ST. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES
FACULTY OF BUSINESS

Assessment of Loan Recovery performance in Development Bank of Ethiopia

BY: ENDALE KIFLU

JUNE, 2015

Addis Ababa Ethiopia

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THESIS SUBMITTED TO ST.MARY'S UNIVERSITY SCHOOL OF GRADUATE STUDIES IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION IN ACCOUNTING AND FINANCE

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DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Zenegnaw Abiy (PhD), All sources of material used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institutions for the purpose of earning any degree.

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ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a university advisor.

Zenegnaw Abiy (PhD) ________________________

Advisor Signature

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ABSTRACT

This study is carried out as an assessment of loan recovery performance in Development Bank of Ethiopia. The study is based on primary data collected through questionnaires survey from 118 employees working in loaning unit of Bank. The study also uses secondary data collected from financial statements, quarterly reports, annual reports, credit policy, and procedure. Descriptive research methods has been employed to identify the loan recovery performance of the Bank. The assessment result shows that the loan repayment period, assessment of customer credit history, collateral estimation, project follow up, monitoring and controlling system, delays to decide on non performing loans has affected the loan recovery performance of the Bank. The study is of crucial importance to measure whether DBE does have adequate policies & procedures manual, whether the credit unit verifies outstanding liabilities of the borrowers before additional and new loans are granted, the existence & adequacy of feasibility study, whether the bank has a proper way of gathering credit information internally & externally. Inadequate credit policies and procedures manuals, unrealistic loan repayment period, inefficient analyses of customers' financial statement and absence of well-designed project follow up system are the major finding of the study. Based on these findings, I recommend the bank to exert maximum efforts to be updated & review the credit policies & procedures manual frequently as the policies & procedures of the bank are outdated and do not consider the current situation, Furthermore, the bank loan repayment period should consider the nature and cash flow of the project in order to collect the loan as per the repayment schedule instead of performing based on assumption and in terms of loans period. At the final point, the bank should give prior attention to the human resource development through short term training, job rotation, and experience sharing. Particularly creating awareness in relation to analysis of customers' financial statements is crucial since Analysis of the financial statements of borrowers is an important means to obtain information about how the borrowers operated in the previous period. The study will help to enhance the efficiency and effectiveness of loan administration operation & provide different methods and ways to safe guard asset (primarily loans), adequacy, and accuracy of its loan review function; promote to comply with management policy, procedure, applicable laws, and regulation

Key Words:

Loan , Loan Recovery performance , Loan Repayment , Credit , Credit Management , Non –performing loans ,Collaterals, Disbursement , Credit Policy , Credit Risk, Loan portfolio

LIST OF ACTRONYMS

CP	Credit Process
DBE	Development Bank of Ethiopia
KYC	Know Your Customer.
LPM	Loan Portfolio Management
NBE	National Bank of Ethiopia
NPL	Non Performing Loans
PRLR	Project Rehabilitation and Loan Recovery Sub-Process
RCMP	Risk & Compliance Management Process

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1. INTRODUCTION

1.1. Background of the Study

Credit has recognized as one of the important financial service that contributes to the success of a business venture. This success is in turn believed to contribute towards economic development of the country. However, the existence of credit facility alone does not necessarily result in supporting economic development unless and otherwise it is accompanied by the existence of factors conducive to the efficient utilization of credit funds. For instance, a loan has to be repaid on time, if the objective of making loan able funds available to those who want them for productive purpose on continuous base is to be met. (Nelson, 2003).

Development Bank of Ethiopia (DBE) is bound by minimum reserves obligation without considering of whether it makes profit or not. These reserves are called legal and general reserves, which constitute 25% & 75% of its capita respectively. (NBE, 1994) If the bank has to retain sufficient money for the business operations, it has to generate more income.

As an effective loan recovery performance increase the bank's income, more income is also improving the recovery performance since it bestows energize to the bank to spend more for follow up recovery activities and other administrative costs that are related to the recovery activities. Both of them are strongly feeding each other.

Therefore, systematic follow-up recovery of loan plays a significant role in the Bank's operations. In fact, this is not exaggeration of the state that effective recovery of loans is the backbone of any financial institutions. In finance, the term recovery refers to collection of amount due.

According to various literatures, the normal recovery depends on the purpose, time, and condition, business-running process etc. Due to this, the bank can fix installment period based on nature of their business since recovery is different from one loan to another, as normally loan amount will be recovered on installment basis.(DBE loan manual June 2014)

Beyond the urge to extend credit and generate revenue, banks have overtime developed credit policies and procedures, which stipulate the lending process. This process includes among others the credit appraisals, documentation, disbursements, repayments, monitoring and recovery processes, which comprises the established international standards.

Credit policies and procedures should safeguard the financial credibility of the Bank while at the same time maintaining a positive resource flows to borrowers. It should also reduce the negative effects borne by borrowers implementing projects and businesses financed by the bank. Through more systematic information, it should help borrowers to better program their repayments. .(DBE loan manual June 2014)

Last but not least, the need to study Loan Recovery performance of Development Bank of Ethiopia (DBE) is to evaluate the banks operation by reviewing the efficiency and effectiveness of loan administration operation, ability of different components to safe guard the Bank's assets in general, the recovery of loans in particular, adequacy and accuracy of its loan review function and compliance with prescribed management policies and procedures, applicable laws and regulations.

1.2. Statement of the problem:

As the components of loan recovery administration functions, responsible management must understand and demonstrate, in monitoring and controlling of the repayment of loans by the clients. These include not only implementing appropriate policy procedure, but also assessment of the borrower business liability, through various key indicters.

The determinates of loan repayment performance have been studied by, Abraham Gebeyehu in 2002, Kibrom Tadesse in 2010, Mulugeta Shiferaw in 2010, Adamu Legesse in 2013 and Muluken Tariku in 2014 and each researcher used different methods applied to their studies. However these previous studies over emphasized in specific commodity or product, branches (which do not have many and positional borrowers to reflect the true picture of the bank) as a result the output of the researches did not show the overall loan recovery performance of the Bank. In addition to those researchers' main source of data was customers' files and field survey that has been obtained from borrowers' information. Currently customers' files and follow up reports are being criticized by the management because of the quality and the content of the reports due to lack of commitment and competency of officers.

This research paper however will use employees' information (manager & other professionals) as primary data and try to assess overall recovery performance of the Bank; from this perspective, the study will be different from that of previous research works.

DBE's loan recovery performance for the past 4½ years starting from 2011 up to December 2014 shows 41%, 70%, 51%, 41% and 31% sequentially. As per the Bank's report, the main reason for not meeting the loan recovery performance target because of various reasons that this research paper to deal with. Since, loan recovery issue has gained increasing attention the last five years. The immediate consequence of large amount of loan recovery balance in the banking system is creating sever operational functioning problems and it would decrease the Bank's opportunity in relation to take advantage the competitive environment.

Thus, studying loan recovery performance and knowing the related factors that may contribute to the exhibited weak loan recovery performance of the bank, factors like problems in credit policy, the appraisal process, disbursement, follow-up, repayment contracts, and other unforeseen cause of default, which enforce the researcher to conduct this study.

Main Research Questions:
What problems does the bank face in the process of loan recovery?
What are the appropriate measures to improve the efficiency of loan recovery performance of the bank?
What mechanism does the bank follow to enhance loan repayment of the clients?
What are the recommendations to make?

1.3. General Objectives the Research

The main objective of this study is to assess the loan recovery performance of Development Bank Ethiopia in the last five years. In doing so, the study survey will address the following Specific Objective:

- To assess the appropriateness performance of the credit policy in achieving loan recovery performance in order to improve the efficiency of loan recovery performance of the bank.

- To examine the appropriateness of credit assessment process used by DBE & identify the problems in the process of loan recovery.
- To examine the appropriateness of the loan disbursement procedure & enhance loan repayment of the client.
- To examine how efficient is the project follow up system & propose suggested solutions.

1.4. Significance of the Study:

The study will show management and other interested parties, the true picture of loan recovery performance of DBE, and will help the bank to enhance the efficiency and effectiveness of loan administration operation. The research result will provide different methods and ways to save guard asset (primarily loans), adequacy, and accuracy of its loan review function; promote to comply with management policy, procedure, applicable laws, and regulations. In addition to this, the study paper will contribute for other researcher as an input who wants to do further study on this topic.

1.5. Scope and Limitation of the study

The study will attempt to assess and analyze the total loan recovery performance of Development Bank of Ethiopia at corporate level, and undertaking on the data, for the period covering 2011 up to 2014. The problems, which I face in conducting this research, are time constraints & unable to collect the entire questionnaires from the respondents.

1.6. Organization of the Paper

Including this introduction section, the study has five sections. The second section deals with the different literatures that reviewed in relation to the topic under consideration. Section three deals with the methods used while undertaking the study. The data analysis and findings of the study presented under section four. The last section, section five, summarizes the study and recommends possible solution.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2. LITERATURE REVIEW

This chapter reviews the previous works that are related and relevant to the proposed study In order to understand the different facts associated with the study area and create common knowledge on the topic both theoretical and empirical reviews is made on literatures of the area.

2.1 DEFINATION OF KEY TERMS

Loans means any financial assets of a development finance institution arising from a direct or indirect advance of funds (i.e. unplanned over drawings, participation in loan syndication, the purchase of loans from another lender, etc.) or commitment to advance funds by a development finance institution to a person that are conditioned on the obligation of the person to repay the funds, either on a specified date or dates or on demand, usually with interest. The term includes a contractual obligation of a development finance institution to advance funds to or on behalf of a person, claim evidenced by a lease financing transaction in which the development finance institution is the lessor, and line of credit to be funded by the development finance institutions on behalf of a person. (NBE, Directive, No. SBB/52/2012, Article, 4.5)

Medium or long term loans means according to National Bank of Ethiopia a loans with original repayment or maturity period of two years or more **and Short term loans** means loans with original repayment or maturity period of less than two years..(NBE, Directive, No. SBB/52/2012, Article, 4.6 & 4.14)

Loan Repayment: This is the act of taking back the money one has browed from a financial institution.

