

**The trend of Loan Recovery Performance  
in Banking Industry: *A case study of Awash  
International Bank S.Co.***

A PROJECT PAPER PRESENTED TO  
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**DEPARTMENT OF ACCOUNTING AND FINANCE**

*In partial fulfillment of the requirement for the degree of  
Master of Science (MSC) in Accounting and Finance*

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**JUNE 2009**

**ADDIS ABABA**



## **Declaration**

I, the undersigned declared that, this project paper is my own work and has not been presented in any other university. All sources of material used for this project paper have been duly acknowledged.

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This is to certify Feyisa Gurmu has completed his project work entitled “The trend of Loan Recovery Performance in Banking Industry: A Case Study of Awash International Bank s.co” successfully in partial fulfillment of the requirement for the award of Degree of Masters of Accounting and Finance. In my view, the work is original effort of the candidate and all materials used to the project work have been acknowledged.

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**THE TREND OF LOAN RECOVERY PERFORMANCE IN BANKING  
INDUSTRY: A CASE STUDY OF AWASH INTERNATIONAL BANK S.Co.**

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## **ACRONYMS**

*AIB S.Co.Awash International Bank share company*

*NPL – Non-performing Loan*

*NBE-National Bank of Ethiopia*

*CBE-Commercial Bank of Ethiopia*

*DB-Dashen Bank*

*NIB-Nib International Bank*

*DBE-Development Bank Ethiopia*

*WB-Wegagen Bank*

*CBO-Cooperative Bank of Ethiopia*

*LIB-Lion International Bank*

## **Abstract**

*The study endeavors to examine the trend of loan recovery performance of banking industry, a case study of Awash International Bank s.c. Many factors attributed to the growth of banking industries. Among these, the major one is loan recovery performance of banking industry.*

*The data used to conduct this research was collected both from method was primary data and secondary data. Primary data was collected from National Bank of Ethiopia Banking supervision department and primary data was collected from 60 employees of AIB s.c who are working in the area of loan activity. Moreover, semi-structured and structured interview was also used to gather information that can be used as a case study from AIB's loan officers. In addition, questionnaires were employed to AIB city branch managers and credit department employees. The findings of the study indicated that there are many factors which hamper loan recovery performance of the Awash International Bank s.co. For example: poor loan assessment procedures; lack of effective use of man power; lack of revision appropriate revision of credit manual and lack of willingness of borrowers to disclose their information fully etc.*

*The trend of Loan Recovery Performance in Banking Industry: A case study of Awash International Bank S.Co*

## CHAPTER ONE

### Introduction

#### **1.1. Background of the study**

In fact many factors attributed to the growth of banking industries, but the rate of loan recovery performance has got an immense effect on the growth of the banking industries.

An efficient financial system contributes to positive economic development. A financial system in its role as an intermediary performs an important role of channeling saving to investment. When savings are allocated to projects that are profitable, they will result in generating high-return on investments. The more investments are productive, the higher the rate of economy growth (Sonali, Abeyrante, 2001).

Capital and interest receivable are among a bank's primary assets. Of these, interest comprises a bank's principal source of revenue, and therefore of profit. Accordingly, from a bank's perspective it is essential that its borrowers keep their contractual commitments and

repay interest and capital as schedules. Defaults are inevitable, but when they occur a bank should take appropriate remedial action (J.D Von Pischke, 1991).

As stated by Sonali Abeyrante (2001), empirical evidence worldwide confirms that countries with well-developed financial systems tend to have better economic performance, while countries with weak financial systems are associated with low economic performance. Financial institutions transform financial assets acquired through market and constitute them in to a different and more widely preferable type of assets (F. Fabozzi and F.Modigliani, 1996).

Financial intermediaries include depository institutions (commercial banks, saving & loan associations, savings banks & credit unions, insurance companies, pension funds and finance companies). These intermediaries obtain funds by issuing financial claims against themselves to market participants, then investing those funds. The investment made by financial intermediaries can be in the form of loans and/or in securities (Brick, John R.1984).

Among the depository institutions, banks are the most important financial institutions in the economy. They are the principal source of credit for many households, for most local units of government and for

businessmen. The principal economic function of banks is to make loan. For most banks, loan accounts for half or more of their total assets and about two thirds of their revenue (Ibid, 1984).

Commercial Banks are so named because they specialize in credit to commercial and industrial businesses. Commercial banks are owned by private investors, called stockholders or by companies called bank holding companies (Encyclopedia Deluxe, 2004).

The term credit may be explained as the provision of financial accommodation to a person, in return for a promise to repay it at some future date. Credit may be extended as a cash loan, or through the medium of deferred payment for the supply of goods and services. Credit transactions may also be classified according to the purpose for which they were extended, method of repayment and whether security is taken. Whatever the classification may be, the economic function of credit remains the same, i.e. it enables a person to spend in excess of his current or actual receipts, and to facilitate the present enjoyment of goods and services other wise beyond his means (John P.Bonin and Yiping Huang ,2001).

Shekhar (1993) further noted that, Credit exploitation and banking go side by side. Banks in their stages of development are always related to credit. It is practically impossible to see one independent of the other.

According to J.D Von Pischke (1991), repayment performance is critical features of credit, because persistent poor repayment performance ultimately leads to financial failure in any lending institution. Financial failure is defined in hard term as the inability to cover cost out of the interest income and fees, or in soft term as a failure to attract fund sufficient to maintain the institution in a nut shell.

If there will be low repayment performance for a continuous period, it jeopardizes the financial position of the lending institution, it undermines public confidence in formal financial market and causes savers to withdraw their funds, and it increases staff turn over due to doubt on the capacity of the institution. If bank neglects to do so or the recovery process is unduly protracted, the impact on it may be severe. The bank may end up with a large loan portfolio in arrears, which in turn would affect the bank's capital ratios. In such circumstances, the bank may find itself having to offer higher than average deposit rates to attract more capital. Inevitably, these higher rates will be reflected in the bank's lending rate. Higher lending rates may in return adversely affect the

average quality of future lending, forcing the bank to lend high-risk borrowers. If the bank is to lend to the more creditworthy borrowers, it may be forced to cut margins to levels, which would be insufficient to generate profits (Brown Bridge 1998).

Evidence from many countries in recent years suggests that collateral values and recovery rates can be volatile and, moreover, they tend to go down just when the number of defaults goes up in economic downturns (Altman, Resti, & Sironi 2001).

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

According to Robert C. Vogel, (1997) Loan guarantee programs are thought to overcome some of the imperfections by allowing lenders to shift part of the loan recovery risk to the guarantee program—risks that typically cannot be secured by collateral furnished by small and new borrowers. In large measure, policymakers see guarantee programs as collateral substitutes for disadvantaged borrowers.

The loan guarantee covers part of the lender's risk of recovering loans made to target groups. It is often further argued that once lenders have experience with new clients who are covered by loan guarantees, these clients will later be able to graduate to borrowing without subsidized loan guarantees; partly because borrowers learn how to obtain formal loans, and partly because lenders assemble sufficient information about these new borrowers to make later loans without special guarantees.

## **1.2. Statement of the problem**

The loan extended to various sectors of the economy must be recovered in full if the objective of circulating more and more financial resources to meet the increasing demand for credit and to keep the bank in sound financial health is to be achieved. Both the principal and interest must be recovered. The bank collects the principals and interest from the clients on the due date.

But default may occur on the side of the client due to various reasons. If there is high incidence in the deficit of client, this leads the bank to be insolvent and weak in its financial position. Finally this situation will paralyze the investment program as well as the economy as a whole.

In this study, the researcher focuses to evaluate the credit recovery performance of the banking industry in general and, Awash International Bank s.co in particular between the Periods 2004 to 2008.

Thus, this study will try to answer the following major research questions.

1. Which loan sector (s) is (are) more efficient in returning their debt? (E.g. Agriculture, Industry, Domestic trade & services, Export, Import etc)
2. Is the trend of loan recovery performance in Awash International Bank S.Co satisfactory? (By sector)
3. Causes of weak loan recovery in the Awash International Bank s.co?

### **1.3. Objectives of the Study**

#### **A. General Objective**

The main objective of the study is to examine and assess the loan repayment performance of the banking industry in general and Awash International Bank S.Co in detail.

## **B. Specific Objective**

- To examine loan recovery performance among different loan sectors in yearly basis
- To examine the efficiency of Awash International Bank in loan recovery performance.
- Investigate causes and recommend solutions etc.

### **1.4. Significance of study**

It is believed that this paper will clearly reflect most of the difficulties observed or major factors that affect loan recovery performance of this Bank and gives possible solutions as to how to handle loan effectively and properly take up measures when problem occurs. And for other researchers it can be used as an additional reference for their findings. It is also hoped that this research paper gives guidelines to the concerned managers of the bank with regard to how they properly address the major factors that mainly affect Bank's loan recovery.

### **1.5. Scope and limitation of the Study**

The researcher intends to address different issues regarding loan recovery performance of this Bank. The research has taken specifically Awash International Bank s.c as a sample case for practical considerations. Because of financial and time constraint it is too difficult

to take all Banks that exist in Ethiopia in detail. Thus, the scope of the study is limited to discussing the practice in Awash International Bank s.co.

### **1.6. Hypothesis**

Though there are many factors which affect the growth of banking industries, poor loan recovery performance is believed to be the main factors which affect the growth of the banking industries. Thus, the writer of this study hypothesizes that in most cases loan recovery performance affects the growth of AIB. In addition, the writer believes that next to poor loan recovery performance the following factors may be the causes for the poor loan recovery. These are

- Lack of monitoring and follow up of loan disbursement and collection to different sectors
- Length of legal system and loan procedure
- Inadequate regulations

### **1.7. Research Methodology**

The method of the study is descriptive type and data is both quantitative and qualitative in nature. The type of the data that used in this paper is mainly secondary data and to some extent primary data is also applied. In the primary data collection effort, a questionnaire is also distributed to credit Department staffs of the Bank for securing feed back

on the credit recovery performance of the organization particularly in repayment of loan. On the other hand, secondary data is also gathered from Awash International Bank S.Co and National Bank of Ethiopia, which constitutes annual report of the year 2004 to 2008.

Since the type of study is descriptive type and the data is both quantitative and qualitative in nature, the analysis will be done in percentage, and ratio on tables of loan repayment performance of the bank different economic sectors. Recovery rate comparisons between the years will be used and this clearly helps to analyze and evaluate the credit repayment performance of the bank.

# CHAPTER TWO

## Loan Recovery: Conceptual and Theoretical Overview

### 2.1 Introduction

The chapter reviews the existing literature on loan recovery performance of banking industries, covers discussion on non-performing loans, and provides highlight on the history of Awash International Bank s.co.

*The numerous and varied risks in lending stem from the many factors that can lead to the non-payment of obligations when they come due. Losses sometimes result from “acts of God” such as storms, droughts, fires, earth quakes and floods. Changes in consumer demand or in the technology of an industry may affect drastically the fortunes of a business firm and place once profitable borrowers in a loss position. A prolonged strike, competitive price cutting, or loss of key management personnel can seriously impair a borrower ability to make loan payments. The swings of the business cycle affect the profits of many who borrow from banks and influence the optimism of business peoples as well as consumers.*

*Some risks arise from personal factors that are difficult to explain.  
Edward W.Reed (1985).*

According to World Development Report (1989), Developing Countries require efficient debt recovery procedures in order to fuel their ambitious development programme and economic growth .In most developing countries however, debt recovery is in crisis.

World Bank and the Asian Development Bank report (1993) also added that Poor debt recovery has become one of the most important problems facing lenders in developing countries, which has had a wide spread negative impact on economic growth. Investment has been impeded as a consequence of increased lending costs and denial of credit to many borrowers.

