be properly kept under the control of responsible person. Security documents, such as land holding certificate, car ownership booklet, and the like together with original contracts are separately kept in safe under lock. (Ibid)

Credit Information is information related to applicant performance and reputation. Personal integrity, character, and credit worthiness have to be collected from different sources carefully and as much as possible genuinely. Other banks could be Useful sources. In resent time National bank of Ethiopia has started new system of sharing credit information of any borrower's with in all banks. (Ibid)

Banks undergo certain processes while dealing with loans. There are definitely a number of steps to follow:

I. Loan Application and Enquiries

To start any loan processing, a written application must first be submitted by the applicant. The letter of application should state the purpose of the requested fund, loan amount, name of the applicant, signature of the applicant, type of collateral to be offered and duration of the loan period. Besides basic requirements like valid and appropriate license, audited or provisional financial statements should be fulfilled. (Dashen Bank Manual and procedure, 2007, Addis Ababa)

II. Interview Stage

Before starting the paper work for the actual processing of a loan, borrowers must be interviewed by the respective loan officers of a branch. (Ibid)

III. Credit Information

All available internal and external sources should be used to obtain credit information about the applicant before deciding on the financing of the business. (Ibid)

IV. Field Visits

The loan officers should go and visit the applicant's business sites to perform the required procedures. (Ibid)

V. Property Estimation

The property assessor, on behalf of the bank performs the estimation of secured property. (Ibid)

VI. Deliberations at Bank's Loan Committees

Bank loan committees are expected to review the cases presented seriously and exhaustively to arrive at a careful and fair decision and recommendation. (Ibid)

VII. Informing Customers about the Decision of the bank

All decisions must be communicated to the applicants in writing with the specific reasons considered in the decision at the shortest possible time. (Ibid)

VIII. Disbursements

Loan officers must make sure that all necessary legal and other documentary formalities are fulfilled. After that, disbursement should be effected within three months time. (Ibid)

IX. Follow up

This step starts just after the loan disbursement has been effected. It is only with close follow-up that a bank avoids ending up with sick loans. (Dashen Bank Manual and procedure, 2007, Addis Ababa)

2.1.7 Loan Approval

Loan approval form is a bank document in which a request for loan is approved in full or in part, or declined. In addition, it also serves to pass decision on various requests related to already approve loans. The request could be waiver of repayment, extension of due date, reduction of monthly repayment, change of collateral or a combination of any of these. Decision to be passed on large sum request will pass through various levels, there is existence of authority limit in decision making, which is called Discretion. (Ibid)

All the steps taken in the evaluation process of the loan could only serve one purpose i.e. to give decision on a loan request of a customer. Whether the analysis made on the financial statements, and credit information collected gives positive or negative results, the request for a loan has to have an answer. Thus, the next stages of the loan processing cycle will be decision making i.e. approval or rejection. To arrive at a fair decision, analysis made on the financial statements and information gathered are summarized in bank format know as Loan Approval Form (LAF). (Ibid)

A loan proposal that meets all the criteria as well as the terms and conditions enumerated in the policy and procedural manuals of banks have to be submitted by a loan officer to the bank's loan committee. The loan committee is the higher body in the screening processes and is empowered to accept, amend, differ or reject loan proposals submitted to it. In view of the power and responsibility given to it, it is important that the committee be composed of, as many members as possible so that its deliberations can have necessary balance. (Ibid)

All the information given under the LAF is meant to serve the final stage of the loan process i.e. approval. The individual or the committee authorized to pass decision on loan requests thus have summarized information about the loan request. Hence, after reviewing the information available in the LAF, and discussions are made with the committee members, decisions will be made. The decision is written on the decision space of LAF and is signed by the committee members. Approval date is also written. If there are deviations from recommendation reasons will be given here. (Ibid)

Once the loan has approved it has to be communicated to the customer. Then there should be a loan contract. Moreover, securities should be registered and the borrower is required to insure the property, even if type and extent of insurance coverage differ from property to property and the risk involved in any case. Completion of the contract registration, receipt of documentary evidence of properties held as collateral and insurance policy endorsed in the name of the bank proves formalities for disbursement of the loan. (Dashen Bank Manual and procedure, 2007, Addis Ababa)

2.1.8 Loan Contracts (Agreements)

Loan agreement is a legal agreement specifying the terms of a loan and the obligations of the borrower. If a loan is approved, a contract is prepared immediately in as many copies as there are parties to the agreement (including guarantors) and signed by the bank's signatories, witnesses and the borrower. Basically, there are two types of bank loan contracts term loan contract and open credit contract. Term loan contracts are contracts, which are applied for all approved term loans and open credit contracts are contracts, which are applied for all approved overdraft. Once all concerned parties sign the contracts it should be sent to the respective office for registration of the date secured against the properties. The purpose of registration is mainly to control the transfer of title to other parties without the consent of the bank until the loan is fully settled. (Ibid)

2.1.9 Loan Disbursement Process

Banks succeed when the risks they assume are reasonable, controlled and commensurate their resources and credit competence. Lending officers must accurately identify measure and manage risk if their banks are to succeed. (P. Henry Muller, 1981)

Before a bank agrees to commit its funds to a company, its loan officers analyze the prospective borrower to determine credit worthiness. Loan officers have responsibility to grasp the quantitative and qualitative details of each transaction thoroughly, analyze its variables and make adequate for their impact (Ibid)

Evaluation of borrower's ability and willingness to repay a loan at maturity involves financial analysis, including forecasting and sensitivity and analyses, a qualitative assessment of management's character and capability, due diligence and an identification and analysis of risk. (Ibid)

Financial Analysis

A thorough financial analysis requires preparation of the following: year – to year comparisons of financial statements, cash - flow statements, Liquidity analysis, Capital structure analysis, projections and sensitivity analysis, Estimation of asset value such as market value and liquidation value and comparison of actual versus budgeted performance.(P.Scott P.Mason,1991)

Qualitative Assessment

Credit evaluation also requires assessment of the character and capabilities of the persons to whom a loan may be extended, i.e. the persons responsible for achieving the goals of the operation and financial plans. Lenders must determine the quality, breadth and depth of the management team. Assessing their ability to implement operating and financial plans will give the lender insight into the management team's capability. Banks pay high price for hasty credit decisions. Though judging the integrity of a new customer takes time, integrity is a critical component of any lending decision. (Ibid)