Credit Risk means the potential that a bank's borrower or counterparty will fail to meet its obligations in accordance with agreed terms. (DBE's Risk Management Policy, Jan., 2011).

Non-performing loans means loans whose credit quality has deteriorated such that full collection of principal and/or interest in accordance with the contractual repayment terms of the loan or advance is in question.(NBE Directives No.SBB/ 48/2010)

Loan Portfolio shall mean the full collection or assortment of loans extended to of the Bank. (NBE, Directive, No. SBB/52/2012).

Collateral a security pledge for the payment of a loan, DBE's requires first-degree collateral right up on the project itself.(DBE's Loan Manual, June 2014)

2.2 THEORETICAL LITERATURE REVIEW

The following section the researcher summarizes the theoretical review that are arrived on the different literature made on the same areas.

2.2.1 Concept of debt recovery:

Debt recovery is the process of pursuing loans, which have not repaid, and managing to recover them by convincing the loonies to attempt to repay their outstanding loans. Normally, this role of recovering loans is not an easy task as clients will go out of their way to prove inaccessible to the lender (bank).the banking industry in most cases has a debt recovery unit, which is in charge of following before they become delinquent and attempt to recover the loans. (Beatrice A.,2012)

Debt recovery is a very important component of banking as it plays a key in ensuring that the main objective of the bank (to issue loans) results into the desired outcome of making a margin out of the loans advanced. It is evident that the presence of debt recovery puts pressure to the loans to pay up lest they get the dreaded calls from the banking staff through the debt recovery unit. Debt recovery unit is involved in the day today role of ensuring that the loans issued to the bank's customers repaid as per the schedule of contract signed by the customer and bank. The task of debt recovery entails compiling a list of overdue loans and proactively managing the loans by calling up customers who are defaulting. This unit is equally charged with the role of liaising with lawyers no draft demand letters to the loan defaulters and sending the same to the customers who are defaulting.(Beatrice A.,2012)

2.2.2 Loan Overdue and Recovery:

The magnitude of recovery amount overdue is one of the most important indicators of financial health of banks. Currently, the accepted standard of measurement of over dues is in relation to demand. The logic for the demand as the basis is that it is the amount, which has become due and not the amount, which is yet to become due for repayment. This distinction is important because loans will have varying due dates for installments' as they are issued based on future cash flow from investments. (K.C.Sharma.et al.2001)

The term "over dues" is used to convey the meaning that installments' of loans and Interest thereon are not paid on due date. The term "recovery" of dues relates to repayments of loans and interest thereon in time. Therefore, over dues exist if recovery of loans is not in time.(K.C.Sharma.et al.2001)

2.2.3. Credit Policy:

Credit policies reviews and monitored on regular basis to take account of changing market conditions, company strategy, competition, and financial needs a carefully documented. Credit policy is a fundamental requirement to put into practiced sound credit management, and should serve at least the following purpose according to Beatrice A.(2012) :

- To define the objective of credit extension in the context of corporate of strategy and organization structure
- To define the authority and responsibilities for credit granting, establishing and varying terms and the timing of collection actions
- To provide documented procedures in relation to the above that can be communicated to all staff
- To specify training policy for credit staff
- To specify performance targets and monitoring activities for credit staff
- To reinforce "one company-one customer" culture throughout the organization

The credit policy of a company should developed in accord with the strategic, marketing, financial, and organizational context of the business and be designed to contribute to the achievement of corporate objectives. (Beatrice A., 2012)

2.2.4. Credit Assessment:

The major credit risk assessed by the bank while assessing a credit proposal through borrower analysis. Full particulars of the proprietor, partner, directors, and others are examined and their management capability is ascertained in this analyses. Overall performance and credit status of the allied concerns of the client group is also assessed. Industry include before extending credit in an area, overall business conditions of the area or sector is critically examined, prospects and problem are ascertained by the bank officials. Demand and supply of the concerned goods and services, demand and supply gap, contribution of the borrower in meeting the gap, strength and weakness of the borrower and their competitors to be accurately assessed. Supplier/Buyer Analysis on whether the borrower depends on a single or very few customers or gets the supply of the raw materials/dealing items from a single supplier. Such sales and supply concentration are given a very careful consideration, because it has significant impact on the future viability of the borrower.(Rana,2013)

2.2.5. The “five C’s-the basic components of a credit analysis:

According to Borrios (2013), credit analysis is the method by which a financial institution calculates the creditworthiness of a business or organization. While each lending situation a bank reviews is unique, most banks utilize some variation of "The Five C's of Credit" when making credit decisions - Character, Capital, Capacity, Collateral and Conditions.

Character

Character is the personal impression borrowers make on the potential lender. The lender decides whether or not borrowers are sufficiently trustworthy to repay the loan. It is important that loan applicants get a copy of their personal credit report and score before they apply for the loan and make sure that the information is accurate and that there are not errors.

Capital

Business loan applicants must have a reasonable amount invested in their business, equity investment. This reflects a personal commitment and ensures that, when combined with borrowed funds, the business can start and continue operations. For start-up businesses, banks usually will require at least 20 percent of the total funds to be invested by the owners; for some businesses the percentage could be higher. Funds for the equity investment have to be available at the time of the loan application.

Capacity

Borrowers have to be able to demonstrate their ability to repay the intended loan from their business operation. Banks will require detailed financial projections showing when business income will become cash and when the expenses must be paid. Financial projections include a cash flow statement, broken down on a monthly basis and covering three years after the loan is received. A critical factor in loan approval is making sure the lender understands how revenue projections will be generated. This is especially important when the projections are for a new business.

Collateral

It is well known that cash flow and not collateral will repay the loan. However, collateral is a form of security which can be used to assure a lender that borrowers have a second source of loan repayment. Assets such as equipment, buildings, accounts receivable, and (in some cases) inventory are considered possible sources of repayment if they can be sold by the bank for cash. Banks will usually take for collateral assets that are usable in the business; however, if the value of the business assets is not sufficient to secure the loan, banks can require personal assets that remain outside the business as collateral.

Conditions

Lenders will also consider local economic conditions and the overall climate, both within the industry and in other industries that could affect the business. Borrowers should prepare market research. The research will provide important information about the industry and enhance business decision-making. If an industry is expanding, this will provide a positive factor for the credit analysis of the loan (Borrios ,2013).

2.2.6. Financial analysis of the borrower:

Financial analysis using business or financial ratios provides a mean of assessing a company's strengths and weaknesses. Using data from the balance sheet and income statement, various ratios can be computed which can then be compared directly to those of competing companies of varying sizes. Comparing the firm's operating results with those of specific competitors or the industry as a whole helps identify relative strengths and weaknesses. In addition, comparing changes in a firm's ratios over time can highlight improvements in performance or problem areas needing attention. Generally, financial ratios are calculated for the purpose of evaluating aspects of a company's operations and fall into the following categories according to Dr.Mihaela(2010):

a. liquidity ratios
b. Solvability ratios
c. solvency ratios
d. profitability ratios
e. efficiency ratios

a. Liquidity Ratios:

The company should provide information that indicates whether or not the business will be able to pay its creditors, expenses, loans falling due at corresponding periods in time. A company may be profitable but if it fails to generate enough cash to settle its liability is said to be insolvent.
Suppliers and providers of short-term finance are interested in these ratios as they are used in assessing the ability of the business to settle its current liabilities. Liquidity ratios indicate the ease of turning assets into cash.

b. Solvability ratios :

The balance sheet is one of the most important financial statements of a company, which highlights the financial position of a company at a particular date. The cash flow and income statements record performance over a period of time, while the balance sheet is a snapshot in time. The balance sheet provides information on what the company owns (its assets), what it owes (its liabilities), and the value of the business to its stockholders (the shareholders' equity). The reason it is called a balance sheet is that both the sides balance, or Assets = Liabilities + Equity.
The balance sheet provides a creditor with many clues to a firm’s possible future performance. In order to acquire assets, a company must pay for them with either debt (liabilities) or with the owners' capital (shareholders' equity).

c. Solvency ratios:

These ratios are also called the leverage ratios. These are mostly used by providers of finance to assess the finance risk of the business. Increasing amounts of debt in a business's capital structure means that the business is becoming heavily geared. This condition negatively affects long-term solvency because it represents increasing legal obligations to pay interest periodically and principal at maturity. Failure to make these payments can result in bankruptcy. Long-term solvency has to do with the business's ability to survive for many years – the bank must assure that the "going concern" accounting principle is fulfilled when decided to finance a certain business. The aim of long-term solvency analysis is to point out early that a business is on the road to bankruptcy. Declining profitability and liquidity ratios are key signs of possible business failure. As indicated earlier on, the ratios on their own carries less business meaning unless interpreted together with other non-financial indicators, such as loss of key suppliers, threatened litigation against the business, failure to settle liabilities and failure to adapt to new technologies.

d. Profitability Ratios:

The objective of profitability relates to a company's ability to earn a satisfactory profit so that the investors and shareholders will continue to provide capital to it. A company's profitability is linked to its liquidity because earnings ultimately produce cash flow.

e. Efficiency Ratios:

Efficiency ratios provide information about management's ability to control expenses and to earn a return on the resources committed to the business. Management is required to maintain an optimum level of working capital. If an entity is having high inventory levels it will incur high storage costs, theft, insurance costs and stock losses. Likewise having low stock levels will disturb the production run of the company as it will regularly run out of inventories thereby loosing important business opportunities. The same can be said about receivables, having more receivable the company may run the risk of bad debts but also being too strict with debt repayment period may result in loss of customers. The asset management ratios are also known as working capital ratios or the efficiency ratios. The aim is to measure how effectively the firm is managing its assets. These ratios are designed to answer the question: does the total amount of each type of asset as reported on the balance sheet seem reasonable, too high, or too low in view of current and projected sales levels? If the company has too many assets, its cost of capital will be too high hence its profit depressed. On the other hand, if asset are too low, profitable sales will be lost (Dr.Mihaela ,2010).