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

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

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

## **2.2 Overview of the history of banking in Ethiopia pre and post 1991**

### **Pre 1991**

According to Tekle-Birhan G/Michael, Birritu, 2007/08 special publication, it is the agreement that was reached in 1905 between Emperor Menilik II and Mr. Gillivary, representative of the British owned national Bank of Egypt marked the introduction of modern banking in Ethiopia. Accordingly, the first bank called of Abyssinia was inaugurated in February 16, 1906 by the Emperor. The society at that time being new for the banking services, bank of Abyssinia had faced difficulty of familiarizing the public with its services.

The bank had faced many pressures as a result of its inefficiency and purely profit oriented. Thus, an agreement was reached to abandon its operation and be liquidated so as to disengage banking from foreign control and to make the institution responsible to Ethiopian's credit needs. By shortly after Haile Sellassie came to power, the Bank of Ethiopia was a purely Ethiopians institution and was the commercial activities of the Bank of Abyssinia and was authorized to issue notes and coins.

During the invasion (1935) the Italians established branches of their main banks namely Bankca d'Italia, Banco diRoma, Banko diNapoli, and Banca Nazionale del lavoro.

In 1941, another foreign bank, Barclays Bank came to service in Addis Ababa till withdraw in 1943, shortly before the commencement of the full operation of the Bank of Ethiopia. The state Bank of Ethiopia acted as the central Bank of Ethiopia and as the principal commercial bank in the country and engaged in all commercial banking activities until ceased to exist by bank proclamation issued on December 1963.

The Ethiopian Monetary and Banking proclamation that came in to force resulted in splitting the function of commercial and central banking creating National bank of Ethiopia and Commercial bank of Ethiopia.

Pre 1994 Ethiopian banking industry was characterized by relatively less competition, low deposit mobilization, relatively high government intervention in their management and more loan access to state owned sector.

### **Post 1991**

Following the change in the economic policy, financial sector reform also took place. Monetary and Banking proclamation of 1994 established the National bank of Ethiopia as judicial entity, separated from government.

In 1994, Construction and Business Bank was established under proclamation number 203/1994 by taking over the rights and obligations

of Housing and saving Bank, which was previously established under proclamation number 60/1975 .Development Bank Ethiopia has also established under Regulation of 1974.

Monetary and Banking proclamation No.83/1994 laid down the legal basis for investment in the banking sector; consequently shortly after the proclamation the first private bank, Awash International Bank S.C was established in 1994.

The banking proclamation of 1994 has brought some changes in the credit policy of state commercial banks so as to react to competition forces from new entrants and at the same time to retain and enhance their market share in the industry. (Tekle-Birhan G/Michael, Birritu, 2007/08).

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

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

### **2.3.1. Capacity (Repayment Ability/Borrowing Capacity)**

“Capacity” of a borrower requires two aspects to be assessed. First, borrower must have legal capacity to borrow. For example, banks will not lend to minors. An assessment of the “financial capacity” of a borrower is relevant in ascertaining the repayment ability of a borrower (Sonali, Abeyrante, 2001).

*W.Reed and K.Gill (1985) also added that Banks are interested not only in the borrower's ability to repay but also in his or legal capacity to borrow .Banks make few loans to minors, since they can*

*disaffirm at a later date unless the proceed of the loan used are used for essential purpose when a loan is made to a minors, a parent, guardians or other person of legal age is usually asked to cosign the note.*

### **2.3.2. Character (Human /Management Factor)**

“Character” of a borrower plays an important role in the credit assessment process. A lending bank will look to a borrower’s past record, its banking operations, integrity and reputation to establish his character (Sonali, Abeyrante, 2001).

*W.Reed and K.Gill (1985) stated that the concept of character definition relates to credit transaction means not only willingness to repay debt but also a strong desire to settle all obligations within the terms of the contract. A person character usually possesses attributes such as honesty, integrity and morality, but character is difficult thing to evaluate. It is entirely possible for a person not to have all these qualities but still wish to repay financial obligations. Character worthy of credit is largely function of a person’s honesty and integrity.*

J.H Clemens (1989) also addressed character as “the banker should have complete confidence in the integrity and ability of the customer to use the money to advantage and to repay it within a

reasonable period. In the absence of such confidence it is preferable to decline to lend, no matter how much security may be available.”

Every banker needs to fix in his mind a clear picture of the ideal customer. This is true when the manager has known the customer well, by personal dealing with him and by repute over many years. Sinkey, Joseph F. JR (1996). Ibid (1996) also noted out that factor such as management goals, objectives and motivations need to be addressed. In a business loan assessment, adequate financial, technical and business management ability needs to be analyzed critically before making decision.

### **2.3.3. Capital (Financial position)**

Capital is the amount of funds invested by the borrower in a business to support both fixed asset and current assets in other words it described as “net worth support” (Flesig, H. 1995).

Banks should make sure that every borrower has sufficient equity to enable the creditors to recover their funds through the sales of assets other than the collateral pledged for the loan.

*“The equity of a company is an important factor to consider if the potential borrower is small business and also new to a bank, or where the business is relatively new. In the first few years of a small business it will usually have little or no retained earning, and*

*very little external financial help. It would, therefore, have to rely on its own capital in the event of externally imposed challenges such as interest rate fluctuations, inflation and changes in market conditions” (Sonali Abeyrante, 2001).*

#### **2.3.4. Condition (Economy)**

Economic conditions affect the ability of the borrowers to repay financial obligations but are beyond the control of the borrower and the lender, according to K.C Shaker (1982). In addition Ibid (1982) stresses that economic conditions make up the environment within which business units and individual operate, therefore, he noted out that the loan officer must become an economics forecaster.

Market conditions as well as social and economic conditions, affect a potential borrower’s business activities. It is quite possible that a borrower may satisfy all the other elements of credit assessment but if the potential borrower were engaged in a business that has an uncertain market, lenders would be reluctant to advance the money. A prudent lender will always closely study the prevailing conditions in a county before granting a loan (Sonali Abeyrante, 2001).

### **2.3.5. Collateral (Security)**

“Collateral” is not mandatory in the securing of a loan. Lenders, however, will favor the availability, if, in the bank’s view, there is an element of doubt as to the repayment capacity of a borrower. The amount of collateral that is taken must reflect that element of doubt (Sonali Abeyrante, 2001).

*Collateral refers to the particular assets of the firm that the bondholders (in our case the bank) receive if the firm defaults on the bond/loan (Barrow and et al 1981). Loans are frequently secured by assets of the borrowers, most cars, for example are purchased on credit and automobile serves as collateral for the loan. Security is taken in most instances to strength a weakness found in one or more of the credit factors such as ability to create income (J.H.Clemens, 1989).*

## 2.4. Principles of Good Lending Policy

*According to (Bedi & Hardikar 1993) when evaluating loan requests, bankers can make two types of errors. The first is extending credit to a customer who ultimately defaults; the second is denying a loan request to a customer who ultimately could repay the debt. In both cases, banks loose a customer and its profits.*

To minimize such errors and prevent problems of loans before their occurrences, there are few general principles of good lending that should be noted while considering an advances proposal. These include safety, liquidity, and purpose of loan proceeds, profitability and diversification.

**2.4.1. Safety:** the most important principles of good lending. When a banker lends, he must feel certain advances is safe. That is the loan is certainly collectable. If for example, the borrower invests the money in unproductive or speculative venture or if the borrower himself is dishonest, the advance would be in problem.

Similarly if the borrower suffers loss in his business due to his incompetence, the recovery of the money may become difficult. The banker ensures that the money advanced by him goes to the right type of borrower and is utilized in such a way that it will be safe at the time of

lending but will remain so throughout and after serving useful purpose in the trade or industry where it is employed, and is repaid with interest.

**2.4.2.Liquidity:** may simply defined as the ability of bank to convert to a sufficient amount of assets in cash readily and at favorable price to satisfy at any time both the normal and abnormally high withdrawal demand of its operation. A bank is said to be liquid if it has immediate access to funds at reasonable cost precise time as the funds are needed. In order to ensure liquidity of the bank, it is necessary to check liquidity of the loan to be granted. Therefore, it is not enough that the money will come back, it is also necessary that it must be collected on demand or in accordance with agreed terms of repayment.

The borrower must be in a position to repay with in a reasonable time after demand for repayment is made. This can be possible only if the money is employed by the borrower for short-term requirement and not locked up in acquired fixed assets, or in schemes that take long time to pay back. The source of repayment should be definite. The reason why bankers attach much importance to liquidity as to safety of their funds in that bulk of their deposits is repayable on demand or at short notice.

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

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

## **2.5. Non- performing loans and Banking crisis in different countries**

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

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

*“The impact of non –performing loans is not limited to only financial institution, loan losses also influences the employment rate. Qualitative analysis based on panel data (Dyama and Tanka, 2003) confirms that banks losses influence the unemployment rate. The*

*outcome indicates that the structural shift in the bank's loan loss ratio in the late 1990s in Japan accounts for roughly 20 % of the total shift in the unemployment"*

According to Working Paper done John P. Bonin and Yiping Huang January 2001, Chinese banks suffer from serious financial fragility manifested by high proportions of non-performing loans and low capital-adequacy ratios. A key policy introduced recently by the Chinese government to reduce financial risks is the establishment of four asset management companies (AMCs) for dealing with bad loans. The Chinese government has taken a series of measures designed to build a strong banking system including: recapitalization of the state-owned banks (SOBs), adoption of the international standard accounting system, for dealing with bad debt.

A discussion of China's banking problems concentrate on NPLs, although the exact quantification of these is difficult. Chinese authorities do not release official data for confidence reasons. Prior to 1998, Chinese banks used a loan classification system based on actual loan performance that divided NPLs into three types: overdue, doubtful and bad. This approach underestimated NPLs, as it did not include highly risky loans that were still paying interests and were not yet overdue (Ibid 2001).

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

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

## 2.6 Disposal of Non-performing loans

In some countries like Japan and China non-performing loan disposal can be accomplished in several ways (Takeo Hoshi & Anil 2004). One is for the regulators to force banks fully disclose non-performing loans, sell them to the market, and recognize the losses. Alternatively, or in addition, the government can set up an asset management company to purchase the non-performing loans directly from banks. Though this method has one potential problem in such that it can merely serve as a warehouse for non-performing loans.

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

According to Ross et al, (1998) a firm usually goes through the following sequence of procedures for customers whose payments are overdue: i) it sends out delinquency letter information the customer of the past-due status of the account ii) It makes a telephone call to the customer iii) It employs a collection agency iv) It takes legal action against the customer.

## **2.7 Loan Recovery through the courts**

A bank may institute an ordinary debt recovery suit by presenting a written document to a court of competent jurisdiction. The court will thereafter order summons to be issued to the defendant ordering him to appear before it on a given date to answer the claim against him. But if defendant refuses to acknowledge the service of summons, it could be served by affixing a copy of it on the outer door of his house (Sonali, Abeyrante, 2001).

On the day stated in the summons, both the plaintiff and the defendant must be present in court either in person or by their respective attorneys and the defendant must file a written statement of his defendant in court. The court will, thereafter, fix a date for the trial. Where the defendant does not appear and it is proved that a summons was duly served and that his absence was intentional, the court may order the suit to be heard (Takwani, 1994).

At the trial, issues will be framed, oral and documentary evidence will be recorded and arguments by both parties will be advanced. After the case has been fully heard, the court will pronounce its judgment in open court either on that day or on a future date. Once judgment is given it is followed by a decree. If a plaintiff is unhappy with the judgment, he can appeal to the court of appeal against the judgment on a question of

law or mixed fact and law, and then to the Supreme Court. Having obtained a decree from a court to recover the outstanding debt from the judgment debtor the lender must then proceed to execute the decree (Ibid 2001).