Management's interests should be aligned with the company and with the bank's interests. (Ibid)

Due Diligence

Even if it is time consuming, it is an essential aid to understand better how the prospective borrower does business. It can include trade checks, plant tour, and interview with the borrowers' competitors, customers, employees and suppliers. Comprehensive due diligence also includes reviews of compensation and benefits, management's planned capital expenditures, employee relations, other debt obligations and management information system and technology. An environmental audit may also be important. (Ibid)

Risk Assessment

Risk assessment is another component of credit evaluation process. Thus, these risks should be identified and analyzed properly. Some risks are associated with the borrower and his/her business, other risks are associated with potential changes in the regulations, environment, cyclical activity or other unanticipated development. The loan officer must make judgments about future conditions that could affect the borrower's willingness and ability to repay the

obligations. Determining potential risks and evaluating their level of severity, the probability that they will occur, and the estimated costs associated with their occurrence are critical. The structure of the credit facility and loan agreement attempts to minimize risk. (Ibid)

2.1.10 Loan Categories

Dashen Bank provides various loan facilities to the business community operating within the country. It entertains requests of business organizations for loans regardless of size, economic sector, ownership and location. However, the disbursement requires primarily the soundness and viability of project proposals. The loans disbursed for various economic sectors need deep and multi – dimensional analysis on the purpose they requested before disbursement. The major economic sectors identified in the banking environment are Agriculture, Manufacturing, Domestic trade and services, Export, Import, Building and construction, and transportation. Dashen Bank categorizes loans by their “end-use”. Loans can be categorized based on their purpose as follows: (Dashen Bank Manual and procedure, 2007, Addis Ababa)

Agricultural Production Loan: These are loans granted for crop harvesting, purchase of inputs, fertilizers, improved seeds, combined harvester, truckers, construction of storage facilities, etc. (Ibid)

Manufacturing Loan: Loans granted for manufacturing, cottage industries and mining fall under this category. (Ibid)

Consumer Loan: These loans are only granted to salaried people for the purchase of household goods, equipment, etc. (Ibid)

Automobile Loan: Loans that are granted for acquiring automobiles for business or personal use are classified under this category. (Ibid)

Construction and Bridge Loan: These loans are granted for contractors to bridge shortage of finance and to be serviced by upcoming payments. (Ibid)

Building and Construction Loan: Loans granted to borrowers who are facing shortage of money at the completion phase while building. (Ibid)

Transport Service Loan: Loans for working capital requirements to business engaged in the transport service sector. (Dashen Bank Manual and procedure, 2007, Addis Ababa)

Transport Vehicle Loan: Loans granted for the purchase of new or used trucks/bus are classified under this category. (Ibid)

Hotels and Tourism Loan: These are loans granted for hotel businesses, restaurants, tour businesses, etc (Ibid)

Wholesale and Retail Trade Loan: Loans for businesses engaged in wholesale and retail trade activities are classified under this category. (Ibid)

Health Service: These are granted to pharmacies, hospitals, clinics, etc.

Miscellaneous Domestic Services: Loans granted for garage, beauty salons, laundry, etc are under this category. (Ibid)

Import: These loans are granted for importation of general goods and other. (Ibid)

Export: Export loans are granted for the export of goods and services. (Ibid)

Mortgage: These loans are granted for the purchase of residential and business house.

2.1.11 Loan Repayment

Banks, while giving loans to customers, should also figure out the way they will have to collect or refund their money. Lenders in general have two sources of loan repayment:

1. The cash flow ability of the firm to service the debt and,
2. If that source fails for some reason, the collateral value of the security.

2.1.12 Credit Follow up in Dashen Bank

In practicing proper follow up, once funds are disbursed the concerned bank officer cannot afford to rest and expect that all repayments will be collected as scheduled. Therefore, the loan officer prepare schedule which contain the repayment date and telephone address of the loans in order to make the follow up task easy. After this the officer is expected to call when payment is not made on the payment date.

Sometimes borrowers seem to ignore repayments for one reason or another. In such case, Dashen bank undertakes practice on the following follow-up activities:

- Giving Verbal reminder after calling the customer and discussing the matter. If this fails and no payment is made then the bank choose to the second step. Personal visit

is more productive than telephone calls. This should be performed within one week after the installment is due.

- Sending first written reminder using language of general persuasion and explaining that the money the bank lent out belongs to the bank's depositors and that the bank is accountable. This should be done if installment is over due by a month.
- If the first reminder fails, second written reminder that shows the bank is legally and morally bound to collect the debt would follow. The reminder will be worded in such a way as to show the bank's determination to proceed with further measures if repayments are not forthcoming. It is very important that the bank use every means to make the borrower come up with alternative proposals if possible until the bank make fairly certain that payments are unlikely to come. If the customer does not show any cooperation then the bank would write and send the third reminder.
- On the third reminder the loan officer tell the borrower that if payments are not made within 15 days the bank would be compelled to pass the matter to the legal services.

All the above mentioned methodologies and mechanisms are observed from Dashen bank loan manual and internal memos.

In Dashen Bank there are two stages to implement different mechanisms to reduce the balance of their non-performing loans. One is before disbursing new loan and the other is after disbursement.

(i) Before Disbursement Mechanisms

In Dashen bank before disbursement mechanisms include proper credit analysis, proper design and implementation of loan eligibility criteria and proper loan disbursement procedure. (Dashen Bank Manual and procedure, 2007, Addis Ababa)

(ii) After Disbursement Mechanisms

According to the loan manual and different internal memos, in Dashen bank broadly used after disbursement mechanism to reduce the balance of non-performing loans is proper credit follow up. (Ibid)

Evaluation of borrower's ability and willingness to repay a loan at maturity involves financial analysis, including forecasting, sensitivity and analyses, a qualitative assessment of

management's character and capability, due diligence and an identification and analysis of risk.

2.1.13 Credit Risk

Banks failures have involved with the combined effects of severe liquidity and credit deterioration. Credit Risk is a failure to fulfill the terms of any contract with the bank or to perform as agreed. Credit sensitive funds providers may work that the bank's increased credit exposure leads to insufficient profits and credit problems. A bank may increase its liquidity risk that assumes more credit risk through adoption of new underwriting or asset concentration in relation with risky business line. (James Ballard, 2003)

2.1.14 Credit Risk Management

All organizations are in the business of placing capital at risk pursuing ventures, which are uncertain in terms of producing income, and remain as well off at the end as they were at the beginning. They include financial institutions, government bodies, and other organizations. They all have goals, and allocate resources to pursue them. Because all organizations face uncertainty in achieving their goals, they all face risks that are specific to that organization.