2.2.6. Loan Appraisal:

A number of factors are evaluated by banks before loans are availed. The considerations are usually made with respect to the nature, size & type of business for which loan is sought for. However, when loans are large, each of the consideration becomes very import. Bank's credit analyses is used to refer to the complex process of assessing the credit worthiness of a(prospective)borrower via investigation of the records of the financial. The essence of the exercise is to find out the extent to which the borrower could honor its financial obligation in the face of an eventual default. Credit analyses involves a wide variety of financial analyses techniques, including ratio and trend analyses as well as the creation of projection and a detailed analyses of cash flows. It may sometime include an examination of the collateral and other sources of repayment as well as credit history and management ability of the borrower.(C.Chris & R.Santos,2013)

2.2.7. Loan proposal characteristics:

Although the exact elements of a loan package will vary depending on a company's size, industry, and stage of development, most lenders will want the following fundamental questions answered:

a) Who is the customer?

b) How much capital do they need and when?

c) How will the capital be allocated and for what specific purposes?

d) How will the borrower service the debt obligations (application and processing fees, interest, principal, or balloon payments)?

e) What protection (collateral) can the borrower provide the bank in the event that he is unable to meet the agreed obligations?

f) What are the key business matrices and how well are they measured, monitored and understood (the diagnostic "dashboard")?

According to Dr.Mihaela (2010) the loan proposal should include the following categories of information, many of which might be included under the business plan:

Summary of the request. An overview of the history of the company, the amount of capital needed, the proposed repayment terms, the intended use of the capital, and the collateral available to secure the loan. Also the proposed pricing is included under this section.

Borrower's history. A brief background of your company; its capital structure; its founders; its stage of development and plans for growth; a list of customers, suppliers, and service providers; management structure and philosophy; main products and services; and an overview of any intellectual property owned developed; group structure and support offered by the parent are also to be considered.

Market data. An overview of trends in the industry; the size of the market; the market share of the company; an assessment of the competition; the sustainable competitive advantages; marketing, public relations, and advertising strategies; market research studies; and relevant future trends in the industry as well as expectations for the future.

Financial information. Multi-scenario financial statements (best case/ expected case/worst case), federal and state tax returns, company valuations or appraisals of key assets, current balance sheet, credit references, and the income statement. (Dr.Mihaela, 2010)

2.2.8.Credit approval:

The loan approval process is the first step towards, good portfolio quality. When individual credits are underwriting with sound credit principles, the credit quality of the portfolio is much more likely to be sound although good loans sometimes go bad, alone that starts out bad is likely to stay that way. The foremost means to control loan quality is a solid approval process. The process should be compatible with the bank's credit culture, its risk profile, and the capability of its lenders, further, the system for loan approvals needs to be establishing accountability. (Comptroller's Hand Book,1998)

Each method of loan approval has inherent strength and weakness. The committee method is advantageous because knowledge can be shared, but it may diminish responsiveness .the individual signature clear accountability, but it can create undue credit risk if a lending and experience are inadequate to his or her authority. (Comptroller's Hand Book,1998)

An effective loan approval process establish minimum requirement for the information and analysis upon which accredit decision is based, it provides guidance on the documents needed to approve new credit, renew credit, increase credit to existing borrowing, and changes terms is previously approved credit. (Comptroller's Hand Book,1998)

2.2.9. Disbursement:

Disbursement ensures that money is not availed until all approvals and documentation requirements are met. It also ensures that security and other required documentations are obtained before funds are disbursed. If disbursement control is weak, the whole integrity of the credit process can be weakened and abused (Msi,1994 and Nsereko,1995). Thus, documentations and disbursement are important in the management of credit because they ensure that the bank has proper documentation, collateral and guarantees. These are important in the advent of the clients' inability to pay because the bank would be properly secured and have legal recourse to ensure the settlement of debt. This would ultimately decrease the amount of bad debts the banks may have.

2.2.10. Repayment:

The assumption in delivery of credit as a source of finance is that the use of credit would generate enough income to repay the loan with interest. However, generation of adequate additional income has to be accompanied by willingness of borrower to repay the loan with interest. Failure of investment may result in non-generation of income, failure of expected income may lead to inadequate income, perception or pressure of more important and urgent use of income may incapacitate the repayment and finally the borrower's willingness and desire has to be there to fulfill repayment obligation. (K.C.Sharma.et al.2001)

2.2.11. Credit Management Policies:

This will provide a variety of policies and processes that govern the credit function, including credit terms, the processes required for opening new accounts, processing applications, methods and techniques for credit investigation, the creation and dissemination of credit reports, setting lines of credit, and other factors that are involved in the credit management process. (Ken & Peter, 2012)

It should also include monitoring of accounts to ensure that they are compliant with credit terms and include issues such as collection policy and procedures and, for financial institutions, dealing with events of default. As with granting credit, the processes and approach that will be adopted in cases of delinquency need to be mapped out. For instance, in many banks, once an account becomes delinquent, it is transferred from the relationship manager to a specialized unit whose function is to maximize the amount that can be recovered from the credit. It should also be clear who within the organization has the authority to initiate enforcement actions. (Ken & Peter, 2012)

2.2.12. Collections and Work-out:

Banks differ on the methods and organization they use to manage problem loans. The responsibilities for such loans may lie with the originating line unit or a specialized work-out division, depending on the loan size or type. Work-out units are usually staffed with specialized work-out lenders. It is not uncommon for the work-out department to be independent from the line lending unit, but the organization should be dictated by the needs of the bank. Credit policy should articulate how a bank will manage problem credits. A separate policy on problem loans often supplements corporate loan policy. (Kwizera, 2011)

Routine collection activities generally are handled by the account officers or a specialized collection department. When collection problems persist or credit weaknesses become more pronounced and risk ratings deteriorate, many banks find it beneficial to transfer problem loans to a unit that specializes in work-out activity. The additional resources and closer management supervision of a work-out department normally improve results. An effective work-out unit can help craft a strategy to return a troubled borrower to financial health. Because of their proficiency with both rehabilitation and exit strategies, work-out personnel should be closely involved in developing strategy for marginally rated borrowers or any problem loans that are supervised by the line account officer. An experienced work-out unit can provide valuable guidance during initial underwriting and restructures that can help to ensure that the bank's return is maximized in the event of default. Successful loan work-outs depend on early identification of credit weaknesses and adverse credit trends. (Kwizera, 2011)

Managing problem credits is time-consuming (time that a lender could profitably spend on other duties) and requires special knowledge. Many banks require lenders to transfer problem assets to a work-out unit (with provision for documented exceptions). Such an automatic transfer policy enables a bank to ensure that its dealings with troubled borrowers are uniform. In larger banks where a relationship may contain facilities managed by more than one department, it is generally preferable to transfer the entire credit relationship to ensure consistent treatment of the borrower. At least for all larger loans, analysts should compare each loan's terms and characteristics with underwriting guidelines, and they should determine the borrower's financial condition at the time of loan approval, the timeliness of problem identification, the accuracy of collateral evaluation, the effectiveness of financial covenant structure, and adequacy of documentation.(Kwizera, 2011)

2.2.13. Loan Review:

Loan review is a mainstay of internal control of the loan portfolio. Periodic objective reviews of credit risk levels and risk management processes are essential to effective portfolio management. To ensure the independence of loan review, the unit should report administratively and functionally to the board of directors or a standing committee with audit responsibilities. The board or committee approves the unit's operating budget, prepares the performance evaluation for the division's head, approves the unit's strategic and operating plans, acts on the unit's findings, and ratifies administrative matters. While it is not as critical that loan review's administrative lines have independence, the functional lines should not be compromised. The unit's independence that is, its ability to remain objective during examinations should be protected. (Comptroller's Hand Book,1998)

2.2.14. Credit Risk:

Credit risk is the most common cause of bank failures. With the changing dynamics of banking business brings new kind of risk exposure. Credit risk is the possibility of losses associated with diminution in the credit quality of borrowers or counterparties. Credit risk is inherent to the business of lending funds to the operations linked closely to market risk variables. The essential functions of risk management are to identify measure and more importantly monitor the profile of the bank .The objective of credit risk management is to minimize the risk and maximize bank's risk adjusted rate of return.(patil,2014)

2.2.15. Loan Portfolio Management:

The loan portfolio is typically the largest asset and the predominate source of revenue. As such, it is one of the greatest sources of risk to a bank's safety and soundness. Whether due to lax credit standards, poor portfolio risk management, or weakness in the economy, loan portfolio problems have historically been the major cause of bank losses and failures. (Comptroller's Hand Book,1998)

Effective management of the loan portfolio and the credit function is fundamental to a bank's safety and soundness. Loan portfolio management (LPM) is the process by which risks that are inherent in the credit process are managed and controlled. Because review of the LPM process is so important, it is a primary supervisory activity. Assessing LPM involves evaluating the steps bank management takes to identify and control risk throughout the credit process.(Comptroller's Hand Book,1998)

2.2.16. Causes of Loan Default:

According to Anioku,(2012).Loan defaults are caused by variety of factors, some controllable and others uncontrollable. Controllable factors are those that reflect overall bank credit policy as well as inadequate credit analyses. Loan strutting and loan documentation, Uncontrollable factors typically reflect adverse economic conditions, adverse changes in regulations, environmental changes surrounding the borrower's and catastrophic events, while there is little that can be done to prevent uncontrollable variables. Effective credit granting procedure can significantly reduce other source of looses.

