



**Wolkite University**  
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**WOLKITE UNIVERSITY**

**COLLEGE OF BUSSINESS AND ECONOMICS**

**DEPARTMENT OF ACCOUNTING AND FINANCE**

**ASSESSMENT OF LOAN RECOVERY PERFORMANCE IN  
CASECOMMERCIAL BANKK OF ETHIOPIA (WOLKITE MAIN  
BRANCH) A RSEARCH PAPER SUBMITTED TO THE DEPARTMENT  
OF ACCOUNTING AND FINANCE FOR THE PARTIAL FULFILLMENT  
OF THE REQUIREMENT FOR BACHELOR OF ARTS DEGREE IN  
ACCOUNTING AND FINANCE**

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**WOLKITE,**

**ETHIOPIA**

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### Declaration

I the researcher declared that this senior essay is conducted on the assessment of loan recovery performance in the case of the commercial bank of Ethiopia Wolkite Main Branch. Almost I conducted this research with great cooperation with my advisor and other collaborators. All sources of information and idea that are relevant and included in the research paper are properly acknowledged.

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Place and date of submission: Wolkite University, May 2023.

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## ABSTRACT

*This study conducted to assess the loan recovery performance in commercial bank of Ethiopia in Wolkite main branch. Assessment of loan recovery help an organization accomplish its objectives by bringing systematic principles to evaluate and improve the efficiencies control of cash management, recovery performance, risk management control and governance process. The general objective of the study will try to assessing the loan recovery performance in commercial bank of Ethiopia in Wolkite main branch. The assessment focus on strengthen and weakens with regard to loan recovery performance. Data that are relevant to this study collected from both primary and secondary data sources. The primary data were collected through questioner and the secondary sources are collected from research works, books, and internet and organization manuals. In order to select the sample purposive sampling was employed. The research designs are descriptive. The total number of the population working in the commercial bank of Ethiopia in wolkite main branch are 26 from which samples for my study where drawn. Among this population, the researchers will take 10 as a sample size. The gathered data are analyzed and interpreted by using a descriptive research design, which describes in detail after data, was collected. The finding of my study concludes that training is one of the important requirements for the success of lending institutions. They develop skill on how to do business and money utilizations and banks are not lent without any collateral to ensure the full commitment of the borrower.*

Key words: Loan Recovery Performance, CBE, Employee, Default Rate.

## **Acronyms and abbreviation**

CBE	Commercial Bank of Ethiopia
KYC	Know Your Customer
NBE	National Bank of Ethiopia
NPL	Non-Performance Loans

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# CHAPTER ONE

## 1 Introduction

### 1.1 Background of the Study

Banks have always played a vital role in the country's economy. Moreover, it plays a decisive role in the development of the industry and trade. Banks are acting not only as the custodian of wealth of the country but also as resource of the country, which are necessary for the economic development of a nation. Banks are one of the most important parts of any country. In this modern time money and its necessity is very important. A develop financial system to support not only economic but also the society. Therefore, a modern bank plays a vital role in the socio-economic matter of the country. Some of important role of banks in the development of country is briefly showing below. Delivering/facilities/ loan for the organization, peoples, promote saving habits of the peoples, capital formulation and promote industry, smoothing of trade and commerce functions generate employment opportunity and support agricultural development. the general role of commercial bank of Ethiopia is to provide financial service to general public and business ensuring economic and stability and suitable of the economy. (Garhwalis, 1993). Loan have been around for hundreds of years, as every once in a while, people tend to need a little bit more money to get out of a difficult financial situation, or to purchase something that they cannot afford.

In finance, the tern of loan represents the process of lending money from an organization, individual or entity, to another organization, entity or individual. Therefore, a loan is more or less a debt that provide by an entity to another, at a set interest rate, alongside with a promissory note that is meant to highlight the amount of money being borrow, the rate of interest that parts have previously agreed on, but also repayment terms. A loan also legally entails what people often refer to as the reallocation of a subject's assets for a specified period, agreed between the borrower and the lender. Now days there are a number of government and private owned banks in Ethiopia that providing loan for various purpose. Nevertheless, most banks financial statement shows that the collections of loans from borrowers are not satisfactory. This result a huge

amount of non-performing loans (NBE, Annual Report, 2011). Loans taken from credit institutions vary from country to country, region to region, sector to sector. However, credits of developing countries are found to share one common characteristic suffer from a considerable amount of default rate (the Amount of loans not collect on current and past due loans for the reference period) (Kashuliza, A, 1993) comprises margin, interest and commission.

### **1.2 Statement of the Problem**

Our country Ethiopia characterized by underutilization of land capital and abundant labor resources. There is scarcity of capital, lack of investment opportunity and unemployment. Considering this fact, the commercial bank of Ethiopia in wolkite main branch provide credit for organization, individuals, and entity for expansion of agricultural, industrial and other services with the objective of enhancing the commercial activity and in order to attain profit. The loan extend to various sectors of the economy must be recover in full, if the objective of circulating more and more financial resources to meet the increase demand for credit/loan/ and to keep the bank in sound financial health. Both the principal and interest to meet the operation cost must be recovering. The bank collects the principal and interest from the client during the due date but defaults may occur on the side of the client due to various reasons if there is a high incidence in the deficit of client, this leads the bank to be insolvent and weaken its financial position. This situation will paralyze the investment program as well as the economy as a whole. In this study the researchers, focus on evaluation the credit recovery performance of commercial bank of Ethiopia in wolkite main branch between the period 2011/12- 2014/2015. The preceding researchers not well studied in loan recovery performance on commercial bank of Ethiopia wolkite main branch I think the researcher's team are maybe the first team to conduct such assessment in the CBE of wolkite main branch. The preceding researches are on the assessments of determinant and factors on loan repayment performance but my research give more concentration on assessment of loan recovery performance. Therefore, the research conduct to fill ways of gaps that list in these parts of the study.