Risk management is the process whereby an organization optimized the manner in which it takes risks. All organizations accumulate resources and invest them in activities that are uncertain in terms of their future outcomes. Credit needs to be managed well because it is the major source of income and its repayment on time saves the problem of banks in meeting the demand of depositors. If loans are not repaid on time, the lending bank experiences certain risks and the loans will change their character and become non performing loans which remain unpaid for three consecutive repayment times. (Ibid)

For most banks, loan accounts are half or more of their total assets and about half to two-third of their revenue. Moreover, risk in banking tends to be concentrated in the loan portfolio when a bank gets serious financial trouble, its problems usually come from loans that have become uncollectible due to mismanagement, illegal manipulation of loan, misguided lending policies, or unexpected economic downturn. (Ibid)

2.1.15 Credit Analysis and Appraisal

Credit analysis is the evaluation of borrower's capacity in properly servicing the loan. It is done to ensure that loans are made in appropriate terms to clients who can and will pay it

back. What analysis is needed and in what scope, is primarily determined by the type and size of loan, but the ultimate purpose is to place good loans so that both parties can benefit from it and meet their objectives. In properly analyzing the credit worthiness of borrowers, lenders often look at some five factors that are known as the five C's of credit. (James Ballard, 2003)

In Dashen Bank credit analysis should include a clear indication of the bank's target of the level of non-performing loans balance. This analysis should set out who is eligible for credit and for how much, what type of credit are available, and under what term and condition the credit should be granted. According to Dashen bank loan manual the 5 C's of credit are practicable techniques in the bank. (Ibid)

Character

It is the extent to which the borrower is willing to pay the loan. The debt repayment capacity is useless without the will of the borrower to repay the debt. Character is about the manner of the borrower in terms of having a well defined purpose, and a responsible attitude toward using the borrowed sum. Responsibility, truthfulness, serious purpose, and intention to repay are important elements in evaluating character. The credit officer can ensure this through serious interviews. (Ibid)

Capacity

It represents the debt repayment capacity of the borrower. Earning can be taken as a good indicator of loan repayment capacity. For instance, for a poor farmer, the capacity can be determined by looking the possible discretionary income he/she can have. That is income left after meeting essential requirements like food, and clothing. The average family size should be taken in to consideration since it affects the discretionary income to a large extent. A family with three members can have better discretionary income than a family with six members because the total income that seems to be fixed is going to be shared by large number as the family size increases. Another factor that can dictate the capacity of the borrower is the indebt of the borrower so far. For instance, if he is indebted to some one else (may be to local informal money lenders), he may use the proceed he gets from selling the product towards the payment of his earlier debt. (Ibid)

Capital

The success of the business depends on the motivation attached to ownership interest, Banks will have to make sure that there is proportionate risk of the owners in the venture; hence the level of capital will have to be evaluated to ensure that the risk is shouldered by the party with ownership interest. In this connection factors like customers net worth, equity in home and other assets should be taken as indicators. (CBE 2000)

Condition

The environment surrounding them affects borrowers. For instance, climatic condition (absence of rain, for example) is one factor that affects the agricultural sector. Farmers are much affected by drought, hail, and uneven rainfall. The ability of farmers to repay their debts is directly linked to such risk in terms of successful crops, selling stocks etc... In addition to this, market for the product is another condition that affects the capacity of farmers to pay back their loans. For instance, if the productivity in other areas of the country is good, then the price for agricultural product will decline which adversely affect the cash flow of the farmer. All conditions that can affect the borrower in the future should be assessed before the loan is granted. Failure to recognize such things may lead to bankruptcy especially if the loan portfolio is concentrated on certain regions. (Lulseged Teferi, 2002)

Collateral

Collateral is the security held to back up the loan in the event of possible default. It can be anything of value, which is readily saleable. (Ibid)

2.1.16 Loan Monitoring and Review

Proper credit risk management involves due credit analysis, having the preposition approved, cash disbursed and ultimately follows up the loan in order to have the extended credit repaid back. Many good credits could become problem loans unless a continuous follow up is made which enables to detect signs that reveal difficulties. (Ibid)

The objectives of the credit monitoring and review, among others, include.

- Ensure that loans are directed to the intended purpose
- Ensuring that the loan covenants are complied with
- Following up borrowers business condition
- Maintaining good quality of the loan
- Identifying emerging problems

Attention should be given to the following particulars while conduction of monitoring and review of credits. (Lulseged Teferi, 2002)

Check on all early warning signals

- Check the end of the loan funds
- Asses all conditions of the borrowers
- Asses financial needs of the borrowers
- State findings and interpret them/improvements, deterioration, and changes.

2.1.17 The Major Source of Loan Fund

Deposit

A bank is an organization whose principal operations are concerned with the accumulation of the temporarily idle money of the general public for the purpose of advancing to other investment.

Deposits are the major sources of loan-able fund in commercial banks, deposits provide most raw materials for bank loans and advances, thus it represent the ultimate source of bank profit and growth. As other profit making organizations commercial banks are aiming at maximizing their profit by increasing the quality and quantity of the loans.

- Banks mobilize deposit from depositors by offering interest and other features of benefits that meet customers' needs better than alternative uses of funds. Deposits can be categorized in to the following major forms: (Awash International Bank News Letter, 1997)
- **Demand or Current Deposit:** are funds such as checking account balances, which may be withdrawn in whole or in part at a time. (Ibid)

- **Saving Deposit:** are funds accumulated for special purpose or cash saved for the future, which earn compound interest. It is common practice to permit the depositor to withdraw these funds without advance notice of intention to do so. (Awash International Bank News Letter, 1997)
- **Time Deposit:** relatively high interests earning bank deposit for a specified period. Withdrawal before the end of the specified period results in partial or total loss of accrued interest. (Ibid)

The principal reason commercial banks are operating in their environment is to maximize their profit by extending credit facilities to their customers.