The following affects loan default's according to Anioko,(2012)

1. Bank-related factors
   - Lack of in-depth knowledge of customer operation.
   - Excessive dependents on financial statement.
   - Connected lending..
   - Inadequate project monitoring.
   - Inadequate knowledge of project appraisal techniques.
2. Customer-related factors
   - Most business failures result from management expertise, inadequate planning & accounting systems, outright fraud and general incompetence.
   - Inadequate initial capitalization.
   - High financial & operating leverage.
   - Misconception of bank loans.
   - Strong completion.
   - Loan diversion.
3. Uncontrollable factors
   - Economic downturn.
   - Change in economic polices
   - Change in taste and preference.
   - Natural hazards.

2.3. Empirical Literature

There are many researches regarding disbursement and repayment of loans, locally as well as internationally. The researcher states the following empirical literature reviews from different perspective and titles which will help this studies as an input.

2.3.1 Empirical Evidence in the World:

Research made in the Dominican Republic about the repayment of loans disbursed by a typical developing country specialized lender indicated that borrower characteristics (land tenure status and credit rating by the bank), loan characteristics (restriction on use of borrowed funds) and regulatory instruments (Bank's own funds and international targeted funds) are mostly affect client loan repayment. (Aguilera &Gonzalez, 1993). In addition Reza and Mansoori (2008) studied the factors that influencing the loan repayment performance, they used a logit model and the output were the farmer's experience , income , received loan size and collateral value , have a negative effect ,whereas the loan interest rate , total application costs and number of installment have a negative effect on repayment performance of borrower.

2.3.2 Empirical Evidence in Africa:

There are studies on credit repayment in Africa among these research made in Malawi about the probability of agriculture credit repayment indicated that crop sales, income transfers, degree of diversification and quality of information are positively related with credit repayment. While the size of club is negatively related the probability of repayment. Factors like amount of loan, sex, household size and club experience were found to be insignificant. (Chirwa,1997). According to Geraid & Deogratïes (2013) study on credit rating and loan repayment performance indicated that years of experience in running the project, age , credit rationing , loan diversion, business management skills, alternative source of income , unfavorable weather conditions are among factors which influence loan repayment performance. From the other perspective of viewing the impact of credit risk management on the performance of commercial banks in Nigeria, one study used the panel regression model and came up with the bank's nonperforming loans from their loan portfolios is caused by poor credit risk management practices of the bank. (Idowu, 2014).

In project financing for agriculture sectors the major determinants of small scale holder for loan repayment and factors influencing defaults in loan repayment are also researches made, by using Tobit modal and showed time of loan disbursement , nature of loan disbursement (in cash or in kind), number of supervisor visits made by credit officers, family dependency level , total farm cost and income of beneficiary , government policies ,are major factors that also influenced default in loan repayments. (Okovie, 1996, Umoren A. et al. 2014).

All the above studies are focus on the main determinant factors for credit repayment; it is based on their own specific sectors, projects and countries. However the banking laws are differing from country to country, their central bank policies regarding financing of project not similar with that of National Bank of Ethiopia. And also the role of Development Bank of Ethiopia is significantly different from other commercial banks in Ethiopia. Thus working on loan recovery in performance Development bank of Ethiopia definitely will come up with unique result.

2.3.3 Empirical Evidence in Ethiopia:

There are studies made by Ethiopians specifically in loaning area, Abraham (2002) studied with the aim of identifying the major factors behind the loan default problems of Small Scale Enterprises, specifically borrowers of Development Bank of Ethiopia at Zeway Branches. The researcher used Tobit models and came up with loan diversion is found to be one of the major determinants adversely affected the loan recovery rate. Another study made by Adamu (2013) on similar topic, the researcher found out inefficient market knowledge of local entrepreneurs, lack of managerial skills, exchange rate fluctuation, and inadequate follow up coverage ,overrun increases for project implementation are among determinants of failure of the project.

The research on loan repayment of micro finance using Tobit modal indicated that, education, income, loan supervision, suitability of repayment period, availability of other credit source and livestock are important and significant factors that enhance the loan repayment performance. (Jemal, 2003).

A couple of study made also on the determinants of loan repayment performances and found that educational level of the borrowers , repayment period of the loan , availability of other source of income ,purpose of the loan and type of labor, managerial experience of the project managers, marital status of the borrower determine loan repayment of borrowers. (Kibrom ,2010; Mulugeta ,2010, & Muluken ,2014).

What I have learnt from the empirical evidences are:- as central bank policies, regulations & directives different from country to country, banking laws & regulations are also different from one another thereby every bank of the countries is highly influenced by the government regulatory bodies. When we come to the empirical evidences of our country, particularly in connection with DBE, diversification of loans, lack of managerial skills, inadequate follow up coverage & unsuitable loan repayment periods are played the major role in affecting the loan recovery performances

CHAPTER THREE

3. RESEARCH METHODOLOGY

3.1. Methodology

This research study has conducted to assess loan recovery performance of DBE for the period covering from July 01, 2010 to December 31, 2014. The study used both primary data and secondary to assess the bank's loan recovery performance.

3.2. Research Design

The study survey employed descriptive research method since, descriptive research examines a situation as it is and enables us to understand the way things to assess the weak loan recovery performance in the Development Bank of Ethiopia.

3.3. Data Sources

Primary data source of the study survey collected from Managers and Employees of the Bank who have direct exposure with the study survey using questioner. While secondary data collected from annual financial reports of the bank issued during the period covering 2011 up to 2014, credit policy, and procedure manuals.

3.4. Data Gathering Tools

The Questionnaire survey used as primary data collection method because of the reason that it is quick method to collect data, it is less time consuming, it is able to cover entire sample with the propose time frame work also and it offers grater assurance of anonymity . Document review of reports, previous research, unpublished materials, and strategic planning document of the Bank used to collect secondary data's to reference the study with actual and supported facts.

3.5. Sampling and Sampling Techniques

The study used simple random sampling method to select the respondents of the study survey. The main reason is to achieve the quality of anticipated data that fairly assess the loan recovery performance of the bank. According to the information obtained using preliminary discussion with DBE human resource process owner (manager), there were 118 professional employees found at Development Bank of Ethiopia who had serving under credit corporate units, which comprised under four-unit section.

The first section was Credit Process (CP) that had 42 employees; five of them were managerial staff member. The second section was Appraisal sub process unit that had 30 employees; four of them were managerial staff. The third section was Project Rehabilitation and Loan Recovery sub-process (PRLR) unit that had 24 employees; three of them were managerial staff member. The other unit was Risk & Compliance Management Process (RCMP) that had 22 employees; four of them were managerial staff member. From the total population the study sample has 92 respondents, which includes 14 managerial staff member that expected to conduct the research objectives. The sample size has determined using Kerjcie and Morgan (1970). For further reference, the table is located under appendix 1.

While, the selection of 92 professional included 42 professional employees (5 management and 37 non-management employees) who were working in CP again 38 employees had selected and four of them were management members. Out of 30 employees (4 managements and 26 non-managements) who were working in Appraisal 23, employees selected three of them management staff. Twenty four employees (3 managements and 21 non-managements) were engaged in PRLR 19 employees had selected of which two of them were management members. The rest of 17 employees selected out of 22 employees from RCMP out of which 3 of them were management members, that selected using simple random sampling method because considered the simplest, most convenient and bias free selection method.

3.6. Data Analysis Techniques

The collected data had entered into Statistical Package for Social Science Software (SPSS) version to run the descriptive data. It selected because of its simplicity and clarity to draw inferences. Besides, it used averages, percentage, diagrams, and tables for the analysis of the collected data.

Data analysis techniques can be using both analyses tool, quantitative and qualitative. It involves collections of quantitative information that tabulated along a continuum in numerical form. Therefore, for this study, combinations of both qualitative and quantitative analysis had employed to describe the existing scenarios regarding loan recovery performance of the Bank in comparison against the given theoretical framework.

CHAPTER FOUR

4. RESULT AND DISCUSSION

This chapter deals with the presentation and the analysis of data, which was collected from respondents. The assessment of this study was based on the specific objectives. The study used both primary and secondary data. The researcher distributed questionnaires paper for 92 individuals based on sample size to collect primarily data concerning loan recovery assessments performance of the bank. From the total sample size, 83 respondents or 90.11% of the total have been properly responded. In addition to the primarily data, the study also used financial statements, quarterly reports, annual reports, credit policy, and procedure as a secondary data. Presentation and discussion of the research findings embraces two part ,the first one is background information which consists job grade and work experience of the employees and the second part elaborates the assessment result of credit policies and procedures, credit assessment, loan disbursement procedure and the system of project follow up.

4.1. Part one-levels of job grade and work experience of the respondents

Under this part, the researcher tries to indicate the respondents' current position and their work experience in DBE.

4.1.1. Job grade

This questionnaire gathers the respondent current job position in DBE. The purposes of this information are-

- To obtain diverse information
- To upgrade the quality of the study
- To increase the credibility of the information

Table .1 Current Job Position

	Frequency	Percent
Loan Officer	18	21.7
Sr.Loan Officer	43	51.8
Principal Officer	8	9.6
Process/Regional/Manager	4	4.8
Junior officers	10	12.0
Total	83	100.0

We can see from the table-1, out of the total respondents loan officers hold 21.7% , Sr. loan officers 51.8 %, Principal officers 9.6 %,Managers/process owner4.8% and junior officer 12.%. This implies that all levels of job categories are involved in gathering this information, which enables the study to obtain diverse information from different respondent observations.

4.1.2. Work experience

The survey questionnaire had raised related with the respondents' work experience to obtain quality information & assess of entire loan recovery performance based on employees work experiences. The survey result summarized under table 2.

Table 2 Experience loaning units

	Frequency	Percent
1 to 5 years	38	45.8
6 to 10 years	25	30.1
11 to 15 years	2	2.4
16 to 20 years	8	9.6
Above 20 years	10	12.0
Total	83	100.0

As can be seen from the table -1, out of the total respondents, 46.3% of them are below 5 years, 53.7% them are above six years. The data reveals that most of the employees are working in the loaning unit have served above six years, which helps to provide relevant and reliable information for the study.