### **1.3 Objective of the study**

#### **1.3.1 General objective**

The general objective of the study is the assessment of loan recovery performance in case of commercial bank of Ethiopia in wolkite main branch.

#### ***1.3.2 Specific objectives***

- To examine the credit assessment process of the bank in relation to loan recovery.
- To assess the follow up system of the bank in relation to loan recovery.
- To assess the collateral related problems of the bank in relation to loan recovery.
- To examine the loan work-out performance of the bank

#### **1.3. Research Questions**

*These research papers try to answer the following research question.*

- *What type of credit assessment process used by the bank in relation to loan recovery?*
- *How does the follow up system of the bank in relation to loan recovery look like?*
- *What are the collateral related problems of the bank in relation to loan recovery?*
- *What is the loan work-out performance of the bank?*

#### **1.4 Significance of the Study**

The main advantage of this study will to establish knowledge base that enable to make a sound decision take corrective action. In addition, based on this, the finding of this study can help the policy makers; to formulate successful credit policy and programmers that enables them to allocate scarce financial resource for the development of lending institution. It would help the bank to identify the major characteristics that distinguish credit worthy borrowers and defaulters. Therefore, it could act accordingly for future screening purpose.

The findings of the study would have some important contribution to the manager of the commercial bank of Ethiopia in wolkite main branch. In the assessment of loan grant procedure of the bank. It would help the bank to identify the major characteristics that distinguish credit worthy borrowers and defaulters. Therefore, it could act accordingly for future screening purpose.

## **1.5 Limitation of the study**

The main limitation of the research is:

- Lack of enough source documents or manuals as a secondary data in the branch.
- Lack of the adequate experience by student researchers on how to study the research.

### **1.5.1 Scope or Delimitation of the Study**

The study will focus on assessment of loan recovery performance in commercial bank of Ethiopia in wolkite main branch. Hence, this study will address issues relate to loan recovery and collection in commercial bank of Ethiopia in wolkite main branch.

## **1.6 Organization of the research**

The general content of this research paper contains five chapters. Chapter 1 present the introduction part, which contains background of the study, statement of the problem, objectives of the study, research question, scope & limitations of the study and significance of the research paper. Chapter 2 also presents the review of literature part of the study. Chapter 3 contains the research methodology part, which contains research approach, research design, data source and methods of data collection, sample size and sampling techniques and methods of data analysis. The research results and discussion were presented in chapter four. The final part of the study was chapter fiveforwarded conclusions and some recommendations.

## **CHAPTER TWO**

### **2 Literature Review**

In this section, the review of related literature present. It starts on the theoretical foundation of the study. Subsequently the relationship between lending and credit repayment performance types of loan, and factors of loan repayment performance were presented respectively. At the end, empirical evidence that shows the determinants of loan repayment performance in Ethiopia and outside the country was also presented.

#### **2.1 Theoretical foundation of the study**

This part of the paper takes a closer look on theoretical foundations and contributions on the subject matter. A bank exists to perform a number of functions chiefly, accepting deposits and granting credits (loans and advances) categorically provided as primary or banking functions; in fact, banking means accepting for the purpose of lending of investment of deposits of money from the public. Granting of credit facilities by commercial banks which is the primary function as pointed out earlier, expose them to credit risk. Credit is a device for facilitating transfer of purchasing power from one individual or organization to another. As indicated by (Oyatoya,1983) credit provides the basis for increased production efficiency through specialization of functions thus bringing together in a more productive union the skilled labor force with small financial resources and those who have substantial resources but lack entrepreneurial ability.

In more explicit analysis of the association between finance and economic development (Schumpeter, 1933) treated the banking system and entrepreneurship as the two key enabling agents of development. He argues that the banking system's capacity to supply initiative and entrepreneurship in addition to credit creation enabled it to transfer resources from less productive uses to more economically rewarding uses because those who control existing resource or have claims on current wealth are not necessarily those best suited to use these resources. The banking system credit creation equipped entrepreneurs with purchasing power with which they were able to express overriding command over real productive resources.

Promises are frequently broken and there may be no objective way to determine the likelihood that promise will be kept (Jaffee Dwight, and Joseph Stiglitz, 1990). Banks in many Developing countries hold a truly alarming volume in non-performing assets. Differences

between promised and actual repayments on loans are the result of uncertainty concerning the borrower's ability or willingness to make the repayments when they are due which creates the risk of borrower's default (Pischke, 1991), (Vigano, 1993), (Kitchen, 1989). The inapplicability of the standard demand and supply model for credit market give rise to credit rationing phenomena. Credit rationing as defined by (Jaffee M. Dwight1971) is the difference between the quantity of loans demanded and loans supplied at the ruling interest rate. In this case lending institutions make use of their own screening criteria to identify credit worthy borrowers so as to decrease the probability of default.