Banks are expected to support their local business communities with an adequate supply of credit for all legitimate business and consumer financial needs and to price that credit reasonably in line with competitively determined interest rates. Indeed, it is the principal economic role of banks-to provide loans to the business entities and individuals who are engaged in various economic activities (Agriculture, manufacturing and industry, import/export, trade and services, housing etc.) The bank's role in finding involves assisting prospective borrowers by availing working or investment capital from which it generates profit.

How well a bank performs its lending function has a great deal to do with the economic development of the country, because bank loans support the growth of new businesses and create jobs within the banks' environment and promote economic growth, Moreover, bank loans often seem to convey positive information to the marketplace about a borrower's credit quality, penalty, enabling a borrower to obtain more and perhaps some what cheaper funds from other sources.

For most commercial banks, loan accounts are half or more of their total assets and about half to two-third of their revenue.

2.1.18 Non - Performing Loan

Loan is considered to be non-performing when; Principal or interest is due and unpaid for 90 days or more. NBE's directive No.SBB/32/2002, define non performing loans as loans or advances whose credit quality has deteriorated, so that full collection of principal and/or interest in accordance with the contractual terms of the loan or advance is in question. Loans

or advances with pre established repayment program shall be considered non-performing when:-

- The debt remains outstanding for ninety consecutive days or more beyond the scheduled payment date or maturity.
- The debt exceeds the borrower's approved limit for ninety consecutive days or more.
- Interest is due and un-collected for ninety days or more
- For overdrafts, the account has been in active for ninety consecutive days and/or deposit are insufficient to cover the interest capitalized during the period. (Awash International Bank News Letter, 1997)

Non-performing Loans are loans or advances whose credit quality has deteriorated, full collection of principal and/or interest in accordance with the contractual terms of the loan or advance is in question.

Non-performing loans are those loans which are past their due dates. They are classified into:

1. **Sub-Standard**:- Non-performing loans or advances past due 90 days or more but less than 180 days shall at minimum be classified sub-standard.
2. **Doubtful**:- Non-performing loans or advances past due 180 days or more but less than 360 days will be referred as doubtful.
3. **Loss**:- Non-performing loans or advances past due 360 days or more will be classified as loss.

2.1.19 Causes for Non - Performing Loans

Causes for non - performing loans are merely varied from bank to bank as well as countries to countries. Even the classification of this causes differ one to the others. Corporate Planning and Development Department of Dashen bank on its October 2005 report classified the causes in two broad groups.

Internal Factors

- Lack of continuous follow up of repayment due to man power shortage.
- Lack of consultation and communication with defaulter.
- Overstating the collateral value at the time of estimation.

- Lack of credit information to be gathered from other commercial banks.
- Agency problem (i.e. branch managers focus merely on increasing their loan = portfolio by accepting loan without making due analysis).

External Factors

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

There are large macroeconomic reasons for wide spread of NPLs, and the causes for it have multi faced dimensions. Though different banks encounter different causes for NPLs, general consensus of common causes, are also there. Some of these common causes are

- Bankruptcy of the borrower business
- Absence of risk assessment
- Poor follow – up
- Lack of credit information and moral hazard
- Providing loan over the total capital of the firms or business entities
- Providing loan with out sufficient back up/adequate safety of collateral or security
- Providing loan without sound credit principle and appraisals
- Providing loan to unfamiliar borrowers and without adequate information about the borrower.
- Providing loan without the quality and dependability of personal guarantee.
- Providing loan (large sum) with out audited financial statement of borrower firm/company
- Providing additional loan without additional collateral
- Providing loan without the expertise of engineering appraisal and without consideration of depreciation and current fair value of the property of the borrower.

- Providing with non – existent marked ness and if there is, its marketability that is not fast moving items.
- Providing loan without sufficient credit history or information of the borrower.
- Providing loan with a collateral, which has no legal document, or registration with the municipality.
- Providing loans without viable project/business proposals.

The damages of NPLs on Dashen Bank occurred due to the above causes aggravated.

2.2 Empirical Review

We are tried to assess other research paper about loan and advance in the case of Dashen Bank. The name of the researchers is Abebaw Leyew, Abebu Tesfazgi, Alemu Menasbo and Rahel Siyoum. However, this research paper mainly focused on type of loan and advance, type of security, Lending Procedure, Loan Repayment procedure, problem faced by the bank while dealing with repayment, steps of loan processing in the bank, Loan evaluation in the bank and types of non-performing loans. So these research objectives are different from our research objective. Generally, this research study focuses on credit department process of loan and advance, but our research assessment is focused on effect of credit approval procedures and credit management.

CHAPTER THREE

Data Presentation & Analysis

3.1 Introduction

The primary objective of commercial banks like any other business institution is to grow and survive. This can mainly be achieved by making profit. In the case of banks, profit is a function of both the volume and the quality of loan, among others; good quality of credit can only be considered as a good source of profit. The effect of poor quality loans is not limited to that of affecting the profit of one particular bank but has an effect that extends it self in to the economy at large. Hence, prudent bank is concerned about the quality of their loans. This study is concerned with the Credit Management and Practice of Dashen Bank Sh.Co.

From a target population of 250 staffs, questionnaires were distributed to 40 staffs of the bank purposely, all (100%) had completed and returned. So, the following analysis and discussions done on the collected data from the questionnaires. The purpose of this section is to assess the credit practices and management of the bank. The major findings from the responded questionnaire are compared and presented here under by respective questions.

3.2 Background Information of the Respondent

No.	Questions and Alternatives Answer	Respondents	
		No.	%age
1.	Educational Background		
	Diploma	4	10
	1 st Degree	34	85
	Above 1 st Degree	2	20
	Other.	40	100
	Total		
2.	Your status		
	Senior Management	2	5
	Middle Management	2	5
	Line Management	8	20
	Other clerical	28	70
	Total	40	100
3	How long have you been working in Dashen Bank		
	Below five years	30	75
	5-10 years	8	20
	Above 10 years	2	5
	Total	40	100

Table 1.

Source Questionnaire

The previous Table, Shows the general information of the respondents

- ❖ As we can see from the table the respondents educational background compositions 85% of hem are 1st degree holders and 10% are diploma holders and 5% of them are above 1st degree.
- ❖ 70 % of the respondents were other clerical, 20% were line managers, 5% were middle manager and the rest 5% of the questionnaire were responded by senior managers.
- ❖ 75% of the respondents work in Dashen Bank below five years. On the other hand, 20% of the respondents have more than five years work experience and 5% of the respondents have more than a decade work experiences in Dashen Bank.