4.2. Part Two

Under this part, the presentation and discussion of research finding embraces four categories that are correlated in to the specific objectives: These are Credit policy and procedures, Credit assessment, disbursement procedures, and Project follow up system.

4.2.1. Credit policy and Procedures

Under this category, the study tries to examine-

- The adequacy of credit policies & procedures
- Whether credit policies and procedures frequently updated or not
- The existence of monitoring & controlling of loan status
- The existence of portfolio management policy & updated annually
- Whether DBE has a reasonable loan repayment period or not

a. The adequacy of credit policies & procedures

Table 3 **Have adequate procedures and guidelines**

	Frequency	Percent
Yes	54	65.1
No	29	34.9
Total	83	100.0

Like all other institutions, DBE has a credit policy that guides and governs its operation. The study attempted to find whether there is adequate credit policy and procedures in the Bank or not. As can be seen from the table-3 65.10 % of the respondents agreed that the Bank has adequate policies &procedures, but the rest 34.90% of the respondents disagreed. The reason for the disagreement was:

The Bank's policy & procedure do not classify/categorize the economic sector whenever the projects have been held as collateral. For instance, when project is financed in the agricultural sector, the Bank treated equally as an industrial sector by 70:30 ratio methods.(70:30 means in loan manual of DBE, defined in article number 2.4.17 as ‘’ project promoters should at least meet the 30% of the total project cost, while the difference of 70% is to be meet by co-financers, that is in line with DBE's established policy of 70:30 debt-equity ratio for all priority area projects). Furthermore, the policy does not encompass the responsibilities & accountabilities of the employees those who have involved in the loaning process. The policy do not also properly applied due to external organs intervention

b. Credit policy frequently reviewed and update

In addition to the adequacy of policy & procedure, the respondents also replied whether DBE credit policy frequently updated or not. The research finding indicated that 15% of respondents agreed but 84.20 % or 48 respondents disagreed see table 4.

The reasons for their disagreements were: DBE does have a trend to review and update credit policy and procedure by its initiation unless & otherwise instruction is issued by the regulatory body. Most of the time the government has been considered the Bank's credit policy as the country strategy & policy, the bank is not able to review in a regular basis even if it is needful. Due to this, the Bank has been enforced to retreat in reviewing & updating annually. The Bank does not also have concerned unit or department which to review the policy & forwarded to the Bank's management when changes are needed.

Table.4 Are Credit policy frequently updated

	percent	percent
Yes	10	12.0
No	73	88.0
Total	83	100.0

c. Loan portfolio management policy

The study is also sought to identify whether the Bank's loan portfolio management policy is reviewed or not based the changing of industrial market condition. As it can be seen from table-5, 61.40 % of the respondents did not agree that the bank's does not have a trend to review and update changing of market condition, on the other hand, 22.90 percent are agreed, and the rest 15.7 % respondents were neutral.

Table- 5 Loan portfolio management policy reviewed frequently

		Frequency	Percent
Valid	Yes	19	22.9
	No	51	61.4
	Neutral	13	15.7
	Total	83	100.0

d. Loan repayment period

Table.6 Repayment period reasonable for all loans

	Frequency	Percent
Yes	37	44.6
No	45	54.2
Neutral	1	1.2
Total	83	100.0

According to the above table-6, 44.6 % of the respondents were agreed that the bank has proper & fair repayment period, which could not be able to affect the loan recovery performance, 54.20% of the respondents disagreed, and rest 1.2% respondents were neutral. The reasons for their disagreement was that the Bank should not determine the repayment period by using cash flow of the project; instead, the repayment period is usually performed based on assumption and determined by terms of loan period that is short, medium, and long term .

4.2.2 Credit assessment

Under this section, the study tries to assess or examine DBE's practice on credit assessment for new entrant and existing customer, credit history of the customer & collaterals estimation.

I. Credit Information for existing & new borrowers

The study tried to assess the Bank's credit assessment practice and raised the following question to the respondents:

- Whether the credit unit verifies outstanding liabilities of the borrowers before additional and new loans are granted.

- The existence & adequacy of feasibility study.
- Whether the Bank has a proper way of gathering credit information internally & externally.

Out of the total, 53.6 % respondents agreed that DBE's credit unit verifies outstanding liabilities of the borrowers before additional and new loans are granted, and 42.7% of the respondents did not agreed and the rest 3.7% were neutral to respond. It is for obvious reason that National Bank of Ethiopia has established a networked central credit reference center to check the credit worthiness of the borrower and if there is any liability of borrowers from other financial institutions.

Table.7 Credit information for existing borrowers

	Frequency	**Percent**
Yes	**45**	**53.6**
No	**35**	**42.7**
Neutral	**3**	**3.7**
Total	**83**	**100**

II. Customer credit history

The study requested the respondent to obtain the data whether DBE is properly gathering information in related to customer credit history from financial institutions or not.

Table.8 Properly gather Previous credit history information

	Frequency	Percent
Yes	32	38.6
No	47	56.6
Neutral	4	4.8
Total	83	100

The research finding indicates that 38.60% of respondents agreed, 56.60 % disagreed and the rest 4.8 % were neutral. The majority of the respondents disagreed due to the fact that :- The credit information, which has been sent by the concerned body, is inadequate since it does not reveal the entire history of the customer. It shows only the amount of debt & the status of the current loan, which could not be able to collect records of accomplishment of the customer and Unable to identify the source of own contributions of the borrower.

III. Collaterals estimation

Table.9 Are collaterals estimated properly

	Frequency	Percent
Yes	37	44.6
No	44	53
Neutral	2	2.4
Total	83	100

As can be seen from the table-9, out of the total respondents 53.60% of the did not agreed, 44.60% of them agreed and the reaming 2.4 % were neutral. The respondents disagreed because in the collateral manual of the bank engineering estimation considered only material cost, equipment cost, labor cost, starting value of the lease; overhead & profit cost of the contractor and does not consider the market value of the collateral, there is also a lack of check and balance with the estimation process.

4.2.3. Loan disbursement procedure

a. Disbursement procedure manual

Table 10 Is there any problem in procedure manual

	Frequency	Percent
Yes	41	49.4
No	40	48.2
Neutral	2	2.4
Total	83	100

The respondents were asked whether the procedure manual has a problem or not. The finding indicated that 49.40% of the respondents said there was no problem in the procedure manual, 48.20% did not agree, and the rest 2.4% were neutral. The reasons for their disagreement were: The procedure manual did not show precise and clear explanation how the loan disbursement would be conduct when there were deviations* & exceptions* in the loan approval time. and also did not show clear authorization limit whenever exceptions & deviations were existed for the Bank's President and Board of Management, in addition to thus, disbursement procedures manual were similar for all types of economic sectors or did not consider the nature of the project.

***Exceptions:** Exceptions shall mean or refer to loans approved by variations from the Credit Policy. However, the nature of the loan request or issues raised therein is within the spirit of the Credit Policy.

***Deviations:** Deviations shall mean orb refer to loan requests which are not covered by the Credit Policy. The nature of the loan request or issues raised therein is outside or beyond the spirit of the Credit Policy.

In this respect there are some project loans which the government or other parties has a special interest on it and they wanted to treat such project exceptionally , unfortunately such loans have huge amount of portfolio, it could be among the top ten borrowers of the Bank. Processing such project loan in contrary to the bank's policy and procedure manual is contributing to have high number of non performing loans.

b. Loan disbursements based on project progress

Table.11 Does loan disbursed based on project progress

	Frequency	Percent
Yes	51	61.4
No	30	36.1
Neutral	2	2.4
Total	83	100

As can be seen the table-11, out of the total respondents 61.4% agreed that the bank effect the disbursement based on the progress of the project,36.1% are disagreed, and the rest 2.4% were neutral. The reason of disagreement was loan disbursement based on project progress can be done for industrial loans however for agricultural it was difficult the risk and sensibility of the project.

4.2.4. Project follows up system

One of the major functions, which enhance loan recovery performance, is project follow up system of the bank. If the Bank fails to do it means an alarmingly increases the bank's NPL positions. Under this part, the researcher tries to investigate the following items.

a. **Repayment of loan within the contract date**

Table.12 Does repayment made as per contract date

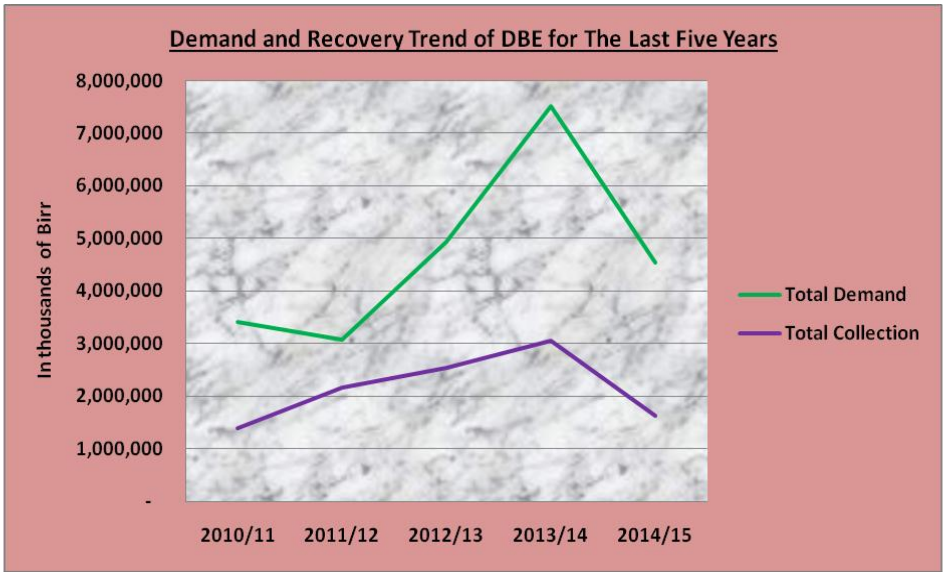
	Frequency	Percent
Yes	11	13.3
No	71	85.5
Neutral	1	1.2
Total	83	100