There are those who argue that the failure of lending agencies in playing their roles in loan disbursement and recovery process is a major contribution to loan default (OkorieAja, Andrewc, Iheanacho, 1992), (Vigano, 1993), (Fry, 1995). They contend their view that determining credit worthiness requires investment of time and resources to evaluate firm specific and industry wide variable, structural or cyclical, by analysts with specific professional skills. A mistake on the evaluation of the borrowers' characteristics or the introduction of inappropriate loan conditions may increase the total risk of the transaction (Vigano. L 1993). A non-economic obstacle relating to the failure of banks lies in the risk adverse attitude of loan officers (Kitchen, 1989). He revealed that financial repression and credit rationing encourage unprofessional lending practices such as collusion and corruption. He has found that unprofessional practices lead to high default rates, thereby increasing risk. Taking care of this issue is more important in development banks where accountability of loan officers is often a problem. (Fry 1995) listed bank lending criteria in East Africa in order of importance to show how the method of credit analysis is weak: first, the securities offered, second, any other additional securities, third how short the period to maturity is, fourth the commissions to receive in connection with the granting of credit, fifth the standing of the would be borrower, sixth the amount and seventh the project.

## **2.2 Relationship Lending and Credit Repayment Performance**

One of the primary objectives of financial institutions is to provide financial services (credit and saving) to people in order to release financial constraints and help alleviate poverty. Each financial institution tries to maximize its repayment performance, whether or not it is profit oriented (Han, 2008). High repayment rates are indeed largely associated with Benefits both

for the financial institution and for the borrower. They enable the financial Institution to cut the interest rate it charges to the borrowers, thus reducing the financial cost of credit and allowing more borrowers to have access to it (Kon and Story, 2003). Improving repayment rates might also help reduce the dependence on subsidies of the financial institution, which would improve sustainability. It also argued that high repayment rates reflect the adequacy of financial institutions services to client's needs. They limit the incidence of cross subvention across the borrowers. Related also, repayment performance is a key variable for donors and international funding agencies on which many financial institutions still depend for their access to funds. The first-best level of repayment performance is a perfect (100%) on-time repayment rate (Ongena and David, 2001). If the maximum repayment rates the financial institution can reach given its lending methodology is lower than the target 100%, the financial institution will use second-level strategies to increase its repayment performance. Such strategies include the allocation of larger loans to borrowers with lower default probability and attempt to reduce the delay in repayment. The financial institution will develop incentive mechanisms to meet these objectives. The main factors influencing repayment are either relate to information asymmetries, to adverse shocks affecting the borrower, or to the low performance of institutions (Elsas and Krahen, 2000.)

Information asymmetries arise when gaining information on the characteristics or on the behavior of the borrower are costly for the financial institution. Information asymmetries generate problems of adverse selection, allocation of loans to borrowers with undesirable characteristics such as a high level of risk or inability to take advantage of the loan as well as moral hazard the borrower may behave in an undesirable way make little or insufficient effort to take advantage of his loan or used it for unproductive purposes ( Lown and Morgan, 2003.) Adverse selection and moral hazard increase the proportion of borrowers who cannot repay their loans on time. Borrowers that have enough money to reimburse their loan might also default strategically. The cost of strategic default might indeed be low if the lending institution has low collateral requirements and if the legal system gives little power to the financial institution to enforce contracts. Financial institutions try to restrict the occurrence of those three types of situations in designing appropriate credit schemes.

The theoretical foundations of relationship banking are found in the modern literature of financial intermediation that acknowledges the special role of banks in alleviating the informational symmetries in the credit markets. Early works of (Brow and Zehnder 2006) Stress the information production function of banks. Screening and monitoring procedures give an information advantage to banks that allow them to overcome information and incentive problems between the bank and the borrower. Therefore, the main benefit attributed to bank financing with respect to other sources of finance is that banks help overcome problems of asymmetric information by producing and analyzing information and by designing loan contracts that improve borrowers' incentives. Bank financing may also entail some costs. (Degryse and Cayseele 2000) develop a model of loan pricing in which firms bear search costs to find a new bank. They show that loan rates offered by the relationship bank are higher than those offered at competing banks, because the latter are willing to offer an interest lower than their funding cost in order to capture the firm. The critical assumption in that model is the existence of exogenous search costs. In the early nineties, two influential papers warned about the potential costs of bank lending even when there are no exogenous costs of starting a relationship. (Elsas and Krahen, 2000.) Present a model in which relationships arise endogenously. A bank that lends to a firm learns more about that borrower's characteristics than do other banks.

This generates an asymmetry of information among banks. Therefore, a distinction is made

between relationship (informed) banks and transaction (uninformed) banks. Informed lenders can capture some rents generated by their older costumers, while the uninformed competitors face a winner's curse problem. In a competitive world, the implication for loan pricing is increasing interest rates with the duration of the relationship. In the model of (Kano, Uchida, Udell, & Watanabe 2006), a firm balances the costs and benefits associated to two borrowing sources, namely informed debt and arm's length debt. Bank debt is provided by an informed bank that monitors the firm and exerts some control on the owner's decision to continue a project only if it has positive net present value. However, informed bank debt generates distortions on the owner's incentives to exert effort. In contrast, arm's length debt guarantees that the owner exerts the optimal level of effort but lenders do not have control over the owner's continuation decision. It shows that borrowing from multiple sources is a way to restrict the bank's ability to extract surplus. In a later contribution, (Kon&Storey 2003) derived the optimal loan contract that avoids the lock-in costs with a single lender: a long-term debt contract consisting in a line of credit that the lending bank may terminate at any Point in time, but if it chooses to continue financing it should do so at *ex ante* specified terms. This arrangement can optimally limit the informed lender's bargaining power without the need for multiple bank relationships.