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

*It is clear that the problems encountered by lenders cannot be resolved only by enacting effective laws. There is a vital need to provide suitable training to judges who deal with commercial cases. In addition the administrative staff in the courts and the fiscal department must be made aware of the new procedure, and made to comply with the procedure set out in the new debt recovery laws. It*

*is equally important to encourage the members of the legal profession to act in the spirit of the enacted reforms (Wheeler, M. and Oldfeild, 1992).*

### **2.7.1 Delays in the courts**

Banks may lose their confidence in the courts, and are disillusioned with the legal systems because of the undue delay and backlog of cases in the courts. Of course in litigation, some amount of delays is inherent to the process but it becomes a problem when the delay is unjustifiable. The delays may be because of too few judges but it is difficult to generalize and conclude that if the strength is increased it would provide more judge time. Delays occur not only when the number of judges is deficient, but also when the judges are inefficient. It is a judge's professional duty to do what he reasonably can do to equip himself to discharge his duties with a high degree of competence. (Sir Bingham 1995).

*If a judge is incompetent, inefficient, or lacks the required skills to adjudicate, it will only be natural in the court where he sits; there is a backlog of cases (Sir Bingham 1995).*

Those researching delays in the developed countries have shown that there is a link between formal litigation procedure and the practice of the lawyers, sometimes referred to as the "local legal culture". In fact,

informal relationship between all the parties involved in litigation must not be ignored because they can become the key to most of the problems (Scott, I, 1995).

## 2.8 Problems Related to Credit Allocation

In the event of default, a lender must have the assurance that the principal sum lent together with interest earned can be recovered without delay. Its ability to do so is an important factor to be considered in assessing the credit risk. The traditional legal approach to loan recovery has been through court-driven procedures, but so far it has not proved effective due to delays experienced in the courts. On the other hand, prudent lending would help to prevent and minimize loan recovery problems (Sonali, Abeyrante, 2001).

(Ibid 2001) further explained that Prudent lending primarily involves effective processing of the entire loan transaction. Proper evaluation of the credit risk, accurate documentation of the loan and security agreements, and systematic monitoring of the progress of the loans will help to minimize loan default.

*“Prevention is better than cure”*: this was an issue that was widely debated in the regional Symposium on legal Issues in Loan Recovery, Credit and Security in Manila in 1993. It was agreed that by the time a loan goes bad it is often too late, and lenders are then faced with focusing on symptoms rather than the causes of default. When exploring the disputes between lenders and borrowers, it

*becomes clear that one of the causes of loan default is the lender's failure to process the loan properly (Murgatroyd, P., 1993).*

Lenders in developing countries find it difficult to gather information about borrowers that will assist them in assessing a borrower's creditworthiness. The available information is often not extensive, prompt or accurate. Lenders, particularly banks, informally exchange information about borrowers between themselves. Where a potential borrower is new to a bank, a formal credit reference from the borrower's bank may be sought. The information provided, however, may be vague and consequently not very helpful. It is also a common practice for banks providing such references to disclaim any liability for the information they provide (Ibid 1993).

External, particularly political pressures also undermine the quality of assessing credit risks and the ability to satisfactorily supervise loan account and their regular recovery. Politicians often promise credit facilities to borrowers, and thereby create situations where wrong procedures have to be followed when loans are being granted. There is a class of persons who, because of their political connections, have succeeded in obtaining large loans from state banks even though their capacity for repayment would be doubtful to prudent lenders. It is well known that among these debtors, the default rate is high but once again

political influence is used to forestall the institution of recovery proceedings (Rama, A.S 1984).

## **2.9 Organizational profile of Awash International Bank S.C**

Awash International Bank (AIB S.C) was established as the first private commercial bank (post 1991) on November 10, 1994 by 486 founder share holder with a paid –up capital of Birr 24.2 million and started banking operations on February 13, 1995.Over a decade the number of share holders and the amount of paid-up capital and reserves have increased to 2205 and Birr 197 million, respectively.

### **Objectives and corporate mission**

1. To meet the needs of the emerging private sector for quality and dependable domestic and international banking services
2. To expand and diversify commercial banking services in response to the growing demands of customers
3. To contribute towards the economic and social development of the country
4. To operate profitably in a sustainable manner.

### **Major activities**

1. To mobilize all types of deposits (savings, demand and time) and pay interest on interest bearing accounts.
2. To provide loans and advances to its customers, including long-term investment/project financing
3. To render domestic and international money transfer services

4. To provide international banking services such as:

- Imports operations
- Exports operations

5. handles foreign currency transactions namely,

- Buying and selling travelers' cheques
- Buying and selling foreign currency notes

6. Maintaining and operating non-resident accounts

7. To provide deposit services in foreign currency for Ethiopian nationals and foreign national of Ethiopian origin provides advice on banking, finance and investment to its customers.

### **Financial Highlight**

The balance sheet of the bank as at June 2007 revealed:

- Total assets : Birr 4,783,061,527
- Loans and advance:2,402,600567
- The capital of Awash International Bank s.c reached Birr 482,531,183

**Branches:** As at Jan 2009 AIB branch network reached 57 in numbers of which 23 are in Addis Ababa (city branches) and the remaining are outlying branches. Most of the branches of the bank are located in business-developed centers.

# CHAPTER THREE

## Research Methodology

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

### 3.1 Research Design and Approach

First, research problem, and general and specific objectives are stated, then related literatures were reviewed to gather empirical and theoretical facts, which are related with the problem in focus. After that questionnaires were constructed, and structured interview questions for AIB S.Co.credit analysts, Branch managers and loan officers were prepared. Experts' opinions were also gathered through depth interview questions. The obtained data were qualitative and quantitative in nature.

### 3.2 Sources of Data

Both primary and secondary data were used in this study. The primary data was collected from Questionnaire prepared for AIB S.C city branch managers, loan officers and head office credit department credit

analysts. Secondary data was collected from National Bank of Ethiopia (NBE) and Awash International Bank s.c annual reports.

### **3.3 Sample Size and Sampling Techniques**

Currently AIB S.C has 60 branches of which 30 branches are located in Addis Ababa, in which there are 30 branch managers and 23 loan officers. Therefore, the sample population of this study is a total of 63.

The basic criteria adapted to select the sample on primary data were two. I) the informants should be an employee of AIB s.c and ii) they should have an experience on credit assessment activities.

### **3.4 Data collection instruments**

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

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

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

### **3.4. Procedures in developing Instruments**

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

### **3.5 Data Analysis Tools**

An attempt was made to employ the relevant data analysis tools which are in compliance with the very nature of the data at hand. Time series analysis, charts and tables were also employed to analyze the gathered data.

In addition, the notes were taken during the interview and the information obtained from secondary data was used to carry out findings of the informants and written materials. Furthermore, the data analysis is presented by compiling the information gathered from both the interviews and questionnaires.

# CHAPTER FOUR

## Data presentation and Analysis

This chapter will contain analysis and interpretation of data collection on the credit recovery performance of banking industry of five years, from 2004 to 2008.

### 4.1 The trend of Loan recovery performance of Banking Industry

#### 4.1.1 Trend of loan disbursement by banks

**Table 4.1 Loan Disbursement of AIB S.Co.**

Year	2003/2004	2004/2005	2005/2006	2006/2007	2007/2008
Loan Disbursed	654.39	1,050.41	1,409.50	1,807.30	1,547.00
Growth Rate		0.62	0.34	0.28	0.14

Source: AIB S.Co.Annual Report 2004-2008)

- Loan Disbursement (in 000's of Birr)
- Growth Rate (in %)

From the data presented in the above table, it would be seen that the loan disbursed by AIB during the five years trend has a sharp decreasing trend from 62% during the base year (2003/2004) to 34%, 28% and 14% respectively to the recent period. During 2007/2008 the loan disbursed by AIB s.co decreased by 14% when compared with the preceding period. This high decreasing trend (from 62%to 34%) in amount of loan disbursed is because of loan disbursed to domestic trade

and service has declined in the same period which covers the lion's share (50%) of AIB loan disbursement. This is also because of the company's customer demand has been decreased. In effect, these would increase the level of risk that the company would face (since the biggest part of profit of the bank is generated from loan, this has a negative effect on the profit of the bank).

On the other hand, when we consider Dashen Bank (Annex 1) which is relatively in the same peer group with the aforementioned bank had an increment in loan disbursement during 2005/2006 and a decreasing trend in the following years( 25%, 40%, 15% and 9%) respectively. For Dashen bank though there is a decrease, it is not as such serious as that of Awash International Bank s.co. Similarly, Commercial Bank of Ethiopia that has lions share of loan disbursement in the market, the fluctuation is more or less similar to that of Dashen Bank as there is no decrease in the amount of loan disbursed during the period under consideration.

The industry average, which will be envisaged as the benchmark for the companies are 52%, 40%, 15% and 9% respectively. Still this loan disbursement trend shows a decreasing for the period under consideration. Hence, it would be possible to say that Awash International Bank s.c is relatively in more risky position than its peer

groups that means AIB's loan disbursement trend shows a sharp decrease than others.

Further more, the market share of Awash International Bank in the loan disbursed during the aforementioned periods are nearly equal for the first four years where as it dramatically falls from 12% to 6% during the last period.

On the other hand, the share of Commercial Bank Ethiopia during the same period on the other hand rose from 34% to 53%.It indicates that more than half of the total market share is dominated by this bank during the last period. This can be because CBE has the biggest lending capacity than other banks. The market share of AIB is even by far less than that of peer groups in the industry such as Dashen Bank, Bank of Abyssinia and Wegagen Bank.

Therefore, it would be implied that both the amount of loan disbursed and market share of Awash International Bank have dramatically declined because of the above mentioned reasons. And in addition during the current period new entrants such as cooperative Bank of Oromia and Lion International Bank have joined the industry. Particularly, this most likely happened from the increased market share of Cooperative Bank of Oromia, since their target customers are the same or mostly they operate the region, Oromia. The lions share that

Commercial bank of Ethiopia has in the market might also have significant impact on the shares of other banks including AIB in general.

#### 4.1.2 The trend of loan collection by banks

**Table 4.2 Loan Collection of AIB S.Co.**

Year	2003/2004	2004/2005	2005/2006	2006/2007	2007/2008
Loan Disbursed	512.70	718.22	813.90	1,191.50	1,078.66
Growth Rate		0.40	0.15	0.46	0.10

Source: AIB S.Co.Annual Report 2004-2008)

#### N.B

- Loan Collection (in 000's of Birr)
- Growth (Rate in %)

As indicated in the above table that the loan collected by Awash international Bank during the period under study(2003/2004 to 2007/2008) fluctuated from 40%, 15% , 46% and 10% respectively. The loan collection of the aforementioned company during year 2004/2005 was 40%. On the other hand, in the same period the loan disbursement raised by 62% indicating that the rate of collection is relatively fair when compared with loan disbursed. This implies the company is efficient in collection its loan for 2004/2005.

During the following period (2004/2005-2005/2006) loan collected decreased from 40% to 15%.This indicates that the customers' profitability decreased which hampered their paying back ability and this

in return has a negative effect up on the amount of loan collection and the bank is not efficient in collecting the loans during the stated period. But, during 2005/2006-2006/2007 the growth rate of loan collection increased from 15%-46% this because during this period the customers are in a good position in paying back their debt because of their profitability. Finally during 2006/2007-2007/2008 loan collection decreased from 46% -10%.This is also can be because of the reasons mentioned for the (2004/2005-2005/2006).

During 2007/2008, both the volume of loan disbursed and loan collected declined. Most of the time, during the periods under consideration the rate by which loan disbursed raised exceeds that of loan collected. On the other hand, envisaging the loan collection of Commercial Bank of Ethiopia (Annex 2), that has lions share in the market increased from 7% during the base period to 39%, 32%, and 48% respectively during the periods under consideration. Dashen Bank, which is in the same peer group with Awash Inter national Bank scores an increase in loan collection by rates of 43%, 25%, 37% and 40%, respectively. From these it could be deduced that their loan collection fluctuation rate is minimal when compared with that of Awash International Bank s.c.

Furthermore, pertaining to the loan collection of the banking industry as a whole, industry average more or less increased in volume (21%, 42%, 33% and 39%) respectively during the periods under consideration. AIB's rate shows high variation. Deviation of AIB's loan collection from industry average also shows the existence of some risks, because AIB's rate shows less than industry average.