The researcher wants to distinguish whether the bank has collected and recovered all types' loans as per the repayment schedule stated on the contract schedule or not. The finding indicates that 13.30% of the respondents were agreed, 85.50% respondents did not agreed and the remaining 1.2% was neutral. The respondents' justifications of the disagreements were-

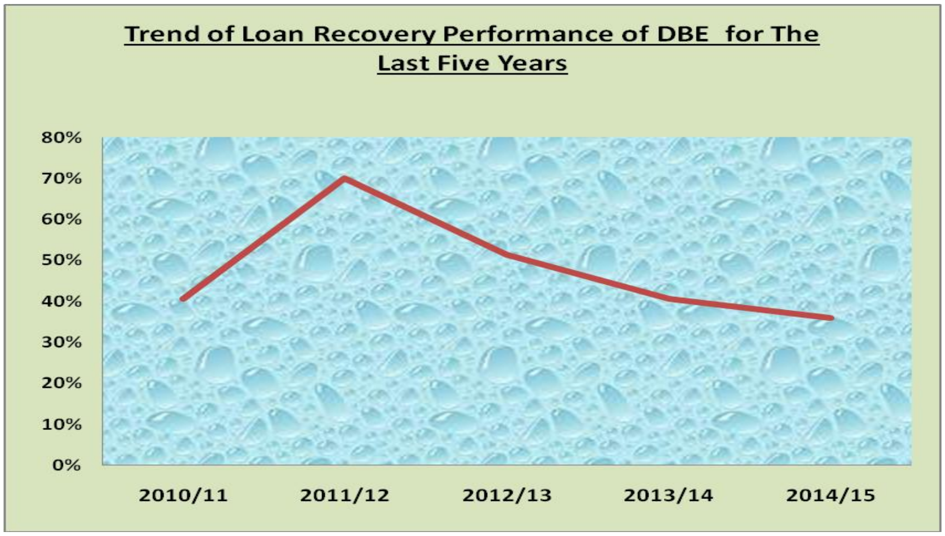
- Delay in the project implementation,
- lack of commitment to repay from the customer side,
- diversification of the project & market problem,
- foreign currency fluctuation which affects the cost of raw material,
- poor project appraisal and follow up,
- infrastructure problem,
- weak equity contribution and in sufficient collateral of the project

Moreover, the Bank trend analysis of loan recovery performances of the bank reveals that the bank loan repayment did not collected as per the repayment schedule stated on the loan contract.

Line graph 1: Demand and Recovery Trend of DBE for the Last Five Years



Line graph 2: Trend of Loan Recovery Performance of DBE for the Last Five Years



Source:DBE's loan recover performance report

Analyses of line graphes

Graphe no.1 actually shows that the total demand & collections performance of the Bank. If you see graph no.1, 3.5 million birr had been demanded to recover the loan in 2010/11.As can be seen up to 2011/12, the graph total demand dipicts less than 3.5 million.However, commencing from 2011/12 to 2013/14 the demand had been terrifyingly incresed to 7.5 million.if you starts from 2013/14 the actual demand decresed to 5.5 million up to 2014/15. In a similer maner, the collection trend analyses of the graph from 2010/11 up to 2013/14 reveals that an incresing symptoms.But starting from 2013/14 up to 2014/15 the graph shows a decresing rate of collection.

When we come to the trend loan recovery performances,i.e. the total collection to total demand ration, The first year of the graph,i.e. 2010/11 had shown 41%.The rate of the percent had been increased to 70% in 2011/12.However, the rate had also been alarmingly decreasing to 31% in 2014/15.

b. Customer Financial statements

Table.13 Assess customers financial statement periodically

	Frequency	Percent
Yes	32	38.6
No	48	57.8
Neutral	3	3.6
Total	83	100

The respondents were asked whether DBE properly assess customer’s financial statements periodically or not. The finding of the study showed that 38.60% of the respondents were agreed, whereas 57.80% of them disagreed and the remaining 2.4% respondents were neutral. Justifications of the respondents for their disagreement were: Customers are not willing to provide their financial statements to the bank periodically, , Poor follow-up and knowledge on the area of financial analysis and its corresponding ratios by the bank’s loan officers and Loan officers of the bank do not have a trend to assess or verify the financial statements of the borrower against with the physical observations.

c. Controlling and monitoring system

Table.14 Well designed controlling and monitoring loans

	Frequency	Percent
Yes	34	41.0
No	47	56.6
Neutral	2	2.4
Total	83	100.0

The study tries to assess or check whether there are well-designed systems, which monitors & controls the status of the bank's loans as per the Bank's schedule. The research finding indicates that 56.6% respondents disagreed, 41% respondents were agreed and the rest 2.4% were neutral. The reasons for the disagreements were-

- The credit process of the bank perform Customers recruiting, loan processing, implementation and monitoring and controlling activities which contradicts segregation of duties and could lead to poor pre & post due diligence assessment please refer current the bank on annex-2.
- The bank does not have follow up and collection unit, which could enhance the loan recovery performance.

D. Non-performing loans

According to NBE directive None-performing loans are loans whose credit quality has deteriorates in terms of repayment of the principal or interest as per the contractual agreement with the lender institutions, however there are different time period given for defaulters of shorter loans, medium and long term loans to be classified as nonperforming loans (NPL).NBE Directives No (SBB/ 48/2010).

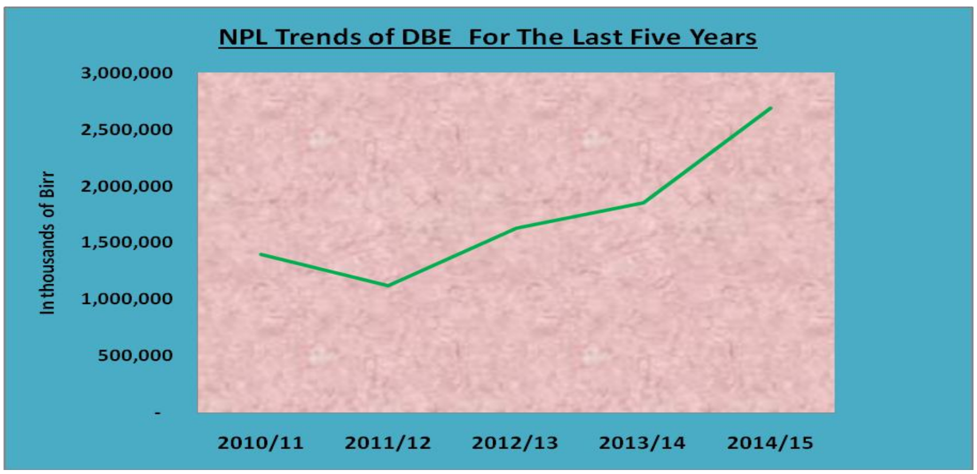
The researcher tried to collect information whether the bank has well designed follow up program or not for none performing loans and the result is shown below.

Table.15 Well designed follow up program NPL loans

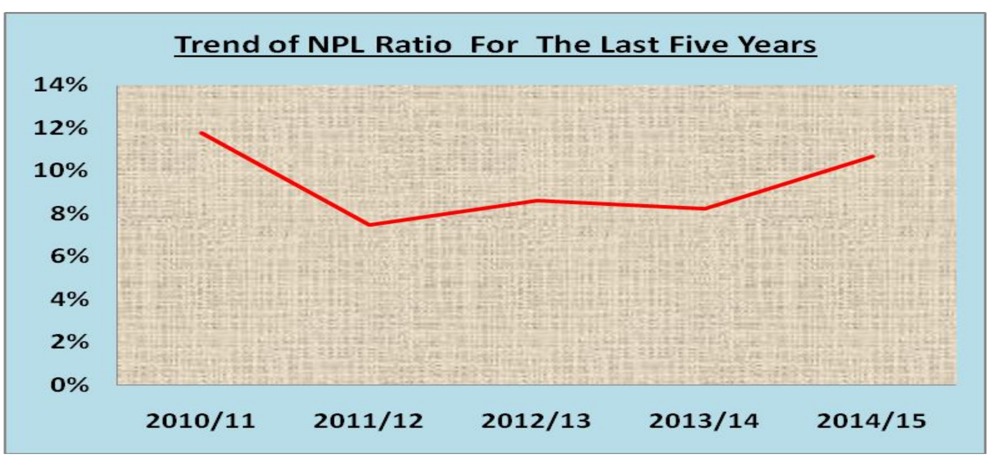
	Frequency	Percent
Yes	38	45.8
No	42	50.6
Neutral	3	3.6
Total	83	100.0

The study tries to investigate whether the bank has well designed follow up program for the NPL loans or not. The respondents of the research replied 50.6% of them did not agreed, 45.8% agreed, and the remaining 3.6% were neutral.

Line graph 3: NPL Trends of DBE For The Last Five Years



Line graph 4: Trends of NPL Ratio For The Last Five Years



Source: DBE's Loan portfolio concentration report

Analysis report of the graph

Non-performing (NPL) ratio: it is the ratio of total NPL to total loan outstanding. The NPL ratio of the bank was 11.78 on the period 2010/11 starting physical year and has shown on annual average decreasing rate 4.46% expected to reach a ratio of 8.89% at the end 2014/15 physical year. Even though the NPL ratio is reducing from time to time between 2010/11 up to 2014/15 periods, the NPL amount shows an increasing trend.

This NPL trend analyses clearly shows that the banks do not have well designed follow up program for NPL loans.

When we compare with the National Bank requirement, the directive dictates that the NPL should have not been 5% of the total loan portfolio of the Bank. However, DBE didn't satisfy the national bank requirement as it is shown more than 11%.