### **2.3 Factors of loan Repayment Performance**

Loans and advances constitute the primary source of income by banks. As any business establishment, a bank also seeks to maximize its profit. Since loans and advances are more profitable than any other assets, a bank is willing to lend as much of its funds as possible. However, banks have to be careful about the safety of such advances (Radha .M, et al, 1980). Bankers naturally try to balance the issue of maximizing profit by lending and at the same time manage risk of loan default as it would impair profit and thereby the very capital. Generally, in developing and under developed countries, the reasons for default have multidimensional aspect. Various researchers have concluded various reasons for loan default. Literature categorizes determinants of loan repayment performance. The following paragraphs were discussed about determinants of nonperforming loans.

#### ***2.3.1 High Interest Rate***

Banks that charge high interest rate would comparatively face a higher default rate or non-

performing loans. Study by (Sinkey&Greenwalt 1991) on large commercial Banks in US depict that a high interest rate charged by banks is associated with loan defaults. (Rajan& Dhal 2003) who used a panel regression analysis indicates that financial factors like cost of credit has got significant impact on NPLs. Study by (Waweru&Kalini, 2009) on the commercial banks in Kenya using statistical analysis indicates that high interest rate charged by the banks is one of the internal factors that leads to incidence non-performing loans. Besides, studies by (Berger and DeYoung, 1997), for the US; (Jimenez G. & J. Saurina.2006), for Spain; (Quagliariello, 2007), for Italy; Pain, 2003, for the UK; and (Bikker and Hu, 2002), (for 29 OECD countries) banks profit margin exhibited by high interest rate affects occurrence of NPLs.

### **2.3.2 Merciful Credit Terms**

Credit sanctioning that has not duly considered the credit terms would potentially lead to occurrence of poor loan performance (Jimenez, Gabriel & Jesus Saurian. 2005) in their study conducted on the Spanish banking sector from 1984 to 2003 evidence that NPLs are determined by lenient credit terms. Cause for the lenience is attributed to disaster myopia, Herd behavior, moral hazard and agency problems that may entice bank managers to take risk and lend excessively during boom periods as per this study. (Rajan and Dhal 2003) Who studied the Indian commercial banks also found out terms of credit determines occurrence of Nonperforming loans.

Radian, R.G. 1994) hypothesizes that bank managers have short-term decision horizons because their reputations are strongly influenced by public perceptions of their performance, as evidenced by short-term earnings. Managers' reputations suffer if they fail to expand credit when the economy is expanding and bank earnings are improving. This herd behavior will result in some loans going to customers with higher default risk than would occur otherwise. (Weinberg, J. A. 1995) also suggests that bank managers adjust lending standards as market conditions change, seeking to smooth overall lending risk. The Office of the Comptroller of the Currency (OCC, 1988) concludes that the dominant reason for bank (failure in the early 1980s was poor bank management, which encompasses lax lending standards. An FDIC study of the causes of the banking crises of the 1980s and early 1990s (FDIC, 1997) finds that a combination of factors economic, legislative, managerial, and regulatory led to the banking crises.

Training is one of the important requirements for the success of microfinance institution (Assefa, et al, 2005). If the lender provides various training, the clients will be able to understand the rule and regulation easily. They also develop skill on how to do business and money utilization. Training is needed not only for clients but also for loan officers. In both cases it has a positive contribution to the repayment rate. (Norell D. 2001) Also agree on the importance of training for the decreasing of default rate. Form of Disbursement: -If the loan is released in cash directly to the borrower, the borrower could have an incentive to divert the loan other than the intended purpose because money is fungible. Thus, a negative sign is expected.

### **2.3.3 Loan Reputation**

The borrower is repeated one he may have acquired more experience on the bank's rules and regulations, hence could efficiently utilize the loan for the intended purpose. Therefore, a negative sign is expected.

### **2.3.4 Rapid Loan Growth**

Studies indicate that loan delinquencies are associated with rapid credit growth.

(Keeton 1999) Who used data from commercial banks in the United States (from 1982?

to 1996) and a vector auto regression model indicate this association between loan and rapid credit growth. (Sinkey&Greenwalt 1991) Who have also studied large commercial banks in the US and found out that excessive lending explain loan –loss rate. (Salas Vincente& Jesus Saurina 2002) Who studied Spanish banks found out that credit growth is associated with non-performing loans. Besides, study by (Bercoff, Jose J., Julian di, Giovanni & Franque Grimard. 2002) shows that asset growth explains NPLs. Similarly (Weinberg 1995) uses data on the growth rate of total loans and loan charge-offs in the United States from 1950 to 1992 to show a pattern of increases in lending preceding increases in loan losses (Weinberg .1995). Hypothesizes that risk-neutral lenders increase lending during periods of economic expansion because the expected returns from investment projects improve, and therefore, the expected returns from all loan customers rise. Supply-side explanations of the expansion of bank loans frequently suggest a relaxation of underwriting standards, whereas loan contractions are said to suggest a tightening of standards. Therefore, with growth of loan size comes poor loan performance ascribing to the relaxed underwriting standard.

### **2.3.5 Collateral**

Collateral (also called security) is the assets that the borrower pledges to the bank to mitigate the bank's risk in event of default (Sinkey, 2002). It is something valuable, which is pledged to the bank by the borrower to support the borrower's intention to repay the money advanced.