The market shares of AIB in loan collection were nearly equal during the periods under consideration except during the last period when unexpectedly dropped below the industry's average share.

### **4.1.3 Trend of loan recovery rate by banks**

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

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

<b>Bank's Name</b>	<b>Trend of Loan Recovery</b>					<b>Total</b>
	2003/2004	2004/2005	2005/2006	2006/2007	2007/2008	
Commercial Bank of Ethiopia	0.32	0.34	0.47	0.59	0.49	0.54
Construction and Business Bank	0.15	0.12	0.18	0.25	0.26	0.25
Development Bank of Ethiopia	0.07	0.07	0.11	0.13	0.11	0.12
Awash International Bank	0.45	0.38	0.43	0.47	0.39	0.52
Dashen Bank	0.26	0.24	0.3	0.32	0.41	0.39
Bank of Abyssinia	0.31	0.18	0.28	0.34	0.56	0.44
Wegagen Bank	0.62	0.65	.56	0.94	0.45	0.45
United Bank	0.85	0.31	0.49	0.29	0.17	0.41
Nib International Bank	0.27	0.25	0.28	0.3	0.42	0.39
Cooperative Bank of Oromia			0.25	0.29	0.47	0.37
Lion International Bank				0.07	0.56	0.43
<b>Industry Average</b>	0.49	0.35	0.38	0.43	0.45	0.46

**Source:** NBE annual report and own calculation

Based on the above table, AIB's loan recovery rate for the year (2003/2004 & 2007/2008) are less than industry average, this shows that AIB's loan recovery performance was not efficient or satisfactory that means AIB's loan collection turn over or the rate at which the bank collects its outstanding loan from its customer is less than the industry average. This implies that the risk related to loan collection is high (high

risk of uncollectible). This has a negative impact on the profitability of the bank of the bank during the stated period. But for the period of 2004/2005, 2005/2006 & 2006/2007 loan recovery rate of AIB was more than the industry average, which shows good performance of loan collection.

#### 4.1.4 The trend of loan outstanding of banking industry

Table 4.4 Trend of loan outstanding of banking industry (Growth rate in %)

<b>Banks</b>	2003/2004	2004/2005	2005/2006	2006/2007	2007/2008
Commercial Bank of Ethiopia	-	0.07	0.01	0.05	0.78
Construction and Business Bank	-	0.06	0.55	0.11	0.04
Development Bank of Ethiopia	-	0.71	0.45	0.09	0.08
Awash International Bank	-	0.39	0.63	0.34	0.09
Dashen Bank	-	0.37	0.58	0.26	0.10
Bank of Abyssinia	-	0.08	0.93	0.19	0.22
Wegagen Bank	-	0.23	0.68	0.35	0.09
United Bank	-	0.41	0.97	0.45	0.22
Nib International Bank	-	0.56	0.44	0.23	0.16
Cooperative Bank of Oromia	-		-	0.69	0.35
Lion International Bank	-			-	0.20
<b>Industry Growth Rate</b>	-	0.22	0.32	0.16	0.33

**Source:** NBE annual report and own calculation

As indicated in the above table & annex 4 (the figures), total loans outstanding of banking industry for the years under consideration is increased except for the year 2006/2007 which indicate decrease from 32% to 16%. But, AIB's total loan outstanding growth rate decreased for the periods 2004/2005, 2005/2006, 2006/2007, 2007/2008 (71%, 45%, 9% & 8%) respectively.

In comparison with this decreasing loan outstanding growth rate, loan disbursement growth rate has also a decreasing rate, which we can clearly see that loan disbursement and outstanding have a direct relationship.

On the other hand, loan outstanding of banking industry (annex 4), during 2007/2008 all bank's loan outstanding decreased from the preceding year. Surprisingly Commercial Bank of Ethiopia's loan outstanding increased by 78% during the stated period. This could be, during the stated period CBE may be disbursed loan more than other banks and CBE loan collection was declined.

## **4.2 The trend of Credit Recovery Performance of Awash International Bank S.Co, by sector**

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

### **4.2.1 Credit recovery performance of the Agricultural sector**

To understand the recovery performance of AIB S.C, it is advisable to thoroughly look at its loan recovery rate by sector. The following table shows the loan recovery performance of the AIB S.C in the agricultural sector.

**Table 4.5 Credit recovery of performance of Agricultural sector**

(Amount in 000'&amp; Recovery rate in %)

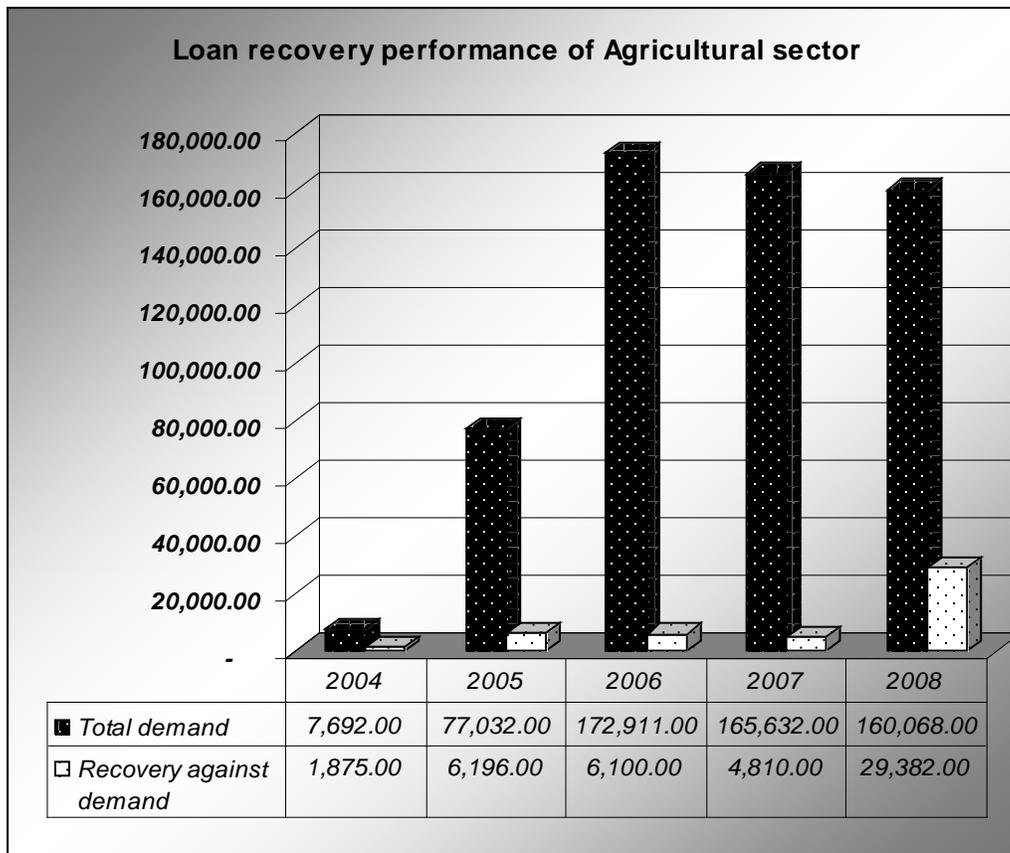
<b>Description</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>Total</b>
Total demand (P+I)	7,692	77,032	172,911	165,632	160,068	583,335
Recovery against demand	1,875	6,196	6,100	4,810	29,382	48,363
Recovery Rate	0.24	0.08	0.04	0.03	0.18	0.09
Balance in arrear as of Dec.31	5,817	70,836	166,811	160,822	130,686	534,972
Percentage of Arrear to total demand	0.76	0.92	0.96	0.97	0.82	0.91

**Source:** AIB annual report (2004-2008) and own calculations

As shown in the above table the total demand for the period under consideration was birr 583 million of which only birr 48 million was recovered. Total demand for agricultural loan indicates increasing trend in all years except year 2008 (decreased by 4%). But the recovery rate shows decreasing trend except year 2008 and generally only 9% of the total demand was recovered. This indicates that the loan recovery performance of the bank in the agricultural sector is declining or no

improvement was seen in the repayment of the loan. On the other hand, percentage of arrears to total demand is also very high for the year under consideration and also in the year 2007 the percentage reached almost 97%. Agricultural sector in developing countries is weather dependent especially in Ethiopia. This is because agricultural loan is a type loan with high level of risk of return which depends up on weather condition (rain feed agriculture).So, this could most probably affect loan recovery performance of the bank.

**Chart 4.1 Loan Recovery Performance of Agricultural sector**



#### 4.2.2 Credit Recovery Performance of industry sector

Awash International Bank s.c provides loans for financing the establishment and expansion of industrial sector of the national economy.

The following table indicates the recovery performance of the industrial sector with in the AIB S.C.

**Table 4.6 Credit recovery performance of the Industry sector**

(Amount in 000'& Recovery rate in %)

<b>Description</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>Total</b>
Total demand (P+I)	184,246	285,642	279,097	244,515	230,816	1,224,316
Recovery against demand	40,202	52,688	45,396	41,847	70,441	250,574
Recovery Rate	0.22	0.18	0.16	0.17	0.31	0.20
Balance in arrear as of Dec.31	144,044	232,954	233,701	202,668	160,375	973,742
Percentage of Arrear to total demand	0.78	0.82	0.84	0.83	0.69	0.80

**Source:** AIB annual report (2004-2008) and own calculations

As indicated in the table above the total demand for industrial sector was Birr 1.2 billion of which only Birr 251 million was recovered (only 20% of the total demand was recovered) for the year under consideration. The total demand indicates a decreasing trend except 2005. On the other hand, the recovery rate of the industry sector has also a decreasing trend (22%, 18%, 16%, 17%, &31%) except for 2008. This shows the industry sector bears some risks because recovery rate is decreasing compared to the base year. The reason behind low recovery rate of the industrial sector is there are some industries which are not profitable and hence weak in paying back their debt in time because these industries are not studied on the side of the borrowers about the profitability of the industry and the same problem is even the bank does not make the necessary industry study before granting the loan.

#### **4.2.3 Credit recovery performance Domestic trade & service sector**

The domestic trade and service sector constitute a major part from total loan outstanding of all sectors .According to credit follow up division of AIB s.c information this sector contains almost 50% of total demand.

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

(Amount in 000'&amp; Recovery rate in %)

<b>Description</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>Total</b>
Total demand (P+I)	417,387	582,410	866,015	826,574	1,151,925	3,844,311
Recovery against demand	11,031	28,489	47,120	95,913	260,722	443,275
Recovery Rate	0.03	0.05	0.05	0.12	0.23	0.12
Balance in arrear as of Dec.31	406,356	553,921	818,895	730,661	891,203	3,401,036
Percentage of Arrear to total demand	0.97	0.95	0.95	0.88	0.77	0.88

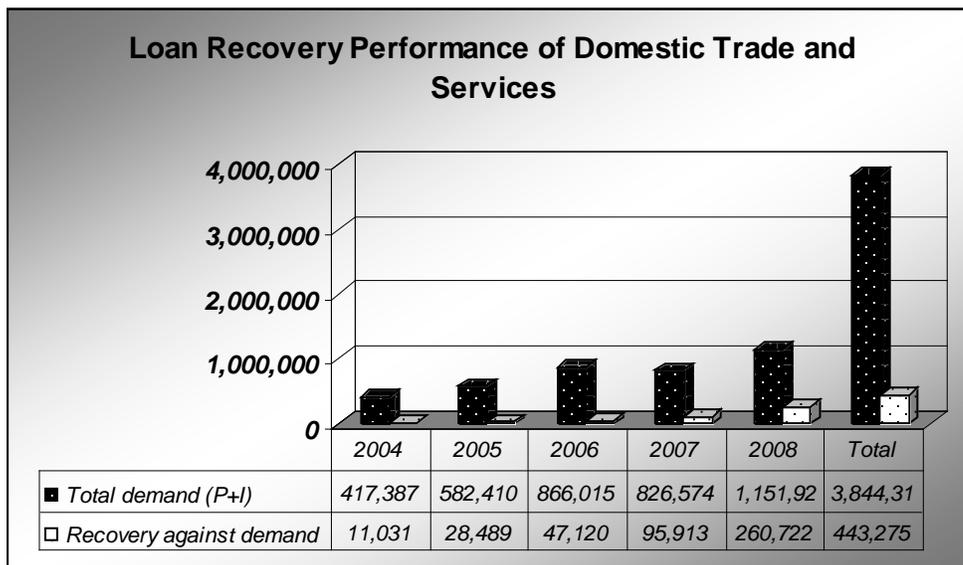
**Source:** AIB annual report (2004-2008) and own calculations

As can be observed from the above table, domestic trade and service sector recovered 3%, 5%, 12% & 23% from total loan demand of domestic trade and service sector for the years under considerations. Since this sector covers lion share of the total loan demand, loan recovery performance of this sector should be looked in to carefully. The total demand for the domestic trade & service for the period under consideration (2004-2008) was about Birr 3.8 billion of which only Birr 443 million was recovered from the sector(only 12%). This means about 88 % is recorded as percentage of arrears to total loan demand of

domestic trade and service sector. The total demand of the sector for the period shows an increasing trend, even though, recovery rate shows an increasing trend as of recovery against demand, and it is difficult to deduce that this sector's performance is satisfactory.