E. Non-performing loan the cases transferred to foreclosure/process

Table-16 Are timely decisions for non-performing loans

	Frequency	Percent
Yes	34	41.0
No	42	50.6
Neutral	7	8.4
Total	83	100.0

The study requested the respondent to obtain the data whether there were outstanding loans cases transferred to foreclosure/process and no decision made timely or not. The responses of the respondent table-17 indicates 50.60 % says the bank decision on bad loans is not timely, while 41% of respondent says there is timely decision and the rest respondent were neutral.

CHAPTER FIVE

5. CONCLUSIONS AND RECOMMENDATIONS

5.1 Summaries of findings

The study survey has conducted to assess the loan recovery performance of DBE which intended to identify better approaches of improving efficiency in connection with loan recovery performance. The study tries to indicate the impact of inadequate credit policy and procedures, credit assessment, loan disbursement procedures, and inefficient project follow up on the loan recovery performance of the Bank.

Empirical evidences proved that the loan recovery performance of DBE has been decreasing from time to time which could undoubtedly lead the Bank in to potential risk, owing to the fact that inefficient loan recovery performance adversely affects the overall operation of the Bank. Based on this study analysis, the following findings & conclusions has been emanated

- ***Inadequate credit policies & procedure manual***

Based on this finding, the Bank's policy & procedures does not segregate the economic sector when the projects have been held as collateral. The policy treats agricultural loan and industrial loan equally in collateral held as loan security.

Moreover, the policy does not address the exact responsibilities & accountabilities of the employees who have involved in the loaning process. This might create a problem if a loan is defaulted due to ineffectiveness of loan officer attributed to his/her reluctance, lack of strict follow up and other reasons.

Due to external organs intervention, the policy do not properly applied. Thus, the researcher concluded that the credit policies & procedures of the bank is not adequate.

- ***Absence of periodical evaluation of loan policies and procedures manual.***

DBE does not have a trend to review and update credit policy and procedure by its initiation unless & otherwise instruction is issued by the regulatory body. Since most of the time the government has been considered the bank's credit policy as the country strategy & policy, the Bank is not able to review in a regular basis even if it is needful.

Due to this, the Bank has been enforced to retreat in reviewing & updating annually. The Bank does not also have concerned unit or department to review the policy & forward to the bank's management when changes are needed.

The summary of the result indicated that: The Bank has no trend to review regularly at a reasonable period of time.

- ***Unreasonable loan repayment period.***

The repayment period of the disbursed loans have not been determined by using cash flow of the project; instead, it has been usually performed based on assumption and terms of loans period i.e. short, medium, and long term.

- ***Inappropriate Collaterals estimation***

In connection with collateral estimation, although the Bank's credit policy has stated that collaterals should be revalued at least once in a year, the Bank does not exercise according to the stated policy. Due to this, the value of the project asset as well as current information of the loan status will be misinterpreted. Furthermore, the Bank's engineers have been estimated collaterals by considering material cost, equipment cost, labor cost, starting value of the lease; overhead & profit cost of the contractor and they do not consider the market value of the collaterals. And also, there is a lack of check and balance control system when ever estimation of collaterals have been conducted.

- ***Inadequate loan disbursement procedure***

The procedure manual has not been precisely demonstrated and clearly explained how the loan disbursement would be carried out when there were deviations & exceptions in the loan approval time. Moreover, it does not clearly reveal the authorization limit whenever exceptions & deviations are being existed. Last but not least, disbursement procedures which explained in the manual are similar for all types of economic sectors and it lacks to consider the nature and types of the project.

- ***Absence of well designed Project follows up system***

As you well aware of, one of the major functions, which enhance loan recovery performance, is well-designed project follow up system of the Bank. If the Bank fails to conduct loan follow up activities on a timely manner, loan diversification of the project as well as unknown problems might be happened by the project, which could undoubtedly lead the Bank's loan in to NPL positions. In addition, the bank could not be able to take remedial action if the customer is unable to repay its debt due to various reasons. Such as market or infrastructure problems, foreign currency fluctuation, this affects the cost of raw material and others since these are the root causes of the loan repayment problem. That is why, the Bank trend analysis of loan recovery performances of the Bank reveals that the bank loan repayment, which should have been collected as per the repayment period, does not collect as per the repayment schedule stated on the loan contract.

In the credit assessment part, the credit information, which has been sent by the concerned body, is inadequate since it does not reveal the entire history of the customer. It shows only the amount of debt & the status of the current loan, which could not be able to gather the records of accomplishment of the customer.

- ***Inadequate analysis of customers' financial statements***

Analysis of the financial statements of borrowers is an important means to obtain information about how the borrowers operated in the previous period. Interpretation of the progression of financial indicators does not always prove to be easy, requiring multiple calculations and combined approaches, while the knowledge and understanding of type of business reviewed are essential in the proper interpretation of the results. Thus, the conclusions of the analysis carried out in a professional manner will be able to correctly describe the progress of the borrowers and to substantiate the user's decisions.

Despite the lack of trend to assess or verify the financial statements of the borrower by the loan officers of the bank against with the physical observations, there are poor follow-up and lack of financial analysis knowledge that leads to the conclusions drawn up as a result of the analysis could not be useful since economic and financial analysis of the borrowers is a laborious trial requiring a quality professional training, capacity & knowledge.

This will lead to the preparation of financial statements that do not reflect the real situation of the company and, consequently, the financial analysis performed will describe a hypothetical company and in no circumstances the company in question. Moreover, customers are not willing to provide their financial statements to the bank periodically

- ***Absence of Well designed controlling and monitoring loans***

Since the credit process of the Bank perform Customers recruiting, loan processing, implementation and monitoring and controlling activities which contradicts segregation of duties, it could undoubtedly lead to poor pre & post due diligence assessment. In addition to this, the Bank does not have follow up and collection unit, which could enhance the loan recovery performance.

5.2 Conclusions

Based on these findings, this paper concludes that the credit policies and procedures of the Bank is not adequate since it does not address the risk areas in different sectors. Moreover the policy does not clearly stipulate accountability and responsibility of officers if loan is defaulted.

The repayment period of the disbursed loans doesn't consider the nature and cash flow of the project; the clients are unable to pay their loan repayment as per loan repayment period.

The value of the project asset as well as current information of the loan status would be misinterpreted b*ecause of inappropriate Collaterals estimation.*

Disbursement procedures, which explained in the manual, are similar for all types of economic sectors and it lacks to consider the nature and types of the project. Thus, I concluded that the procedure manual has not been precisely demonstrated and clearly explained how the loan disbursement would be carried out when there were deviations and exceptions in the loan approval time.

Owing to misleading analysis due to over or under statement of figures on the customers' financial statements, the conclusions of the analysis carried out in a professional manner will unable to depict clearly the progress of the borrowers and to substantiate the user's decisions.

5.3. Recommendations

Based on the research finding and conclusion, the following recommendations are suggested to improve the efficiency & effectiveness of loan recovery performance of the Bank.

- The Bank's policy & procedure should be prepared based on the nature of the projects including clear explanation of exceptions & deviation to avoid doubt & confusion.

- The Bank should incorporate the exact responsibilities & accountabilities of the employees those who have involved in the loaning process whenever the loan is defaulted due to ineffectiveness of loan officer appraisal, reluctance, lack of strict follow up & other reasons.

- Since the policies & procedures that enforce in the bank are outdated and do not consider the current situation, DBE should exert efforts to be updated & reviewed the credit policies & procedures manual regularly at a reasonable period of time. Furthermore, the Bank should assign a concerned unit, whenever changes are needed to review the policy & forward to the Bank's management.

- The loan repayment period should consider the nature and cash flow of the project instead of performing based on assumption and in terms of loans period.

- The collaterals estimation should be revalued based on the credit policy of the Bank and the Bank should install check and balance control system when ever estimation of collaterals have been conducted.

- The procedure manual should encompass a clear explanation of how the loan disbursement would be carried out whenever there are deviations & exceptions in the loan approval time. Moreover, the procedure manual should properly reveal the authorization limit whenever exceptions & deviations are being existed.

- The Bank should design adequate follow up and supervision that focus on the loan collection activities to enhance loan recovery performance.

- DBE should exert maximum effort to be conducted awareness in related to analysis of customers' financial statements since Analysis of the financial statements of borrowers is an important means to obtain information about how the borrowers operated in the previous period. Moreover, inured to enhance the performance of operation and to build up the capacity of employees, DBE should give prior attention to the human resource development through short term training, Job rotation, and experience sharing.

- The Bank should separate Customers recruiting, loan processing, implementation and monitoring and controlling activities to strength pre & post due diligence assessment. Furthermore, the Bank should assign or open follow up and collection unit, which could enhance the loan recovery performance.

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ANNEX

ST.MARRY UNIVERSITY

SCHOOL OF GRADUATE STUDIES

MBA Degree in Accounting & Finance

Research Topic: Assessment of Loan Recovery performance in Development Bank of Ethiopia

Dear Respondents:

This questionnaire is designed to collect data to assess the loan recovery performance of Development Bank of Ethiopia (DBE).The information obtained from this questioner will be used as a primary data for my research, which I am conducting as a partial fulfillment for the requirement of MBA degree.

Thus, I kindly request you to express your opinion honestly and openly as possible, your response will be kept as confidential. Please also try to respond the entire questionnaire's to your utmost effort.