Security is taken to mitigate the bank's risk in the event of default and is considered a secondary source of repayment (Koch & MacDonald, 2003). Supporting of the aforementioned, (Rose & Hudgins 2005) define secured lending in banks as the business where the secured loans have a pledge of some of the borrower's property (such as home or vehicles) behind them as collateral that may have to be sold if the borrower defaults and has no other way to repay the lender. The purpose of security is to reduce the risk of giving credit by increasing the chances of the lender recovering the amounts that become due to the borrower. Security increases the availability of credit and improves the terms on which credit is available. The purpose of security is to reduce the risk of giving credit by increasing the chances of the lender recovering the amounts that become due to the borrower. Security increases the availability of credit and improves the terms on which credit is available. The offer of security influences the lender's decision whether or not to lend, and it changes the terms on which he is prepared to lend, typically by increasing the amount of the Loan, by extending the period for which the loan is granted and by lowering the interest rate

(Norton, J., & Andenans, M. 1997.). According to (De Lucia, R. & Peters, and J. 1998.), in the banking environment, security is required for the following three reasons:

- ✓ To ensure the full commitment of the borrower to its operations,
- ✓ To provide protection should the borrower deviate from the planned course of action outlined at the time credit is extended, and
- ✓ To provide insurance should the borrower default.

### **2.3.6 Loan Follow up (Monitoring)**

Lending decision is made on sound credit risk analysis /appraisal and assessment of credit worthiness of borrowers. Nevertheless, past records of satisfactory performance and integrity are no guarantee future, though they serve as useful guide to project trend

in performance. Loan granted based on sound analysis might go bad because of the borrower may not meet obligations per the terms and conditions of the loan contract. It is for this reason that proper follow up and monitoring is essential. Monitoring or follow-up deals with the following vital aspects (Mengisitu Shimelash pdf):

- ✓ Ensuring compliance with terms and conditions.
- ✓ Monitoring end use of approved funds.
- ✓ Monitoring performance to check continued viability of operations.
- ✓ Detecting deviations from terms of decision.

Making periodic assessment of the health of the loans and advances by noting some of the key indicators of performance that might include profitability, activity level and management of the unit and ensure that the assets created are effectively utilized for productive purposes and are well maintained

- Ensuring recovery of the installments of the principal and interest in case of term loan as per the scheduled repayment program.
- Identify early warning signals, if any, and initiate remedial measures thereby averting from possible default.

There are three types of loan follow up systems. These are: Physical follow up, (FredrickO, Nyasak) financial follow up and legal follow up. Each was discussed in section Norton, J., & Andenans, M. 1997.). According to (De Lucia, R. & Peters, and J. 1998.), in the banking environment, security is required for the following three reasons:

- ✓ To ensure the full commitment of the borrower to its operations,
- ✓ To provide protection should the borrower deviate from the planned course of action outlined at the time credit is extended, and
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There are three types of loan follow up systems. These are: Physical follow up, (FredrickO, Nyasak) financial follow up and legal follow up. Each was discussed in section Physical Follow - up(MBA 2017,pdf), Physical follow-up helps to ensure existence and operation of the business, status of collateral properties, correctness of declared financial data, quality of goods, conformity of financial data with other records ( such as taxes ,register books), availability of raw materials,

labor situation, marketing difficulties observed, undue turnover of key operating personnel, change in management set up among others.

### ***Financial Follow- up***

Financial follow up is required to verify whether the assumptions on which lending decisions was taken continues to hold good both in regard to borrowers' operation and environment, and whether the end use is according to the purpose for which the loan was given.

### ***Legal Follow- up***

The purpose of legal follow up is to ensure that the legal recourse available to the Bank is kept alive at all times. It consists of obtaining proper documentation and keeping them alive, registration, proper follow up of insurances. Specific issues pertaining to legal follow up include: ascertaining whether contracts are properly executed by appropriate persons and documents are complete in all aspects, obtaining revival letters in time (revival letters refer to renewal letter for registration of security contracts that have passed the statutory period as laid down by the law), ensuring loan/mortgage contracts are updated timely and examining the regulatory directives, laws, third party claims among others (HableAsratpdf)

### **2.3.7 Loan Amount**

(VonPischke, 1991) Noted that efficient loan sizes fit borrowers' repayment capacity and stimulate enterprise. If the amount of loan released is enough for the purposes intended, it will have a positive impact on the borrower's capacity to repay. On the other hand, in case of over and under finance, the expected sign is negative. If the amount of loan exceeds what the borrower needs and can handle, it will be more of a burden than help and extra funds may go toward personal use (Norell, 2001), thereby undermining repayment performance. If the loan is too small, it may also encourage borrowers to divert the loan to other purposes (Vigano. L 1993) therefore, over finance is not a problem as such. Moreover, the loan usage is also affecting the repayment rate. If the entire loan used for the intended activities, the repayment will be enhanced. By putting the whole loan for running business, it is possible to generate income and performing the business in a better way. While, if the loan used for unintended purpose like consumption, it will hinder the

repayment performance of the clients. However, (Armendariz, A. and Morduch, J. 2010) stated that moral hazard problem associated with information asymmetry, which means the lenders are not able to ensure that whether the clients are put full effort for the success of the investment.

## **2.4 Empirical studies on determinant of loan performance**

A number of socio-economic and institutional factors affect loan repayment performance. While some of the factors positively influence the loan repayment, the other factors are negatively affecting the repayment rate. Regarding to the loan repayment performance of borrowers several studies have been conducted in many countries by different authors. Some of the studies are summarized below.