From this it is possible to infer that there is a weak but increasing recovery trend because most of the product traded by these borrowers is more demanded by consumers, the products are day to day lives of consumers and mostly during the inflationary period borrowers are in a better position to pay back their debts.

**Chart 4.2 Loan Recovery Performances of Domestic Trade and Service**



#### 4.2.4 Credit recovery performance of Export sector

Table 4.8 Credit recovery of performance of Export sector

(Amount in 000'& Recovery rate in %)

Description	2004	2005	2006	2007	2008	Total
Total demand (P+l)	59,796	90,002	224,612	258,511	163,068	795,989
Recovery against demand	11,031	28,489	47,120	95,913	101,233	443,275
Recovery Rate	0.18	0.32	0.21	0.37	0.62	0.56
Balance in arrear as of Dec.31	48,765	61,513	177,492	162,598	61,835	352,714
Percentage of Arrear to total demand	0.82	0.68	0.79	0.63	0.38	0.44

**Source:** AIB annual report and own calculations

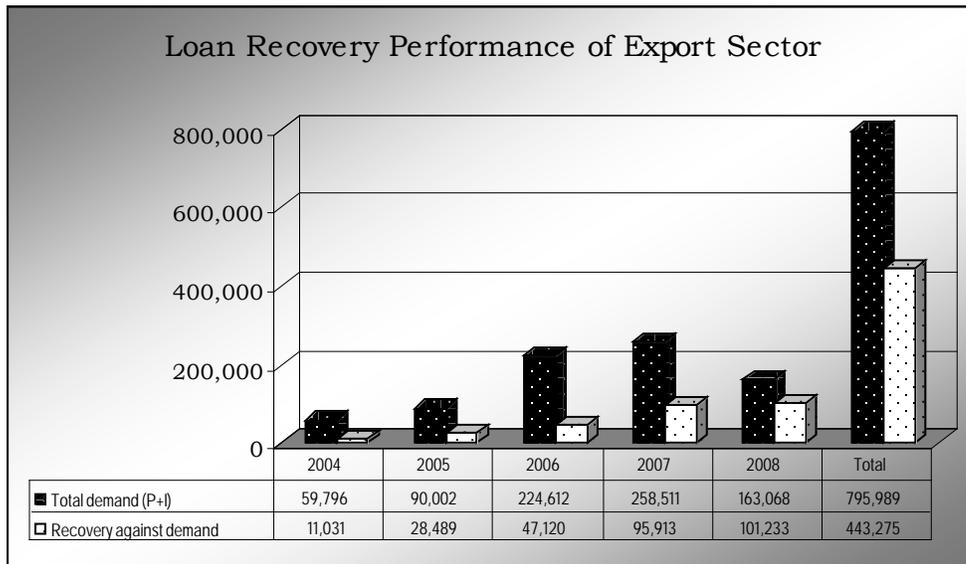
As can be seen from the above table, total demand for export sector has shown an increasing trend except for 2008. The reason for this increase in total loan demand of export sector is because of governmental foreign policy which encourages private sector participation in export sector. But the reason behind for the decrease in total loan demand of the sector in 2008 can be from global economic crises which has a negative impact up on export items for example cut flower and the like.

On the other hand, recovery against demand of the export sector also has shown increasing trend for the period under consideration. This

is because of high exchange rate of dollar in terms of birr which is advantageous for exporter in order to pay back its debt in time.

The recovery rate for the export sector shows an increasing trend except for the year 2006 and also in the year 2008 this sector showed the highest pick (62%). Generally, this sector's recovery performance can be characterized by a good loan recovery performance, 56% on average during the period under consideration.

**Chart 4.3 Loan Recovery Performance of Export sector**



#### 4.2.5 Credit recovery of performance of Import sector

Table 4.9 Credit recovery of performance of Import sector

(Amount in 000'& Recovery rate in %)

Description	2004	2005	2006	2007	2008	Total
Total demand (P+I)	203,968	214,787	294,371	339,170	377,586	1,429,882
Recovery against demand	151,736	161,050	221,880	215,311	344,043	1,094,020
Recovery Rate	0.75	0.75	0.76	0.63	0.92	0.93
Balance in arrear as of Dec.31	52,232	53,437	72,490	123,859	33,543	97,874
Percentage of Arrear to total demand	0.26	0.25	0.25	0.37	0.09	0.07

**Source:** AIB annual report (2004-2008) and own calculations

As can be observed from the above table, total loan demand for import sector increased for the period under consideration. From the total demand birr 1.4 billion; 1.3 billion birr was recovered from this sector. That means almost 93% loan was recovered from this sector for the period stated.

Generally, this can be, since the government encourages the importation of raw materials by arranging duty free importation scheme for the production of goods in the domestic economy for export purpose. After export the borrowers are in a better position to pay back the loan

for import sector. And also since most importers import consumer goods which are widely consumed in the domestic economy, borrowers of this loan sector are also in a better position to pay back their loans.

#### 4.2.6 Credit recovery of performance of transportation Sector

Table 4.10 Credit recovery of performance of transportation sector

(Amount in 000'& Recovery rate in %)

Description	2004	2005	2006	2007	2008	Total
Total demand (P+I)	39,214	47,641	220,340	263,725	214,685	785,605
Recovery against demand	23,915	28,362	50,876	82,620	122,768	308,541
Recovery Rate	0.61	0.60	0.23	0.31	0.57	0.39
Balance in arrear as of Dec.31	15,299	19,279	169,464	181,105	91,917	477,064
Percentage of Arrear to total demand	0.39	0.4	0.77	0.69	0.43	0.61

**Source:** AIB annual report (2004-2008) and own calculations

As per table depicted above, total loan demand for transportation sector was increased from year to year except for the year 2008. As can be seen total demand dramatically increased from Birr 48 million to 220 million Birr for the year 2005 to 2006. And also the amount recovered against demand was increasing from year to year. This yearly increment in the amount of loan recovered from this sector is because, the economy

is a growing economy which has a high demand of transportation (passengers and cargo) and hence high profit earning, this in return has a positive effect up on repayment ability of the borrowers that is why the bank's loan recovery performance had increased for this sector. And out of the total loan demand only 39% was recovered showing low recovery performance of the sector.

#### 4.2.7 Credit recovery of performance of Building & construction sector

Table 4.11 Credit recovery of performance of Building & construction sector

(Amount in 000'& Recovery rate in %)

<b>Description</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>Total</b>
Total demand (P+I)	91,366.0 0	136,304.0 0	253,902.0 0	280,179.0 0	310,801.0 0	1,072,552.0 0
Recovery against demand	24,673.0 0	36,207.00	41,820.00	56,981.00	64,674.00	224,355.00
Recovery Rate	0.27	0.27	0.16	0.20	0.21	0.21
Balance in arrear as of Dec.31	66,693.0 0	100,097.0 0	212,082.00	223,198.0 0	246,127.0 0	848,197.0 0
Percentage of Arrear to total demand	0.73	0.73	0.84	0.80	0.79	0.79

**Source:** AIB annual report (2004-2008) and own calculations

As indicated in the above table, the total loan demand of building & construction sector and recovery against demand of the same sector

has an increasing trend. This indicates that there is an increased demand of construction for both residential and commercial buildings in the country as a whole and also the reason behind for an increasing trend of loan recovery against demand is that there is an increased income level of the citizens which increased their paying ability of the loan. But balance of arrear for the period under consideration shows an increasing trend and this was also because of an increasing trend of demand for the loan in the sector.

Even though the amount of recovered amount increased for the year under consideration, it doesn't mean that this sector is performing well because recovery rate of this sector is very small compared to total demand. On the other hand, the percentage of arrears to total demand shows almost more than 70% from the total demand.

#### 4.2.8 Credit recovery of performance of personal loan sector

Table 4.12 Credit recovery of performance of personal loan sector

(Amount in 000'& Recovery rate in %)

Description	2004	2005	2006	2007	2008	Total
Total demand (P+I)	4,228.00	9,293.00	24,515.00	27,904.00	39,590.00	105,530.00
Recovery against demand	2,185.00	5,772.00	4,553.00	2,930.00	6,775.00	22,215.00
Recovery Rate	0.52	0.63	0.19	0.11	0.18	0.21
Balance in arrear as of Dec.31	2,043.00	3,521.00	19,962.00	24,974.00	32,815.00	83,315.00
Percentage of Arrear to total demand	0.48	0.38	0.81	0.89	0.83	0.79

**Source:** AIB annual report (2004-2008) and own calculations

As shown in the above table, the total loan demand for personal loan sector had an increasing trend this was because of an increased expenditure of households up on necessity goods such as residential building, furniture, cars etc in relation with increased population and also to off set the effect of inflation up on their income level.

On the other hand, the recovery against the demand had fluctuated for the period under consideration. This was because of the decrease in repayment ability of the borrowers because of inflation .The

rate of loan recovery of personal loan sector was increased for the year 2004 & 2005, but automatically declined from 63% to 19% and continued to decrease for the year under consideration. This was because of the inflation effect up on consumer goods.

#### **4.2.9 Sectoral relationships and Comparison of Loan Recovery performance of AIB (2004-2008)**

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

<b>Description</b>	<b>2003/2004</b>	<b>2004/2005</b>	<b>2005/2006</b>	<b>2006/2007</b>	<b>2007/2008</b>
Agriculture	0.24	0.08	0.04	0.03	0.18
Industry	0.22	0.18	0.16	0.17	0.31
Domestic trade & service	0.03	0.05	0.05	0.12	0.23
Export	0.18	0.32	0.21	0.37	0.62
Import	0.75	0.75	0.76	0.63	0.92
Transportation	0.61	0.60	0.23	0.31	0.57
Building	0.27	0.27	0.16	0.2	0.21
Personal	0.52	0.63	0.19	0.11	0.18

**Source:** AIB S.Co Annual Report (2004-2008) and own calculation

In general, the loan demand of AIB for all the sectors had an increasing trend except some years, 2007& 2008. But for industrial sector it had a decreasing trend except for 2005.

And the loan recovery against demand for the sectors such as domestic trade & service, export, import, transport and building & construction had an increasing trend while agriculture, industrial and

personal loan sectors had a fluctuation in their loan recovery trend during the period under consideration.

And also the recovery rate of domestic trade & services and that of export sector had an increasing trend. In contrast, the recovery rate of agricultural, industry and building & construction sectors had a decreasing trend except for the year 2008. But the recovery rate of transport and personal loan sectors had a fluctuating trend while the import sector had a constant recovery rate of trend during the period.