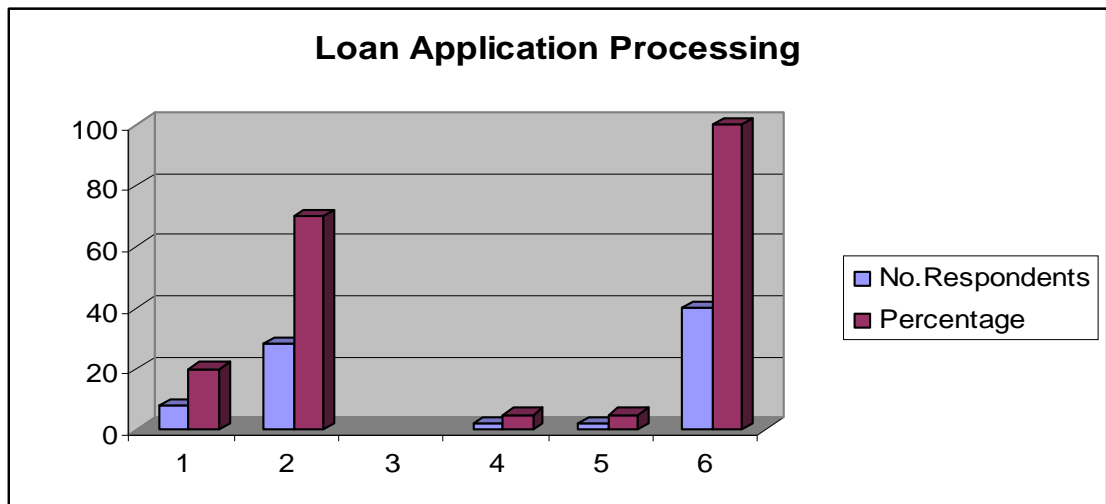
3.3 Analysis of the Finding of the Study

3.3.1 Loan Application Processing

No.	Questions and Alternative Answers	Respondents	
		No.	%age
	How long will it take to processes a given loan application?		
1	Below 7 days	8	20
2	8 - 14 days	28	70
3	15 - 21 days	0	0
4	22 - 28/30 days	2	5
5	Above one month	2	5
	Total	40	100

Table 2.

Source Questionnaire



Graph 1 According to the results in the previous graph, 70% of the respondents replied that within 8-14 days a given loan application can be processed and finalized, While 20% of the respondents said that loan application can be processed below 7 days, While 5% of the respondents answered that loan can be processed within the range of 28-30 days and above a month respectively. In addition the respondents also mentioned that depending on the nature and merit of the loan, the processing period will vary.

Banks pay high price for hasty credit decisions, through judging the integrity is a critical component of any lending decision.

3.3.2 Loans & Advances

A	Are there loans which are granted without taking collaterals?	No of Respondents	Percentages
	❖ Yes	26	65
	❖ No	14	35
	Total	40	100
B	Do you believe the procedure followed for loan approval by the bank is satisfactory?	Respondents	
		No.	%
	❖ Yes	40	100
	❖ No	0	0
	Total	40	100

Table 3.

Source Questionnaire

Item A. shows, 26 respondents, which are 65% of the sample size have viewed that loans granted without taking collateral that is granted to prominent customer on clean basis (a loan with out or partial collateral). On the other hand, 14 respondents, which are 35% of the respondents, replied that there is a consideration of collateral before extending the loan.

Item B. There is a clear indication that 100% of the respondents largely viewed that they are satisfied with the procedure followed for loan approval by the bank which is mentioned in the literature review.

3.3.3 Problems Associated with Loan Processing

A.	Are there problems associated with implementing policy manual of the bank as desired?	Respondents	
		No.	%
	❖ Yes	12	30
	❖ No	28	70
	Total	40	100
B.	Does the bank assess borrowers past financial history, credit worthiness and perform detailed analysis before extending the loan?		
	❖ Yes definitely	38	95
	❖ Yes to some extent	2	5
	❖ Not at all	0	0
	❖ I am not quite aware of it	0	0
	Total	40	100

Table 4.

Source Questionnaire

This indicates 70% of the respondents for question “A” replied that there are no problems associated with the policy manuals, but 30% said that there is some problem associated with it.

Considering question “B” 95% of the respondents replied that the bank assesses borrowers past financial history, credit worthiness and perform detailed financial analysis before extending the loans, while 5% of the respondents replied that yes to some extent.

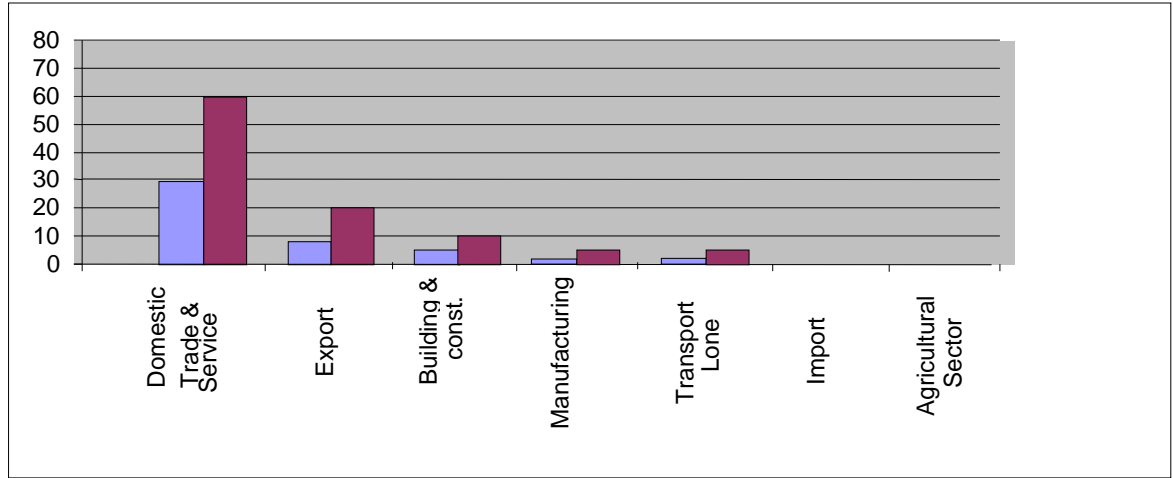
3.3.4 Distributions of Loans by Sectors

Item	Rank	No. of Respondents	% of Respondents
Domestic Trade & Service	1	24	60
Export	2	8	20
Building & Const.	3	4	10
Manufacturing	3	2	5
Transport Loan	4	2	5
Import	5	0	0
Agricultural Sector	5	0	0
Total		40	100

Table 5.