### **2.4.1 Studies in other countries**

(Bhatt N. & Tang S. (2002) studied the determinants of loan repayment in microcredit evidence from programs in the United States. Their study showed that women has low repayment rate because some women entrepreneur in the study might have been engaged in high risk and low return activities. (Godquin, M. 2004) also examined the micro finance repayment performance in Bangladesh. His result is female borrowers did not prove to have a significant better repayment performance. The size of loan and the age of the borrower showed the negative impact on the repayment performance. On the contrast, (Abreham G.2002) showed in his study male borrowers are the undermining factors for repayment.

(Zeller M.1996) Analyzed the determinants of repayment performance of credit groups in Madagascar. His finding is groups with higher level of social cohesion have a better repayment rate. Moreover, the programs that provide saving service to their members have a significantly higher repayment rate. (Olagunju et.al. 2007) also analyzed the determinants of repayment decision among smallholder farmers in southwestern Nigeria. The result showed that the number of visits made by loan officers to the borrowers, higher level of education, and time of loan disbursement would have a better repayment performance. Moreover, borrowers with lower number of household members would meet their repayment obligation better than those with high number of household members. And having access to business. Related information and providing training to

the clients are increasing the loan repayment rate of the borrowers.

#### **2.4.2 Empirical Studies in Ethiopia**

Abafita (2003) analyzed the microfinance repayment performance of Oromia credit and saving institution in Kuyu, Ethiopia. According to his finding; sex, loan size and number of dependents are negatively related to loan repayment. On the other hand, age was found to be positive, while age squared turned to be negative. Income from activities financed by loan, repayment period suitability and loan supervision are positively and significantly related to loan repayment performance. Moreover, loan diversion is significant and negatively related to loan repayment rate. The negative sign implies that the use of diverted funds for non-income generating purposes.

Assefa B.A., (2002) employed a legit model to estimate the effects of hypothesized explanatory variables on the repayment performance of rural women credit beneficiaries in Dire Dawa, Ethiopia. Out of the twelve variables hypothesized to influence the loan repayment performance of borrowers, six variables were found to be statistically significant. Some of these variables are farm size, annual farm revenue, celebration of social ceremonies, loan diversion, group effect and location of borrowers from lending institution.

Retta (2000) employed probability model for loan repayment performance of women fuel wood carriers in Addis Ababa. His finding is frequency of loan, supervision, suitability of repayment period and other income sources are found to encourage repayment hence reduce the probability of loan default. While educational level is negatively related to loan repayment.

## 2.5 Conclusions and identification of knowledge gap

As mentioned above, various studies were conducted on the loan recovery performance in different country such as Kenya, Bangladeshi, and Madagascar but in our country, Ethiopia have limitation of study on the assessment of loan recovery performance. These studies were focused on the credit associated with mostly in agricultural activities and they identified the socio-economic that the loan recovery rate of rural household. However, in the literature review nothing was indicated about the assessment of loan recovery performance all borrowers. Thus, this research could focus on the borrowers who made various types of Business. Most of the preceding study focus or concentrated on the determinate /factors/ **purposive sampling technique to select** Affecting loan repayment performance of commercial bank of Ethiopia but my study concentrated on the assessment of loan recovery performance of wolkite main branch of commercial bank of Ethiopia and also the former study gazer information regarding customer but in our research have the information of employee.

## **CHAPTER THREE**

### **3 Research Design and Methodology**

#### **3.1 Research design.**

(Saunders, M., Lewis, P. Torn hill, 2007) research design is the general plan of how we will go about answering our research question. The design of the research is a specifies the procedure and method for gathering and analyzing collected information. As noted by (C.R. KOTHARI, 2004) A research design is the procedure of environments for collection and analysis of data in a means that purposes to associate importance to the research purpose with economy in procedure. It is guided by the objective of the study, the purpose of the study, the type of study, the significance of the study, the stage of knowledge in the study area, the period over which the data is to be collected and the type of analysis to be carried out, that is whether quantitative or qualitative and the type of data analysis tools that the researcher use. Therefore, the researcher was used descriptive statistics because the study was survey research that helps to get detailed information and gives us the narration of the data. The study survey employed descriptive research method since, descriptive research examines situation as it is and enables us to understand the way things to assess the weak loan recovery performance in the commercial Bank of Ethiopia.

#### **3.2 Research approach**

According to (Creswell., 2003), three research approaches are advanced Quantitative research approach, qualitative research approach, and mixed research approach and the three approaches are not as discrete as they first appear. Because of their numerous benefits in achieving the stated research objectives, the researcher was used mixed research approach because the basic assumption is that the uses of both quantitative and qualitative methods, in combination, provide a better understanding of the research problem and question than either method by itself. The quantitative approach focused on quantification in the collection and analysis of data. Quantitative data was collected from primary sources and secondary used to measure quantifiable responses. On the

other hand, the qualitative approach was used to collect, describe and analyze non-quantitative data from the primary sources. It's convenient to analyze both qualitative and quantitative data and significant to understand deeply the attitude, opinions, ideas, and tendencies of the respondents about the loan recovery performance of the institution

### **3.3 Population Sampling or Respondents of the Study**

In this section the target population, the sample frame, sampling technique used and how the sample size is determining will be discuss.