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

**Table 4.14 Average Loan recovery Rate of AIB (2004-2008) of sectors**

<b>Sectors</b>	<b>Percentage Recovered</b>
1. Agricultural	9%
2. Industry	20%
3. Domestic trade & services	12%
4. Export	56%
5. Import	93%
6. Transportation	39%
7. Building & construction	21%
8. Personal	21%

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

### 4.3 Data analysis and Interpretation of Primary data

In addition to information collected from secondary data, this project paper was carried out using the structured questionnaire with the objective of evaluating the performance of loan recovery in Awash International Bank s.c.

The respondents are branch managers, loan officers, and credit analysts and the respondents have an educational background of B.A and diploma in Business related area with a banking experience that ranges from three to twenty three years of work experience.

**Table 4.14 Respondents' Qualification**

Qualification	Certificate		Diploma		Degree		Masters	
	Fre	%	Fre	%	Fre	%	Fre	%
Accounting			5	0.12	13	0.33		
Management					9	0.16		
Economics					11	0.22	1	0.022
Business Management					7	0.13		

**Source: Own survey data, 2009**

According to the above table, some 33% of the respondents have first degree in Accounting .Slightly more than twenty two (22%)of the respondents have degree in Economics and 16% of the informants have first degree in Management. It can also be seen from the above table that some 13% of the respondents have first degree in Business Management

and 11% of the respondents have Diploma in Accounting. Also there is one second degree graduate in Economics.

As can be observed from the above figure, majority of the respondents are (13 in number) are graduate of Accounting (Degree) and eleven are Economics (Degree) graduates are assigned in area of loan activities.

**Table 4.15 Respondents' experience**

<b>Service year of the respondents</b>	<b>Frequency</b>	<b>%</b>
1-5 years	18	40
6-10	13	29
11-15	7	16
16-20	5	12
21-30	2	5
> 30		

**Source: Own survey data, 2009**

The above table depicts that nearly half of the informants (40%) service years falls under the category of 1-5 years of service. Also (29%) of the respondents have served for 6-10 years. On the other hand, 16% of the respondents have served for 11-15 years and 12% of the respondents served for 16-20 years.

As indicated in annex 5, all of the respondents disclosed that the bank has various loan facilities availed to its borrowers. Apart from the

above description, the respondents noted that the bank has other facilities that include building and construction, & overdrafts too.

Many factors are considered by bank's Credit Department in analyzing a loan request. They are the ingredients which determine the lending officers' faith in the debtor's ability and willingness to pay the obligations. Pertaining to five C's of credit analysis factors, as indicated by respondents, all informants replied that the bank considers all the five C's in order to analyze the loan request.

As illustrated by respondents, AIB's lending procedure has some problems. Around fifty five (55%) of the respondents responded that the lending procedures lack details and completeness. Others indicated that it lacks revision of credit manual to reflect existing objective reality. This is especially common in the loan recovery and collection part and the procedure of legal measures i.e. it would allow to make prompt action as soon as possible. On the other hand, (45% of the respondents indicated that AIB's credit procedure manual is adequate to make the credit risk assessment.

As indicated in the annex 5, some respondents replied that some borrowers are not willing to disclose necessary information that is crucial for loan risk analysis. Around ninety one percent (91%) of the respondents revealed that borrowers are not willing to disclose necessary

information to assess credit risk. This resulted in delay in loan processing and poor lending decision that entails poor recovery performance such as raise in NPL.

As per the information inferred from respondents, majority of the respondents about (93%) denoted that AIB's relationships with defaulters are weak. This could be the major reason for weak loan collection performance. The bank and the borrower should have strong relationship in order to tackle problems attached with NPL.

On the other hand, 89% of the respondents indicated that there are situations in which NPLs are recovered fully. They suggested that NPL could be recovered fully through contacting the customers, or discussion, through sale of proposed collateral, by consent of borrowers, by identifying other attachable properties (legal actions to take over other properties which are not pledged as collateral from the sale of the collateral) and by allowing additional working capital that could reverse NPL to the right track. Contrary to this, only 11% of the respondents indicated that NPL could not be recovered fully due to borrower death and change of addresses (Ethio-Eriteria problem).

As per summary of responses, majority of the respondents about 71% also indicated that the Directive of National Bank of Ethiopia is strictly adhered by AIB to manage non-performing loan management. On

the other hand, 29% of the respondents believe that because of poor documentation of circulars & directives and sometimes the analysis of the bank show that the client can regularize the repayment if chances are given contrary to the directive of NBE.

With regard to the way NPL affect the general growth condition of the bank, majority of respondents reflected similar idea. As per the respondents' suggestion, NPL affects the profitability of the bank since provision is held for every category of NPL, liquidity of the bank and lending capacity of the bank.

As can be seen from attached annex 5, inadequate loan assessment is the major contributing factor for NPL to accumulate. This means it got direct negative effect on performance of loan repayment. All respondents (100%) declared that the accumulation of NPL in AIB is caused primarily as a result of inadequate loan assessment. According to the respondents, problem in loan recovery performance of the bank starts with loan assessment problems. Most respondents also argued inadequate collateral, diversion of funds, and lack of follow up, exaggerated property estimation or over and under estimation of property to be some of the reasons for the accumulation of NPL or poor loan recovery.

# CHAPTER FIVE

## Conclusions and Recommendations

### 5.1 Conclusions

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

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

Based up on the analysis from the secondary data, the researcher had the following conclusions.

Generally, with regard to the loan disbursement by Awash International Bank s.co it had a decreasing trend and in comparison with the banking industry it showed a low share of loan disbursed for the period under consideration. This means the amount of fund that is being lent by the bank is being decreased which has a negative impact up on its profit.

And the trend of loan collection of AIB s.co was fluctuating trend during the period under consideration in comparison with the industry average; it had a low loan collection trend but its peer groups such as Dashen Bank had an increasing trend in their loan collection. This implies that there are/is problems of loan follow-up and supervision.

On the other hand, the loan recovery rate of Awash International Bank s.co during 2003/4 and 2007/8 showed a low loan recovery rate but during 2004/5, 2005/6 & 2006/7 the recovery rate was more than the industry recovery rate.

Regarding the loan outstanding growth rate, AIB's loan outstanding growth rate was decreasing during the period under consideration. But the banking industry's loan outstanding growth rate was increasing except for the year 2006/7. This implies that the bank is

not collecting the amount of loan disbursed in time or the bank is not lending more money which have a negative impact up on its profit.

Based up on the analysis of AIB's credit recovery performance of the sectors the researcher has concluded the following findings:

For the agricultural sector the loan recovery rate was decreasing and out of the total loan demand during the period only 9% was recovered showing a poor loan recovery performance. This can be because of un predicted bad weather condition.

And for the industrial sector, the loan recovery rate was increasing except for the year 2008 and out of the total loan demand of this sector only 20% was recovered and the remaining 80% was arrears or outstanding again showing low performance of loan collection for the sector.

On the other hand, though for both domestic trade & service and export sectors, their credit recovery rate were increasing except for the year 2006 (export sector), out of the total loan demand during the period under consideration 12%&56%was recovered, respectively. This indicates poor loan recovery performance for domestic trade & service sector but good loan recovery performance for export sector.

Again for the import sector, the loan recovery rate was increasing except for the year 2007.And out of the total loan demand during the

period under consideration 93% was recovered showing the biggest loan recovering rate, in comparison with other sectors.

And for both building & construction and personal loan sectors the loan recovery rate showed fluctuation during the period under consideration and out of the loan demand for each sector 21% was recovered indicating low level of loan recovery performance. And again for transportation sector the loan recovery rate was in slight decrease pattern for 2004-2006 but showed an increasing trend for the following years and out of the total loan demand of the sector during the period 39% was recovered.

In general, out of eight loan sectors of AIB under study five of sectors' recovery rates are less than 22%. And out of the total loan demand of AIB during the period, on average only 34% was recovered. This implies on average 66% of the total loan demand was not recovered.

Depending up on the analysis of the primary data the researcher found that:

In reality when educational level and experiences of loan officers is compared with volume of unrecovered loans the bank's effort to exploit the potential of loan officers and the related parties' still short falls.

And the bank's credit procedural manual is not adequate enough for credit assessment since it lacks annual revision, the appropriate detail; and some times lacks objective reality on loan collection.

And finally, lack of willingness from the borrowers side to fully disclose the necessary information which is crucial for the credit risk analysis.

## **5.2 Recommendations**

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

1. To increase the amount of disbursement, the bank should attract more borrowers by giving a better quality loan service so as to share customers from other banks or potential customers.
2. To increase the amount of loan collection or the recovery rate, the bank should properly assess the five C's of the credit analysis factors before the loan is granted and also after the loan is disbursed the bank should follow up whether the loan disbursed is being expended for the intended purpose or not. Not only that, but also the bank should give the proper

specialist advice for the borrower how and where (investment sectors) to invest the fund to be profitable.

3. For the agricultural loan sector, AIB should reduce the amount of loan disbursement, because from all the loan sectors the biggest percentage (91%) of the loan demanded during the period under study was not recovered. And the bank should recommend the borrowers of this loan sector the use of irrigation to reduce the risk of bad weather condition (lack of rain fall).
4. In general, for the industry, domestic trade & service, building & construction and personal loan sectors the bank should design an effective loan procedure which can help to assess the financial position of potential customers to screen out sound which are eligible for the above loan sectors. And the bank should conduct research about the demand and profitability of products of the above sectors.
5. Since 66% of the total loan demand for sectors during the period under consideration was not recovered by AIB, it is advisable to pay attention up on loan collection by all concerned parties i.e. Bank's Board, Management including

Branch managers, loan officers, credit analysts and other related parties.

6. The bank should effectively use the potential of man powers especially loan officers in order to make an effective credit assessment especially for those borrowers who don't want to disclose full information.
7. And finally, AIB should revise its credit procedure manual in order to reflect the existing reality that can reduce uncollectible loans of different sectors (loan procedure manual that can screen out potential defaulters in advance).
8. Prudent lending would help to prevent and minimize loan recovery problems. Prudent lending primarily involves effective processing of the entire loan transaction. Proper evaluation of the credit risk, accurate documentation of the loan and security agreements, and systematic monitoring of the progress of the loans will help to minimize loan default.

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Addis Ababa  
University  
(Since 1950)



**Addis Ababa University School of Graduate  
Department of Accounting and Finance  
(Questionnaire prepared for AIB Credit analysts, Loan Officers and  
Branch Managers)**

**Feyisa Gurmu  
Post Graduate student**

I am a post graduate student in AAU carrying out a research under the topic “The trend of Loan Recovery Performance in Banking Industry: A case study of Awash International Bank S.CO.”

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

**Thanks in Advance**

- **Position in the Bank** \_\_\_\_\_
- **Years of service** \_\_\_\_\_
- **Qualification ( e.g. Diploma in Accounting)**  
\_\_\_\_\_

1. Which of the following credit facilities are entertained by AIB S.C?

<b>Types of Loan By Sector</b>	<b>Tick In the Box</b>				
	<b>Loans By Maturity</b>				
	<b>Yes</b>	<b>No</b>	<b>Short Term</b>	<b>Medium Term</b>	<b>Long Term</b>
Manufacturing and Distribution					
Import & Export Trade					
Domestic Trade & Service					
Transport & Communication					
Hotel & Tourism					
Agriculture					
Merchandise					
Personal or Consumer Loans					

If others please specify \_\_\_\_\_

\_\_\_\_\_

1. Based on your answer on question No.1 above, which credit facilities maturity (repayment period) are affected by the following factors? **(Hint: Tick in the box)**

	Economic Analysis	Industry Analysis	Company Analysis	Technical Analysis	Financial Analysis	Ratio Analysis
Manufacturing and distribution						
Import & Export Trade						
Domestic Trade & Service						
Transport & Communication						
Hotel & Tourism						
Agriculture						
Merchandise						

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

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

If other please specify

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How do you evaluate them? \_\_\_\_\_

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4. Do you think that the banks lending procedure manual has got a defect?