Source Questionnaire

Graph 2



Graph 2, indicates 60% of the respondents, replied that the bank usually emphasized on Domestic Trade and Services (DTS) loan, whereas the 2nd major area of focus is export which holds 20% of loan, the 3rd major area of focus is Building & Contraction which hold 10% and the rest 5% of the respondents, also pointed out that the Manufacturing loan followed by Transport Loan with almost similar proportion.

From the above analysis Domestic Trade and Services account the highest portion of outstanding loan during the period under review and international trade sectors (Export) take the second position most of the years under the study.

From the above observation we can conclude that the bank emphasized on Domestic Trade and Service due to business viability and high demand on the sector.

3.3.5 Follow up Mechanisms of Loan

A.	Is there any credit follow up techniques and procedures designed and implemented by the bank	Respondents	
		No.	%age
	❖ Yes	40	100
	❖ No	0	0
	Total	40	100
B.	Do you have any credit follow up mechanism of your customers after granting the loan?		
	❖ Yes	30	75
	❖ No	10	25
	Total	40	100

Table 6.

Source Questionnaire

The previous table indicates that question under “A”, 100% of respondents replied that there is credit follow up techniques and procedures designed and implemented by the bank.

Considering question “B” 75% of the respondents replied that the bank has follow up mechanism after granting the loan, While 25% of the respondents indicated that there is no follow up mechanism after granting the loan.

As we can observe from the above analysis of the question under “B”, even if there is a designed policy to follow up borrower after granting a loan some of the loan officers, credit analysts and area bank managers fail to meet the objective that exposes the bank to financial loss.

3.3.6 Provision of NPLS

Do you think the level of provision for NPL held by Dashen Bank is sufficient in relation to its NPL?	Respondents	
	No	%age
❖ Yes	40	100
❖ No	0	0
Total	40	100

Table 7.

Source Questionnaire

According to **Table 7**, 100% of the respondents said that the bank holds sufficient provision for NPLs as per the directive of NBE which is always inspected by its external auditors and the regulatory organ (NBE).

3.3.7 Some Mechanisms of Preventing NPLS

	Some mechanisms of protecting loan from being NPL	No. of Respondents	% of Respondents
1	Rearrangement of loan repayment structure	2	5
2	Injection of additional loans	2	5
3	All & others	36	90
	Total	40	100

Table 8.

Source Questionnaire

The above table indicates that 90% of the respondents, replied that the bank used all mechanisms in order to collect the loan, While 5% of the respondents said that Rearrangement of loan repayment structure as a major mechanism. But 5% of the respondents said that Injection of additional loans it's the last alternative methods. Some of the respondents

mention that other mechanism such as taking legal action and sale of mortgage properties as last resort.

In addition as per the interview conducted for question no 4, regarding the preventive measure the Bank has taken an action to control or minimize the banks non performing loan in the past, and also they suggested that setting corporate targets to reduce NPLs to a single digit number, encouraging and closely following up each organ towards materialization of the target, undertaking follow up through visits and consultation, evaluation of the quality of the credit process as well as compliance with the banks policy and applying proper work out loan practice has done as a measure to minimize NPL in the past.

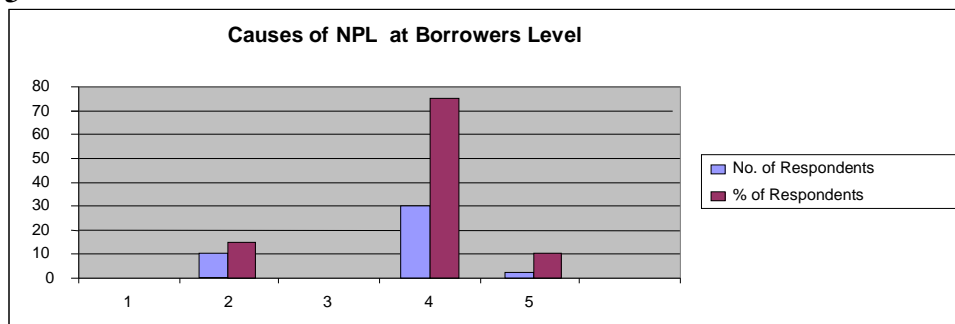
3.3.8 Causes of NPLs at Borrower side

Item	No. of Respondents	% of Respondents
Lack of proper business plan	10	25
Contingencies at borrowers e.g. Death, sick	0	0
Diversion of the borrower fund to other purpose	30	75
Insufficient credit awareness	0	0
Unwilling customer to disclose the information required	0	0
Unwillingness to pay	4	10
Total	44	110

Table 9.

Source Questionnaire

Graph 3



Graph 3 indicates, 75% of the respondents, replied that due to diversion of the borrowed fund to other than initially intended purposes stands 1st, while as per 25% of the respondents believe that lack of proper business plan takes the 2nd place. Besides, this some customers intentionally will not pay their loan and this holds the lowest percentages which is 10% stands at 3rd place.

Therefore, the total number of respondent exceed because of one respondent select more than one causes.

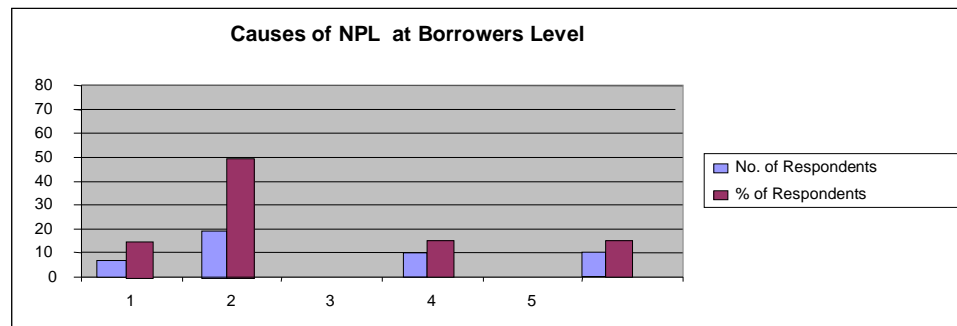
3.3.9 Causes of NPLs at Bank Level

	Item	No. of Respondents	Percentage
1	Lack of continuous follow up and proper risk assessment	6	15
2	Lack of consultation and communication with defaulter	20	50
3	Lack of sufficient credit information from other commercial banks	0	0
4	Mistake on estimation of collateral and evaluating the borrower's financial reports.	10	25
5	Problems associated with loan eligibility criteria	10	25
	Total	46	115

Table 10.