#### ***3.3.1 Target population***

According to (Diamantopoulos, A. &Schlegelmilch, and B.B. 2006.) A population is a group of items that a sample will be drawn from. A sample, on the other hand, refers to a set of individuals/companies/ select from an identified population with the intent of generalizing the findings to the entire population. A sample is drawn because of constraints that make it difficult to cover the entire research population (Leedy and Ormrod, 2005) The total numbers of employee work in Commercial Bank of Ethiopia in wolkite main branch are 26 from this total employee the sample population are 10. This is because, to fill the gap that most previous researchers are studied based on the sample taking only from borrowers or beneficiaries' side and bank employees. The study will include the employees from CBE in wolkite main branch.

#### **3.3.2 Sample size and technique**

*The determination of sample size is influence by many factors that need to be taken into account simultaneously. Therefore, the researcher takes 10 employees as a sample size from total 26 purposive sampling techniques to select Employees in credit management department who isbank's manager and credit Employees in credit management department who is bank's manager and credit officers of commercial bank of Ethiopia in wolkite main branch. These respondents will purposively select since they are involved in day-to-day credit. The reason for used this type of sampling technique would be less costly and less time consuming. I also selec 10 Employees out of the 26 Because of these Employees are Good work experience, attitude, skills and education level.*

### **3.4 Sources and Method of Data Collection**

#### **3.4.1 Source of data**

The researchers use both primary and secondary source of data to achieve the objective of the study. The primary sources of data are the actual data collect from individuals through questionnaire. The secondary sources of data are different documents and internal auditing practice relate reports of the bank

#### **3.4.2 Method of data collection**

All research study requires information. The question however is, from where to get the information (data) and how to get them. (Yin.K 2004). In order to collect the desire information, the researchers are used both primary and secondary data sources. The primary data was be collected from primary source through questionnaire and this questionnaire was conducted by the researchers from the respondents. The secondary data is obtaining from different manuals and other preferences that are relate to the assessment of loan recovery performance in commercial bank of Ethiopia in wolkite main branch.

#### **3.5 Method of data analysis**

As (Yalew, 2011) explaining, there will three issues that must be considering in the decision (selection) of method of data analysis: the knowledge of researchers, objective of the study, and measurement of data. This study is analyzing qualitative data using descriptive statistics involves collecting, analyzing, interpreting data by observing what people do and say and quantitative data involves frequency and percentage through statistics using statistical package for social scientists (SPSS) used to assess or describe the loan recovery performance of banks. Averages, percentages and tables are to analysis of the data.

**4. CHAPTER FOUR**  
**4.1 Data Presentation and Analysis**

This chapter contains analysis and interpretation of data collected on the loan recovery performance of CBE wolkite Main branch in the period of four years that is the period from 2011/2012 to 2014/2015.

3.1 general characteristics of the respondents

Table 4.1 respondents sex structure

Sex	No of respondents	Percentage %
Male	9	90%
Female	1	10%
Total	10	100%

The above table 4.1 shows that about 90% of the respondents of the organization employees are male and remaining 10% of the employees are female. From the above table 4.1 the researcher concludes that most of the respondents are male.

Table 4.2 Educational level of the respondents

Educational level	No of respondents	Percentage %
Master and Above	2	20%
Degree	8	80%
Diploma	-	-
Certificate	-	-
Total	10	100%

Table 4.2 reveals that 80% of the bank's employees are degree holder, and 20 % are above degree holders on the other hand, there are no employees who are holders of certificate and Diploma. Therefore, this implies that the employees are competent to carry out their responsibilities or duties.

Table 4.3 responses given by respondents

No	Question	No of respondents who say		Percentage %	
		Yes	No	Yes	No
1	CBE examine the potentiality of the	10	-	100	-

	clients before giving the loan				
2	Does the organization collect and recover all loans at due date?	8	2	80	20
3	Are there factors responsible for non-payment of loan?	10	-	100	-

As shown on table 4.3 above, for item number question out of Ten respondents all of them responded by saying yes. This implies that the organization or the bank examine the potentiality of customer before giving the loan. Similarity to this, besides the respondents mentioned some of the criteria's such as trade license, master plan, kind of project, professional experience, legal registration certificate, 5cs such as character, capacity, capital, collateral and condition of the clients and the like that the bank provide for evaluation of clients back payment capabilities.

Based on the above information the researcher suggested that the bank holders a collateral, which is at least equivalent to disbursed amount.

According to the above table 4.3, for item number two question 80% of respondents replied that the bank collects and recovers all loans on the due date. Contrasting to this, the remaining 20% of the respondents responded that the bank does not collect all loans on the due date. Based on the above responses the researcher concludes that the bank collects and recovers the loans on the due date.

As indicated on the table 4.3 for item number three question 100% implies or reveals that all of the respondents responded that there is factors responsible non-repayment of loan.

As the respondents explain that the main factors responsible for non-repayment of loan are spending of the loan an intended project, incremental of the price of the raw materials, lack of raw material on the market, internal problem of the organization, and for seen occurrence and negligence of the clients because most of the loan provided to customers are long term loan.

Generally, the respondent's responses which are mentioned above indicate that, as there are different bottlenecks on the collection and recovery of the loan against disbursement.

Table 4.4 Respondents of age and experience.