Yes  No

If yes, in what part? \_\_\_\_\_

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

<b>Factors</b>	Yes	No
Inadequate loan assessment		
Political influence		
Real estate speculators		
Lack of monitoring		
Inadequate regulation		
Length of the legal system		
Corruption		
Lack of follow-up		

If other, please specify 1. \_\_\_\_\_

2. \_\_\_\_\_

3. \_\_\_\_\_

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

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

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8. How often is bank's credit manual & policy revised?

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

Yes  No

If No, what do you think of the effect?

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

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

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

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_
4. \_\_\_\_\_
5. \_\_\_\_\_.

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

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_
4. \_\_\_\_\_
5. \_\_\_\_\_.

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

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_.

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

Yes  No

If yes why? \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_.

If No, why?

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_.

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

Yes  No

If No, why?

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If yes, how, explain it.

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

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

Yes  No

If No, why?

---

---

---

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

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19. What are the commonly accepted collaterals by the banks?

**Loan category**

**Collateral offered**

- |                       |    |
|-----------------------|----|
| 19.1 Term loans ----- | a) |
|                       | b) |
|                       | c) |
|                       | d) |

19.2 Overdrafts----- a)  
b)  
c)  
d)

19.3 Merchandise Loan -----a)  
b)  
c)  
d)

19.4 Advance against import letters  
of credits ----- a)  
b)  
c)  
d)

19.5 Advance against export bills----- a)  
b)  
c)  
d)

19.6 Advance against import bills -----a)

- b)
- c)
- d)

19.7 Temporary credit facilities----- a)  
b)  
c)  
d)

19.8 Loans under export credit guarantee scheme-- a)  
b)  
c)  
d)

19.9. Personal loans----- a)  
b)  
c)  
d)

19.10. Loans under USAID guarantee scheme-----a)  
b)  
c)  
d)

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

\_\_\_\_\_.

**Thank you!!**

## ANNEX 5

### Summary of Reponses

Questions	Number of respondents			
	Yes		No	
	Freq	%	Freq	%
1. Which of the following credit facilities are entertained by AIB S.C?				
➤ Manufacturing and Distribution	44	97%	1	3%
➤ Import & Export Trade	45	100%		
➤ Domestic Trade & Service	45	100%		
➤ Transport & Communication	45	100%		
➤ Hotel & Tourism	45	100%		
➤ Agriculture	45	100%		
➤ Merchandise	45	100%		
➤ Personal or Consumer Loans	45	100%		
2. Do you consider the following five C's credit analysis factors, when you analyze the loan request?				
➤ Collateral	45	100%		
➤ Condition	45	100%		
➤ Capital	45	100%		
➤ Character	45	100%		
➤ Capacity	45	100%		
3. Do you think that the banks lending procedure manual has got a defect?	25	55%	20	45%
4. Do borrowers disclose every data that the bank demands during loan request?	4	9 %	41	91%
5. Do you think the relationship between your bank and default borrower is weak?	42	93%	3	7%

6. Is there any situation in which NPLs are recovered fully?	39	89%	6	11%
7. Do you think that the Directive of National Bank of Ethiopia is strictly adhered by your bank regarding non-performing loan management?	32	71%	13	29%

**Source: Own survey data, 2009**

### **Type of business the rate of NPL is high**

Please indicate in which type of business the rate of NPL is high? What are the reasons you mostly observed?	
1. Manufacturing and distribution	√
2. Import & Export Trade	
3. Domestic Trade & Service	√
4. Transport & Communication	√
5. Hotel & Tourism	
6. Agriculture	
7. Merchandise	
8. Personal or Consumer Loans	

**Source: Own survey data, 2009**



**QUARTERLY DISBURSEMENT OF LOANS BY CLIENTS, BANK AND SECTORS**

In Millions of Birr

	2002/03				2003/04				2004/05			
	Qrt I	Qrt II	Qrt III	Qrt IV	Qrt I	Qrt II	Qrt III	Qrt IV	Qrt I	Qrt II	Qrt III	Qrt IV
<b>Disbursement</b>	<b>987.2</b>	<b>1111.6</b>	<b>861.5</b>	<b>1137.5</b>	<b>1120.9</b>	<b>1505.5</b>	<b>1763.2</b>	<b>1822.1</b>	<b>2,320.3</b>	<b>2,621.8</b>	<b>2,508.6</b>	<b>1,982.3</b>
Public Enterprises	1.9	16.5	21.5	182.5	59.4	68.0	179.9	441.1	578.5	408.6	82.2	243.8
Cooperatives	196.8	87.4	20.0	3.3	248.4	132.8	41.0	44.0	462.3	259.2	324.7	185.2
Private Sector	788.5	1007.6	820.1	951.7	813.1	1304.7	1542.2	1336.9	1279.5	1954.0	2101.7	1553.2
Interbank Lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Disbursement</b>	<b>987.2</b>	<b>1111.6</b>	<b>861.5</b>	<b>1137.5</b>	<b>1120.9</b>	<b>1505.5</b>	<b>1763.2</b>	<b>1822.1</b>	<b>2,320.3</b>	<b>2,621.8</b>	<b>2,508.6</b>	<b>1,982.3</b>
Commercial Banks	552.5	416.6	233.7	433.3	534.3	427.6	460.7	862.9	1,367.6	1,070.5	870.8	663.338
Construction and Infrastructure	12.0	12.1	21.3	23.3	20.0	18.1	32.9	29.9	31.4	75.3	48.8	64.375
Development Finance	7.3	29.0	14.7	5.8	25.2	87.3	92.5	85.3	102.6	139.7	215.5	125.213
Awash International Bank	120.4	132.8	91.4	87.6	111.4	199.2	216.9	127.0	190.5	315.0	298.9	246.035
Dashen Bank	79.2	275.1	107.1	199.2	159.1	251.8	270.1	259.8	232.9	361.5	302.5	284.344
Bank of Abyssinia	42.7	55.5	53.5	51.7	30.6	75.8	56.3	52.7	98.8	79.8	143.9	101.682
Wegagen Bank	94.6	126.8	189.1	194.1	152.7	319.1	461.5	254.1	164.7	372.0	400.1	347.719
United Bank	31.3	21.4	59.5	88.1	40.1	40.4	86.2	51.3	55.8	96.2	122.0	68.362
Nib International Bank	47.2	42.4	91.1	54.4	47.5	86.3	86.1	99.1	75.9	111.7	106.2	81.185
<b>Disbursement</b>	<b>987.2</b>	<b>1111.6</b>	<b>861.5</b>	<b>1137.5</b>	<b>1120.9</b>	<b>1505.5</b>	<b>1763.2</b>	<b>1822.1</b>	<b>2,320.3</b>	<b>2,621.8</b>	<b>2,508.6</b>	<b>1,982.3</b>
Agriculture	212.2	138.6	43.8	50.6	245.2	191.8	76.2	69.8	575.4	351.9	319.1	313.877
Industry	180.7	95.7	129.1	102.6	153.5	189.5	196.9	189.2	224.2	271.3	267.7	317.184
Domestic Trade	272.0	430.4	261.5	249.3	244.3	465.2	449.0	305.1	409.9	668.4	474.0	355.347
International Trade	146.0	208.5	269.5	351.6	240.2	328.0	556.2	531.5	328.4	919.8	1,043.1	647.395
Export	54.5	110.1	173.0	204.0	96.8	189.1	369.5	140.4	96.4	341.2	533.4	270.507
Import	91.5	98.4	96.5	147.6	150.5	138.9	186.7	391.1	232.0	578.6	509.7	376.888
Hotels and Tourism	14.5	8.2	9.4	8.9	7.4	12.2	8.7	4.6	16.4	12.9	11.0	8.581
Transport and Communication	25.5	39.8	39.0	46.8	46.1	74.6	204.7	165.3	91.3	102.1	87.5	90.666
Housing and Construction	93.4	106.8	78.1	114.0	46.4	112.6	142.6	71.0	93.6	193.5	169.9	169.372
Mines, Power and Water	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-	-	-	0
Others	35.6	64.7	20.3	205.7	121.0	113.6	110.6	461.9	565.1	72.9	117.4	60.026
Personal	7.3	19.0	10.9	8.0	9.7	18.2	18.5	23.7	16.0	29.1	18.8	19.805
Interbank Lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-	-	0.0	0
Table 2												
<b>QUARTERLY COLLECTION OF LOANS BY CLIENTS, BANK AND SECTORS</b>												

In Millions of Birr

	2002/03				2003/04				2004/05			
	Qrt I	Qrt II	Qrt III	Qrt IV	Qrt I	Qrt II	Qrt III	Qrt IV	Qrt I	Qrt II	Qrt III	Qrt IV
<b>Collection by</b>	<b>1028.7</b>	<b>1150.4</b>	<b>1116.6</b>	<b>1257.0</b>	<b>1181.9</b>	<b>1196.5</b>	<b>2110.9</b>	<b>1399.5</b>	<b>1,551.6</b>	<b>1,513.3</b>	<b>2,121.3</b>	<b>1,959.9</b>
Public Enterprises	16.2	118.0	14.1	19.6	41.2	107.9	768.9	113.3	161.7	178.2	172.3	92.252
Cooperatives	72.0	174.1	170.0	90.8	91.5	50.0	215.4	127.6	100.7	58.4	301.3	201.462
Private Sector	912.0	841.0	898.4	1116.5	1049.2	1035.5	1094.3	1155.5	1,245.5	1,273.7	1,603.6	1663.17
Interbank Lending	28.5	17.2	34.0	30.0	0.0	3.1	32.3	3.1	43.7	3.1	44.1	3.062
<b>By Banks</b>	<b>1028.7</b>	<b>1150.4</b>	<b>1116.6</b>	<b>1257.0</b>	<b>1181.9</b>	<b>1196.5</b>	<b>2110.9</b>	<b>1399.5</b>	<b>1,551.6</b>	<b>1,513.3</b>	<b>2,121.3</b>	<b>1,959.9</b>
Commercial Banks	585.5	654.2	535.4	537.5	550.6	477.2	1346.5	583.5	758.6	667.9	975.3	748.622
Construction and Development Banks	31.6	29.1	32.3	24.5	25.6	20.0	25.1	27.8	28.1	32.2	31.7	35.684
Awash International Dashen Bank	80.9	87.1	72.2	103.5	136.6	199.0	66.2	110.9	136.5	175.1	206.6	200.015
Bank of Abyssinia	89.7	99.9	112.9	119.1	117.6	122.4	114.9	171.1	176.7	171.0	193.0	211.859
Wegagen Bank	43.5	51.2	50.7	69.6	54.8	40.4	146.5	65.8	93.8	76.3	84.9	91.444
United Bank	97.8	87.6	154.9	191.2	143.7	181.0	68.4	193.0	123.9	160.9	341.4	408.36
Nib International	23.9	27.3	32.6	71.0	45.7	38.8	200.8	85.0	43.3	50.4	81.3	91.428
Collection by	30.7	37.3	48.3	48.5	53.7	53.1	76.1	97.4	78.3	90.9	104.1	97.68
<b>Collection by</b>	<b>1028.7</b>	<b>1150.4</b>	<b>1116.6</b>	<b>1257.0</b>	<b>1181.9</b>	<b>1196.5</b>	<b>2110.9</b>	<b>1399.5</b>	<b>1,551.6</b>	<b>1,513.3</b>	<b>2,121.3</b>	<b>1,959.9</b>
Agriculture	112.0	120.6	194.5	125.7	110.5	73.7	246.6	141.6	120.9	81.6	426.3	222.841
Industry	79.7	98.3	122.2	130.1	94.0	139.0	143.7	131.5	183.6	184.6	236.5	191.571
Domestic Trade	277.0	284.9	234.5	339.7	351.2	291.8	354.2	409.5	403.0	380.9	402.4	428.914
International Trade	278.2	248.1	225.8	283.4	296.4	345.8	1018.3	413.1	458.6	503.1	543.2	721.163
Export	186.4	138.5	125.5	182.9	125.1	104.9	415.8	181.9	240.3	180.1	300.3	422.825
Import	91.9	109.6	100.3	100.5	171.3	240.8	602.5	231.2	218.3	322.9	242.9	298.338
Hotels and Tourism	23.2	20.4	15.9	23.4	23.2	23.0	26.3	13.7	19.2	21.8	65.2	21.425
Transport and Communication	84.6	97.2	109.5	126.7	126.5	89.5	101.3	87.4	76.8	99.8	86.7	117.807
Housing and Construction	90.7	170.7	91.8	75.5	78.2	71.8	73.3	81.2	95.7	131.9	167.5	111.392
Mines, Power and Manufacturing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	46.3	-	6.7	0
Others	47.2	77.7	79.9	112.4	85.9	136.6	94.3	103.9	93.6	83.2	123.7	123.687
Personal	7.5	15.3	8.3	10.1	16.0	22.3	20.6	14.4	10.2	23.4	19.0	18.0851
Interbank Lending	28.5	17.2	34.0	30.0	-	3.1	32.3	3.1	43.7	3.1	44.1	3.061
Table 3												
<b>QUARTERLY OUTSTANDING LOANS BY BANK</b>												
	2002/03				2003/04				2004/05			
	Qrt I	Qrt II	Qrt III	Qrt IV	Qrt I	Qrt II	Qrt III	Qrt IV	Qrt I	Qrt II	Qrt III	Qrt IV
<b>Outstanding</b>	<b>14967.0</b>	<b>15406.9</b>	<b>16060.8</b>	<b>15543.4</b>	<b>17614.4</b>	<b>16583.0</b>	<b>17656.7</b>	<b>17750.0</b>	<b>18,353.1</b>	<b>20,269.8</b>	<b>21,598.7</b>	<b>21,749.0</b>
Central Government												