Source Questionnaire

Graph 4



Graph 4 shows that the major causes for NPLs at bank level, 50% of the respondents, replied that due to lack of consultation and communication with defaulter stands 1st, while both 25% of the respondents said that mistake on estimation of collateral and evaluating the borrower's financial reports and problems associated with loan eligibility criteria take the 2nd position. Finally 15% of the respondents believe that lack of continuous follow up and proper risk assessment are some factors at bank level.

Therefore the total number of respondent exceed because of one respondent select more than one causes.

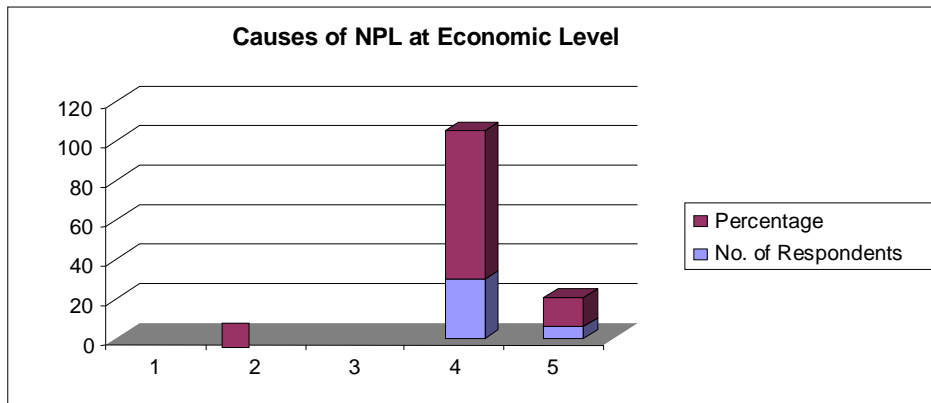
3.3.10 Causes of NPL at Economic Level

Item	No. of Respondents	% of Respondents
Unstable political situation	0	0
Excessive government intervention	4	10
Political power of the borrower	0	0
Weak economic plan and strategy implementation	30	75
Change in fiscal monetary policies	6	15
Total	40	100

Table 11.

Source Questionnaire

Graph 5



Graph 5, shows that 75% of the respondents replied weak economic plan and strategy implementation as a major (1st) cause at economic level. On the other hand, 15% of the respondents respond that change in fiscal and monetary policies by government could result in high inflationary conditions stands in the 2nd place. The rest 10% of the respondents said excessive government intervention are the causes of NPL at economic level stands at 3rd.

3.4 Interview Questions

This topic discusses the interview questions that are forwarded to staffs of Dashen Bank who are engaged in Credit Department particularly Head Follow up Division and one Credit Officer. They were interested to cooperate and entertain my questions with the necessary responses.

Based on the interview conducted for interview question No.4, both respondents replied that the bank management evaluates and ensures profitability and protects its depositors against bank's lending risks by:

- Knowing customer (Character, Capacity, Capital, Collateral and Condition)
- Keeping some rate in deposit and loan
- Reserving money with NBE and other banks (apply in government regulation having provision for NPL)
- Providing prudent credit
- Providing other banking services
- Assessing customer past credit history etc.

The interviewees forward their opinion on “Do you believe the procedure followed for loan approval by the bank is satisfactory?” The required procedure is not satisfactory and their reason is it is time taking as compared to other banks since the loan is approved at the area bank and head office level.

As per the interviewees Ethiopia agriculture is characterized by a subsistence level of farming. Since bank grant a loan against collateral and farmers have no valuable capital assets that can be used as collateral purpose to request loan from formal financial institutes like banks. But recently there is introduction of commercial farming like horticultural, floricultural etc in Ethiopia.

The effect of nonperforming loan as per the interviewees it has an overall effect on the bank.

- Income decline
- Receivables Loss
- Interest Loss
- NBE recognizes as a loss

Generally misguiding the lending policy manual of the bank is another factor of a loan to turn sick.

CHAPTER FOUR

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

4.1 Summary of Findings

Based on researcher's observation the findings are as follows.

- 70% of the respondents replied that within 8-14 days a given loan application can be processed and finalized, While 20% of the respondents said that loan application can be processed below 7 days, While the rest 5% of the respondents answered that loan can be processed within the range of 28-30 days and above the month.
- About 65% of the respondents have viewed that loan granted without taking collateral. While, 35% of the respondents agree with there is a consideration of collateral before extending the loan.
- 100% of respondents replied that they believe the procedure followed for loan approval by the bank is satisfactory.
- About 70% of the respondents agree with there is no problem associating with the policy manual. While, 30% of the respondents replied that there are problems associated with implementing policy manual of the bank.
- Majority of the respondents which is 95% replied that the bank assess borrowers past financial history, credit worthiness and perform detailed analysis before extending the loan.
- 60% of the respondents said that the bank usually emphasized on Domestic Trade and Services (DTS) loan.
- 100% of respondents replied that there is credit follow up techniques and procedures designed and implemented by the bank.

- 75% of the respondents agree that the bank has follow up mechanism after granting the loan. While 25% of the respondents indicated that there is no follow up mechanism after granting the loan.
- 100% of respondents replied that there is sufficient relation to its NPL.
- 90% of the respondents replied that the bank used all mechanisms in order to collect the loan, While 5% of the respondents said that Rearrangement of repayment mechanism.
- 75% of the respondents replied that due to diversion of the borrowed fund to other than initially intended purposes, while as per 25% of the respondents believe that lack of proper business plan as major causes of non performing loan at borrower level.
- The major causes for NPLs at bank level, based on 50% of the respondents, lack of consultation and communication with defaulter, while 25% of the respondents said that there are problems associated with loan eligibility criteria. On the other hand, 25% of the respondents reason out that mistake on estimation of collateral and evaluating the borrowers' financial reports.
- 75% of the respondents replied weak economic plan and strategy implementation as a major cause at economic level. On the other hand, 15% of the respondents respond that change in fiscal and monetary policies by government could result in high inflationary conditions.