No	Description	Specific character	No of respondents	Percentage (%)
1.	Age	20-25	-	-
		26-40	8	80%
		>40	2	20%
		Total	10	100%
2.	Years of services	<3 years	5	50%
		3-5 years	4	40%
		6-10years	1	10%
		>10 years	-	-
		Total	10	100%

Source, own survey questionnaire 2015As shown from the above table 4.4 no 1 out of the total 10 respondents (80%) are between the age 26-40 and 20% are the ages above 40. In another words 80% (8) employees) have the age group between 26-40? From this background the adults of the age group dominate information the researchers come up with the conclusion of CBE of the wolkite main branch. It indicates that the majority of the employees may have trust for their company. In the general term, ages in this group are not engaged for the fraudulent activities.. As shown in the above table 4.2 no 2 half of the respondents (50%) have less than 3 years of experience. It implies the employee who is new for one organization is loyal to his organization because he wants to his job and tries to maintain his work on it. As a result in this branch most employees are loyal to their employers and cannot cheat any physical as well as transaction based cash.

## **CHAPTER FIVE**

### **CONCLUTION AND RECOMMEDATION**

#### **5.2 Conclusion**

The credit assessment of the bank is not satisfactory due to the fact that small no of loans has adequate documentation, new approval of loans for customers with bad credit relation with the bank and loan given to Customers with weak financial potion and poor creditworthiness.

On the other hand the follow up system of the bank is not efficient due to lack of financial follow up, lower budget for loan monitoring ,absence of scheduled physical follow and the follow up is only dependent on repayment follow up.

Collateral related problems of the bank are collateral miss estimation, unavailability of additional collaterals, lack of marketability, collaterals with high depreciable value, fraud made by some dishonest staffs and complicated collateral estimation procedure. This all decreases the loan recovery performance of the bank.

The bank has deficiency in implementing loan workout strategies which increases loan recovery costs and absence of genuine information about the deflated loan strongly affects loan workout strategies

#### **5.3 Recommendation**

The management should improve the credit assessment by applying adequate loan documentation; deep financial statement analysis, functioning on the 5cs of credit analysis, checking the credit relation with the bank and other banks, giving higher attention to credit worthiness of a borrower to examine the ability of a borrower to repay debt. This will help the bank to improve the credit assessment to have good loan recovery performance and reduction of NPLs.

The management of the bank should give advisory service to its customer by preparing well-experienced staffs about the financial position of the customer in order to improve the credit worthiness of the customer and create awareness about the disadvantages of credit default. The management should provide adequate budget to loan monitoring in order to decrease NPL and improve the loan recovery performance of the bank. The management should insist the staffs to strictly apply its credit procedure manual about the follow-up system which are physical- follow-up and financial follow-up.

The bank is required to revise complicated collateral estimation manual in order to avoid miss understanding in estimation and create a check and balance system to eliminate miss estimation and fraud made by some dishonest staffs.

The bank should prepare an action plan for the reduction of NPL by using workout strategies which are restructuring/extension of the repayment period with the consent of the concerned parties (borrower and mortgagor/guarantor), Changing the form of the loan fully or partially, Requesting additional collateral or change of collateral, Arranging the sale of the business to third party with the consent of the borrower and Voluntary liquidation of collateral.

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**APPENDIXES**  
**WOLKITE UNIVERSITY**  
**COLLAGE OF BUSINESS AND ECONOMICES**  
**DEPARTMENT OF ACCOUNTING AND FINANCE**  
**Questionnaire for employees (Modified)**

**Dear respondents.**

I am conducting a research work on the assessment of loan recovery in case of commercial bank of Ethiopia (wolkite main branch), for my partial fulfillment of, BA degree in accounting and finance. I kindly request your honest cooperation with us to complete this questionnaire and this would greatly enhance the quality of my research paper. I assure you that the information that you provide will kept confidential and would only be used for academic purpose only. I would like to thank you in advance for your cooperation to fill this question paper.

Section one: - Background information

1. your sex: -A, Male      B, Female

2. your current position in banking

A. Loan officer

D. Credit director

B. Relationship manager

E. other please specify

C. Recovering/monitoring

3. Indicate your experience in banking:

A. Less than one year

C. 6 to 10 year

B. 1-5 year

D. Above ten year.

4. Indicate your experience in bank credit process:

-

A. Less than one year

C. 6-10 year

B. 1-5 year

D. above 10 year

5. your age

- A. 20-25
- B. 26-35
- C. 36-40
- D. Above 40

6. your education level

- A. master and above
- B. BA degree
- C. certificate

Section 2: - Question related to loan recovery performance difficulties and challenges

1. Are there any difficulties and challenges faced by lenders during the repayment process?
  - A. Yes
  - B. No

Your answer is yes on Q1 what are those difficulties and challenges please list out briefly?

2. Charges big interest rate and long credit term faces high default rate?
  - A. yes
  - B. NO
3. Collateral loan has performed well in the bank during lending process and what are the effect collateral on default rate please explain.
  - A. agree
  - B. disagree
  - C. neutral
4. The borrower's performance during the recovery performance?
  - A. excellent
  - B. very good
  - C. good
  - D. bad

Section three; responses given by respondents the performance of clients on recovery process.

5. Banks examine the potentiality of the clients in the replacement of collateral before giving the loan.

A. Yes B. No

6. does the bank collect and recover the loan at due date?

A. Yes B. No

7. Are there factors responsible for non-repayment of loan?

A. yes B. no

8. training about rules and regulations of the loan perform well

A, agree C, disagree D,neutral

Section 4: -Related with incentive mechanism for borrowers to pay on time

9. banks use incentive mechanism for borrowers who borrow repeatedly

A, agree B,disagree C, neutral

10. Your answer is agreed on Q9 what are incentive mechanisms used by bank please listout.