In Millions of Birr

Public Enterprises	1076.4	1063.0	1,548.1	1224.8	1199.5	1613.5	2032.4	2227.2	2,503.0	3,012.8	3,093.0	3175.254
Cooperatives	768.1	823.4	674.1	600.7	910.8	736.9	566.7	513.5	872.9	1,083.6	1,115.4	1081.189
Private Sector	12624.8	13036.4	13,355.4	13261.4	15062.5	13793.5	14640.9	14595.2	14,596.0	15,794.8	17,047.4	17152.407
Interbank Lending	497.7	484.0	483.1	456.6	441.6	439.1	416.7	414.2	381.1	378.5	342.8	340.188
<b>By Banks</b>	<b>14,967.05</b>	<b>15,406.91</b>	<b>16,060.78</b>	<b>15,543.44</b>	<b>17614.4</b>	<b>16583.0</b>	<b>17656.7</b>	<b>17750.0</b>	<b>18,353.1</b>	<b>20,269.8</b>	<b>21,598.7</b>	<b>21,749.0</b>
Commercial Banks	8903.0	8825.2	9031.8	8361.0	8028.3	8763.9	9211.7	8135.0	8,405.0	9,339.0	9,623.3	9556.422
Construction and Development Banks	699.9	695.6	695.6	701.5	709.9	715.5	737.8	731.2	631.6	674.2	707.4	739.52
Awash International Dashen Bank	631.9	705.5	772.9	800.1	770.8	822.8	971.4	946.2	968.6	1,146.0	1,343.9	1289.753
Bank of Abyssinia	896.1	1039.8	1165.8	1248.9	1305.8	1460.5	1615.9	1680.7	1,739.8	1,993.8	2,138.9	2218.462
Wegagen Bank	681.4	789.4	818.2	788.5	822.9	929.6	981.1	947.6	963.7	1,008.4	1,117.5	1217.801
United Bank	383.2	475.9	543.4	570.9	594.1	766.1	837.2	737.9	753.6	946.1	1,043.7	1002.328
Nib International	173.6	211.9	260.6	290.5	293.3	307.9	364.1	360.1	381.2	433.2	487.1	513.218
	340.8	430.0	522.5	551.0	540.1	655.3	725.5	786.8	839.5	1,024.5	1,103.1	1133.347
<b>Outstanding</b>	<b>14967.0</b>	<b>15406.9</b>	<b>16060.8</b>	<b>15543.4</b>	<b>17614.4</b>	<b>16583.0</b>	<b>17656.7</b>	<b>17750.0</b>	<b>18,353.1</b>	<b>20,269.8</b>	<b>21,598.7</b>	<b>21,749.0</b>
Central Government												
Agriculture	1399.1	1441.0	1304.5	1202.9	1699.7	1384.2	1224.0	1162.1	1,589.0	1,864.7	1,887.4	2018.238
Industry	2547.9	2634.8	2720.0	2749.8	3142.1	2967.1	3067.9	4207.6	4,422.9	4,660.6	4,938.9	5135.592
Domestic Trade	1761.4	1993.6	2089.3	1947.8	1863.6	2150.3	2366.7	2192.6	3,818.5	2,421.7	2,622.3	2660.186
International Trade	2438.1	2510.0	2598.8	2559.2	2143.8	2896.0	3561.0	3396.5	2,931.1	3,990.0	4,900.0	4548.005
Export	681.3	840.9	942.9	856.3	710.5	853.5	1132.7	944.8	840.2	1,297.0	1,901.9	1459.543
Import	1756.8	1669.1	1655.9	1702.9	1433.3	2042.5	2428.3	2451.7	2,090.9	2,693.0	2,998.1	3148.084
Hotels and Tourism	364.7	344.9	344.6	318.5	366.3	320.8	297.0	322.9	372.6	323.7	320.9	316.665
Transport and Communication	765.7	713.8	642.7	599.7	533.5	542.1	745.6	773.1	804.4	834.5	835.5	873.249
Housing and Construction	1810.5	1834.7	1876.6	1896.8	1927.2	1915.5	2039.3	2038.7	1,929.4	2,060.5	2,116.5	2218.318
Mines, Power and Manufacturing	13.6	13.6	13.6	13.6	28.1	13.6	13.6	13.6	13.6	13.6	13.6	13.616
Others	3338.8	3399.0	3946.0	3743.4	5412.1	3893.8	3863.9	3170.7	2,026.5	3,645.7	3,550.0	3449.8651
Personal	29.8	37.5	41.4	55.2	56.5	60.5	61.0	58.2	63.9	76.3	70.8	115.494
Interbank Lending	497.7	484.0	483.1	456.6	441.6	439.1	416.7	414.2	381.1	378.5	342.8	340.188

**Notes:**

Excluding lending to Central Government in the form of T-bills and government bonds.

**Annual Disbursement of loans by clients, bank and sectors**

<b>Disbursement</b>	<b>2005/06</b>	<b>2006/07</b>	<b>2007/08</b>
	<b>12,401.90</b>	<b>15,559.00</b>	<b>27,254.50</b>
Public enterprise	307.40	935.5	5,174.50
Cooperatives	1,965.10	2533.4	5,390.00
Private sector	10,129.40	12,090.10	16,690.00
Interbank Lending	-		
<b>Disbursement</b>	<b>12,401.90</b>	<b>15,558.80</b>	<b>27,254.40</b>
Commercial Bank	4,115.90	5,231.70	14418.2
Construction Finance	430.50	350.60	233.8
Development Finance	572.00	723.90	795.5
Awash International Bank	1,409.50	1,807.30	1547
Dashen Bank	1,676.40	1,935.80	2145.7
Bank of Abyssinia	885.90	982.40	1934.3
Wegagen Bank	1,997.30	2,399.30	2754.1
United Bank	629.80	688.90	746.8
Nib International Bank	469.70	994.50	1144.1
Cooperative Bank	214.90	388.00	1337.6
Lion International Bank		56.40	197.3
<b>Disbursement</b>	<b>12,402.00</b>	<b>15,558.90</b>	<b>27,254.40</b>
Agriculture	2,188.80	2,621.00	5,371.60
Industry	1,301.90	1,524.90	2,739.40
Domestic Trade	2,458.10	2,986.40	5,012.10
International Trade			
Export	1,657.80	2,233.80	3,116.30
Import	1,884.40	2,143.20	6,094.10
Hotels and Tourism	92.40	165.00	243.60
Transport and Communication	1,007.00	1,431.50	1,337.70
Housing and Construction	1,167.00	1,674.90	2,017.00
Mines, power and Water	-	13.30	59.30
Others	503.40	585.40	997.50
Personal	141.20	179.50	265.80
Interbank Lending			

**Annual collection of loans by clients, bank and sectors**

Collection by	2005/06	2006/07	2007/08
<b>Collection by</b>	<b>10,178.20</b>	<b>13,488.50</b>	<b>18,789.20</b>
Public enterpr	917.30	1231.9	686.40
Cooperatives	1,630.80	2559.2	5,024.50
Private sector	7,550.10	9,639.30	12,996.10
Interbank Len	80.00	58.1	82.2

Collection By	10,178.10	13,488.60	18,789.25
Commercial B	4,375.80	5,755.20	8508.184662
Construction ε	192.00	288.50	315.483
Development I	576.00	779.00	669.368
Awash Interna	813.90	1,191.50	1078.658
Dashen Bank	938.60	1,284.60	1793.487
Bank of Abyss	554.00	794.90	1576.275
Wegagen Bank	1,646.20	2,019.10	2707.78
United Bank	419.80	359.90	257.47843
Nib Internatio	409.30	540.00	893.237156
Coperative Ba	252.50	470.40	872.46995
Lion International Bank		5.50	116.8254544

Collection by	10,178.10	13,488.50	18,789.20
Agriculture	1,409.10	2,254.60	4,443.40
Industry	1,153.40	1,442.60	1,587.30
Domestic Trad	1,838.80	2,518.90	3,424.50
International Trade			
Export	1,656.50	1,795.40	2,526.80
Import	1,859.00	2,236.70	3,158.60
Hotels and To	104.70	131.20	201.70
Transport and	509.70	843.20	1,075.50
Housing and c	727.00	975.80	1,431.90
Mines, power a	-		0.40
Others	735.50	1,116.20	733.00
Personal	104.40	112.70	120.60
Interbank Len	80.00	61.2	85.5

**Annual Outstanding loans by clients, bank and sectors**

	2005/06	2006/07	2007/08
<b>Outstanding l</b>	<b>26,751.10</b>	<b>31,102.60</b>	<b>41,339.80</b>
Public enterpr	3,017.40	3263.1	8,732.60
Cooperatives	1,848.80	2025	3,161.10
Private sector	21,610.00	25,588.80	29,269.60
Interbank Len	274.90	225.7	176.5

<b>Outstanding l</b>	<b>26,751.10</b>	<b>31,102.60</b>	<b>41,339.90</b>
Commercial B	9,295.50	9,758.70	17338.5
Construction ε	1,041.70	1,153.40	1198.4
Development I	5,376.50	5,865.50	6,358.00
Awash Interna	1,872.40	2,512.30	2737.9
Dashen Bank	3,154.00	3,980.50	4382.4
Bank of Abyss	1,944.00	2,305.10	2822.7
Wegagen Bank	1,593.50	2,155.10	2346.8
United Bank	855.50	1,239.10	1515.3
Nib Internatio	1,475.40	1,817.30	2108.9
Coperative Ba	142.60	240.30	323.9
Lion International Bank		75.30	207.1

<b>Outstanding l</b>	<b>32,076.00</b>	<b>31,753.10</b>	<b>18,789.20</b>
Agriculture	3,418.00	4,218.40	4,443.40
Industry	6,320.10	6,996.50	1,587.30
Domestic Trad	3,345.70	3,821.40	3,424.50
International l	5,324.90	650.30	
Export	1,580.70	2,334.50	2,526.80
Import	3,744.20	4,165.90	3,158.60
Hotels and Tot	316.60	675.50	201.70
Transport and	1,578.00	2,369.70	1,075.50
Housing and c	3,206.90	3,790.70	1,431.90

Mines,power a	31.10	40.90	0.40
Others	2,842.00	2,316.40	733.00
Personal	92.90	147.20	120.60
Interbank Len	274.90	225.7	85.5