QUESTIONNAIRIES

General Direction:

- There is no need of writing your name.
- Please put (X) mark in the box that fits your response and write your opinion on the space provide
- For questioner that demands your opinion, please try to honestly describe as per the questions on the space provided

Part One – Background Information

1. Please tell me your current position in DBE

a) Loan Officer ☐ c) Principal Officer ☐

b) Senior Loan Officer ☐ d) Process/Regional/ Manager ☐

e) Junior Officer ☐

2. Please indicate your work experience in DBE (years of experience)

a) 1 to 5 ☐ c) 6 to 10 ☐

b) 11 to 15 ☐ d) 16 to 20 ☐

e) Above 20 ☐

3. Have you been working in the bank's Credit Process, Project Rehabilitation or Loan Recovery or Credit Risk Management Process? If your answer is yes, please indicate your work experience in the loaning units

a) 1 to 5 ☐ c) 6 to 10 ☐

b) 11 to 15 ☐ d) 16 to 20 ☐

e) Above 20 ☐

Part II

Under this part the questions have both close ended & open ended besides to this it divided into the following categories:

1. **Credit Policy and procedures**
2. **Credit assessment**
3. **Loan disbursement procedure**
4. **Project follow up system**

Credit policy and procedures:

1.1 Are credit policies and procedures frequently reviewed and updated

Yes ☐ No. ☐ Neutral ☐

If your answer is NO, please state the reason

____

____

____

1.2 Does the Bank have adequate procedures and guidelines to monitor and control the loan?

Yes ☐ No. ☐ Neutral ☐

If your answer is NO, please state the reasons

____

____

____

1.3 Does the Bank have loan portfolio management policy ?

Yes ☐ No. ☐ Neutral ☐

1.4 If your answer for question no.1.3 is Yes, Are loan portfolio management policy reviewed at least annually to determine if they are compatible with changing market conditions.

Yes ☐ No. ☐ Neutral ☐

1.5 Are you satisfied with the credit policy and procedures of the Bank?

Yes ☐ No. ☐ Neutral ☐

1.6 If you say no for question no.1.5 please give your reason.

____

____

____

1.7 What appropriate action should be taken by the Bank, in order to improve its credit policy and ensure high loan recovery performance?

I. ____

____

II. ____

____

III. ____

____

1.8 Is the repayment period schedule reasonable for all loans?

Yes ☐ No. ☐ Neutral ☐

1.9 If your answer to Q 1.8 is no, what do you think is the suitable repayment period?

____

____

____

2. Credit assessment:

2.1 Are borrowers' outstanding liabilities checked to the appropriate lines of credit, before an additional loan is given

Yes ☐ No. ☐ Neutral ☐

2.2 If your answer is YES, What criteria's does the DBE use to evaluate them?

____

____

____

____

2.3 Does the Bank perform a credit investigation on proposed and existing borrowers for new loan application?

Yes ☐ No. ☐ Neutral ☐

2.4 If your answer is YES, What criteria's does the DBE use to evaluate them?

____

____

____

2.5 Are feasibility studies obtained and do they support the viability of new development projects?

Yes ☐ No. ☐ Neutral ☐

2.6 Does the Bank have a proper way of gathering information all applicants' from other financial institutions about their previous credit history?

Yes ☐ No. ☐ Neutral ☐

2.7 Do you think that the collaterals are estimated properly by the responsible body?

Yes ☐ No. ☐ Neutral ☐

3. Loan disbursement procedure:

3.1 Is there any gap (problem) in the disbursement procedure manual of the bank?

Yes ☐ No. ☐ Neutral ☐

3.2 If your answer is YES, please state the problems ?

____

____

____

3.3 Does the Bank effect disbursement based upon progress of the project?

Yes ☐ No. ☐ Neutral ☐

4. Project follows up:

4.1 Does the bank collect and recover all loans as per the repayment schedule stated on the contract?

Yes ☐ No ☐ Neutral ☐

4.2 If your answer is NO, Why?

____
____
____

4.3. Does the bank have a trend to assess its' customers financial statement periodically?

Yes ☐ No. ☐ Neutral ☐

4.4 If your answer is NO, Why?

____
____
____

4.5 Does the bank have well designed system of controlling and monitoring of the status of the loan as per bank's schedule?

Yes ☐ No. ☐ Neutral ☐

4.6 Is there any well-designed follow up program of loans undertaken by the Bank particularly for NPL loans?

Yes ☐ No. ☐ Neutral ☐

4.8 Are there outstanding non-performing loans whose cases are transferred to foreclosure /process and no decisions are made to them so far?

Yes ☐ No. ☐ Neutral ☐

4.9 What improvements do you recommend for successful loan recovery performance of the bank?

4.10 As these questionnaires cannot be exhaustive list of all the problems in the credit activities by itself, please state any comment /matter that you think is essential for improvement of loan recovery performance.-

Thank you for your valuable comment & Precious time!!!

Annex-1

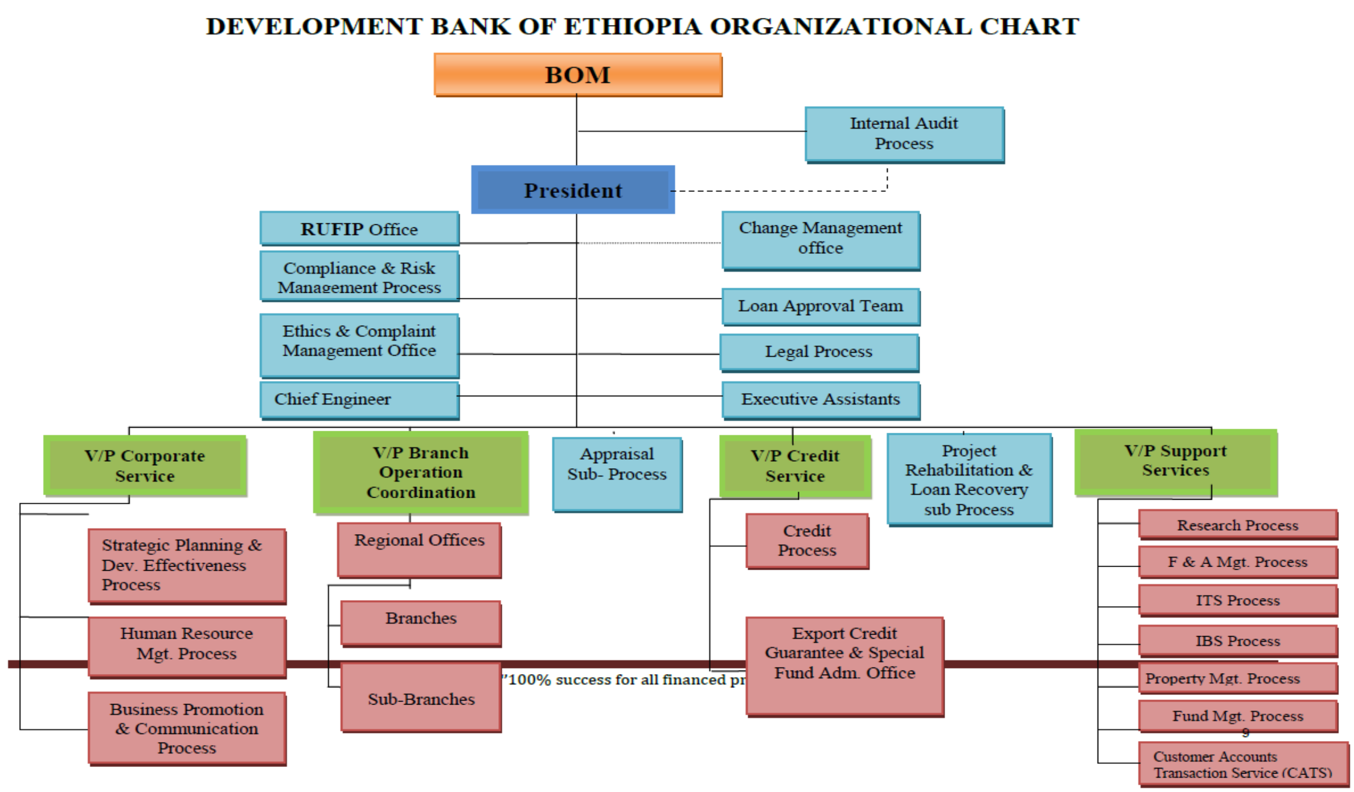
Table 1: Table for Determining Sample Size for a Finite Population

N	*S*	*N*	*S*	*N*	*S*
10	10	220	140	1200	291
15	14	230	144	1300	297
20	19	240	148	1400	302
25	24	250	152	1500	306
30	28	260	155	1600	310
35	32	270	159	1700	313
40	36	280	162	1800	317
45	40	290	165	1900	320
50	44	300	169	2000	322
55	48	320	175	2200	327
60	52	340	181	2400	331
65	56	360	186	2600	335
70	59	380	191	2800	338
75	63	400	196	3000	341
80	66	420	201	3500	346
85	70	440	205	4000	351
90	73	460	210	4500	354
95	76	480	214	5000	357
100	80	500	217	6000	361
110	86	550	226	7000	364
120	92	600	234	8000	367
130	97	650	242	9000	368
140	103	700	248	10000	370
150	108	750	254	15000	375
160	113	800	260	20000	377
170	118	850	265	30000	379
180	123	900	269	40000	380
190	127	950	274	50000	381
200	132	1000	278	75000	382
210	136	1100	285	1000000	384

Note.—*N* is population size. *S* is sample size.

Source: Krejcie & Morgan, 1970

Annex2


DEVELOPMENT BANK OF ETHIOPIA ORGANIZATIONAL CHART
BOM
Internal Audit Process
President
RUFIP Office
Compliance & Risk Management Process
Ethics & Complaint Management Office
Chief Engineer
Change Management office
Loan Approval Team
Legal Process
Executive Assistants
V/P Corporate Service
V/P Branch Operation Coordination
Appraisal Sub- Process
V/P Credit Service
Project Rehabilitation & Loan Recovery sub Process
V/P Support Services
Strategic Planning & Dev. Effectiveness Process
Human Resource Mgt. Process
Business Promotion & Communication Process
Regional Offices
Branches
Sub-Branches
Credit Process
Export Credit Guarantee & Special Fund Adm. Office
Research Process
F & A Mgt. Process
ITS Process
IBS Process
Property Mgt. Process
Fund Mgt. Process
Customer Accounts Transaction Service (CATS)
'100% success for all financed pr