Even if the overall Credit Management and Practice of DB is good, it needs some improvements in order to stay in a leading position in the dynamic business environment and to minimize the banks NPLS as desired.

4.2 Conclusion

From the findings of the study, our researcher makes the following conclusion. In the current competitive environment, more and more lines of businesses, which need a huge investment, are being opened. These huge investments are financed through different sources. One of these financing institutions are banks. With this respect, Dashen Bank plays a role in most of the economic development of the country. To do this, an appropriate credit approval procedure and management practice is vital so as to make the disbursed loan productive, effective and profitable. However, if these financed funds (loans) are not collected or paid back to the bank regularly, they have deteriorating effect on the development of the economy.

Due to improving its service and increasing its branch networking, Dashen Bank performed well in deposit mobilizing and loan disbursement over the last decade. In the lending front, through the balance of outstanding loan has been increasing at increasing growth rate during this period.

Dashen Bank provides various credit lines to different economic sectors. These economic sectors also defined as loan categories in banking industry. Loan disbursed by banks to different economic sectors are classified to different loan categories based on their end use. The Domestic Trade and Service takes the largest share of outstanding loans during the period under the study. Even if Ethiopian economy is characterized by Agriculture the loans disbursed to this sector takes the least share out of the total outstanding loan balance.

According to the study, the causes of Non-performing loan in Dashen Bank are the result of both internal and external factors.

4.3 Recommendations

- Granting loan with out taking collateral will expose the bank to NPLs, thus appropriate precaution should be exercised from the bank's side.
- The bank lending policy should be revised depending on the situation and economic condition of the country.
- Over estimation of collateral or fall in its value upon sale would result in increasing NPLS. Therefore, when collateral is offered the bank should make a proper valuation and check whether it can be converted to cash easily or not.
- The major causes for NPLs at borrower level are diversion of the fund other than the intended purpose of the loan. Therefore in this regard the credit officers of the bank should play an important role as a consultant.
- The bank should assess the risk associated with extending of credit to a particular line of business in view of the risk inherent in the sector in which that business operates.

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Appendix

Declaration

We the undersigned, declare that this senior essay/project is our original work, prepared under the guidance of Belayneh Hailegeorgis. All sources of materials used for the manuscript have been dually acknowledged.

Name

Signature

Samrawit Atlabachew

Yordanos Gidey

Meseret Legesse

Advisor's Declaration

The paper has been submitted for examination with my approval as the university advisor.

Name _____

Signature _____

Date _____

DASHEN BANK
Loan Approval Form

Area Bank _____ LAF No. _____ Date _____

1. Name of Applicant _____

2. Facility Requested for T/L Birr _____ *Mdse loan*

O/D Birr _____ L/C Birr _____

Other Birr _____ Date of application _____

3. Purpose (briefly describe) _____

4. Major line of business _____

Other line of business _____

Address Town A.A Kifle Ketema Kebele House No.



Distance from the Area Bank _____ KM

Date of establishment _____ Trade License renewed for _____

5. Security offered

Type	Value							Remark
	Building				Others*			
	Date of Estimation	Estimated Value	Location Value	Net Value	Year of Manufacture	Value	Discounted Value	
Total								
Grand Total								

* Other include Vehicles, Machinery and equipment

Personal guarantee _____

Cash collateral _____

Bank guarantee _____

Estimated by

Property owned by applicant third party Applicant and third party

Mode of security holding 1st degree 2nd degree

Specify 1st degree holder and magnitude of credit availed if mode of security holding is second degree

6. Comparative financial statements as checked by the Area Bank Manager /Area Bank Loans Committee, to be filled in the absence of audited financial statements.

6.1 Balance Sheet in Birr

(000) N.A

Asset	Current Year As At	Previous Year As At
A) Cash on hand & Bank		
B) Receivable & Prepayments		
C) Stock		
D) Total Current Assets(A+B+C)		
E) Fixed Assets		
F) Total Assets(D+E)		
Liability		
G) Payable including Sundries Asso Enter.		

H) Taxes		
I) Bank Loans		
J) *Total Current Liability (G+H+I)*		
K) Long term Debit		
L) Total Liability (J+K)		
Capital		
M) Capital and retained Earnings		
N) Total Liability & Earnings (L+M)		
O) Net working Capital (D-J)		
P) Capital and Reserve (F-L)		

* Includes current portion of long term loan irrespective of type of liability

- Attached break down of fixed assets

6.2 Income Statement

Birr ('000)

	Current Year	Previous Year
Sales		
Less: Cost of Sales		
Gross Margin		
Add: Other Income		
Sub-Total		
Less: Expenses		
Profit before Tax		
Less: Profit Tax		
Net Income (Loss)		

- 6.3 Give reasons for significant rise/fall in the financial position of the customer

.....

7. Description of Receivable

.....

Is receivable amount verified against documents Yes No.

If no, explain you reason _____

8. Composition of items in stock

Is receivable amount verified against documents Yes No.

If no, explain you reason _____

9. Description of Payable

10. Turnover of O/D or CA Current year(2014) Pervious year(2013)
Birr Birr

- Attach working paper for account swing ad turnover if the credit line requested is overdraft facility

11. Foreign banking transitions channel through DB

Import-Export Transaction

Not Applicable

Current Year		Previous Year	
Authorized	Utilized	Authorized	Utilized

Export Figure

12. Existing Facility with

Dashen Bank

Type Loan	Amount Approved	Amount Disbursed	Date Disbursed	Outstanding Balance	Expiry Date	Status
TOTAL						

Other Banks

Type Loan	Amount Approved	Amount Disbursed	Date Disbursed	Outstanding Balance	Expiry Date	Status
TOTAL						

13. General Information about the customer and observation of the business situation of applicant

.....

14. Information about past loans if any :-

.....

15. Recommendation/Decision of Area Bank Loan Committee

.....

Signature _____

16. Decision of Head Office Loans Committee (give reasons for variation if any)