

**CAUSES OF NONPERFORMING LOANS AT BOSOMTWE RURAL
BANK LIMITED IN GHANA**

By

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The logo of Kwame Nkrumah University of Science and Technology (KNUST) is centered in the background. It features a yellow eagle with spread wings perched on a green shield. Above the eagle is a red flame. The shield is encircled by a yellow banner with the text 'NYANSAPU W'JSANE NO' and 'ADWENNA'.

**A Thesis submitted to the School of Business,
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in partial fulfillment of the requirement for the degree
of
MASTER OF BUSINESS ADMINISTRATION
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Faculty of Arts and Social Sciences**

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KWAME NKRUMAH UNIVERSITY OF
SCIENCE AND TECHNOLOGY
KUMASI-GHANA**

DECLARATION

I hereby declare that this thesis is my own work towards the MBA and to the best of my knowledge, it contains no material previously published by another person nor materials which has been accepted for the award of any other degree of the University or elsewhere except where due acknowledge has been made in the test.

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DEDICATION

This research work is dedicated to my wife Francisca Ekyem for her prayers and patience, which enabled me to devote much time, attention and financial resources to make this work a reality.

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ACKNOWLEDGEMENT

In God we trust. Glory be to God Almighty, who has made this project possible.

I wish to express my profound gratitude to Mr. P.K. Oppong Boakyee of Kwame Nkrumah University of Science and Technology School of Business, my supervisor whose insight and constructive criticism served a good purpose.

My sincere thanks also go to the management and staff of Bosomtwe Rural Bank Limited, especially Emmmanuel Asamoah and Rita Amoako who helped me in a diverse ways to make this work a reality.

Finally not forgetting my brother Isaac Attah Acheampong ("Prof") whose ideas also helped in diverse ways.



ABSTRACT

This study investigates the causes of nonperforming loans at Bosomtwe Rural Bank Limited, as a result; questionnaires were administered to bank staff and loan defaulters. The result shows a strong association between nonperforming loans and inefficient appraisal and monitoring technique, corruption and fraud, rapid credit expansion, bad weather and exchange rate depreciation..

It was found that increased in nonperforming loans were mainly driven by factors within the bank and some external factors such as exchange rate depreciation which is beyond the control of the bank. The weaknesses in the bank appraisal system reflect the vulnerability of the bank credit delivery system.

It is therefore recommended that for nonperforming loans to decrease there is the need to motivate credit officers and also set up a recovery unit independent of the credit department at Bosomtwe Rural Bank Limited.

The bank should give a huge credit to a single borrower only when the financial statement of the borrower has been prepared and audited by a professional accountant and auditor.

Regular professional courses should be organized for the credit committee to abreast themselves with the current economic situation to reduce wrong credit decisions.

TABLE OF CONTENTS

Title page.....	
Declaration.....	ii
Dedication.....	iii
Acknowledgements.....	iv
Abstract.....	v
Table of Contents.....	vi
List of Figures.....	x

CHAPTER ONE: INTRODUCTION.....	1
1.1 Background to the Study.....	1
1.2 Statement of the Problem.....	4
1.3 Objective of the Study.....	4
1.4 Research Question.....	5
1.5 Significance of the Study.....	5
1.6 Scope of the Study.....	5
1.7 Methodology.....	6
1.8 Limitation of the Study.....	7
1.9 Organization of the Study.....	7

CHAPTER TWO: LITERATURE REVIEW.....	8
2.0 Introduction.....	8
2.1 Definition of Nonperforming Loans.....	8
2.2 Causes of Nonperforming Loans.....	9
2.2.1 Inefficient Appraisal and Monitoring Techniques.....	9
2.2.2 Macroeconomic (instability) Variables.....	10
2.2.3 Lending to High Risk Borrowers.....	13
2.2.4 Weak Internal, External Control and Risk Borrowers.....	14
2.2.5 Moral Hazard and Insider Lending.....	15
2.2.6 Corruption and Fraud.....	16
2.2.7 Rapid Credit Expand.....	17
2.2.8 Natural Calamity.....	17
2.2.9 Politically Pressure/ Connected and Related Lending.....	18
2.3 Classification of Loans.....	19
2.3.1 Current Facilities.....	19
2.3.2 Other Loans Especially Mention	19
2.3.3 Substandard Facilities.....	20
2.3.4 Doubtful Facilities.....	20
2.3.5 Loss Facilities.....	21
2.4 Provision for Bad and Doubtful Debt.....	21

CHAPTER THREE: METHODOLOGY	23
3.0 Introduction.....	23
3.1 Research Design.....	23
3.2 Population.....	23
3.3 Instrument for Data Collection.....	24
3.4 Sampling.....	25
3.5 Institutional Profile of Bosomtwe Rural Bank Limited.....	27
3.6 Data Collection	36.
3.7 Validity and Reliability.....	37

CHAPTER FOUR: DATA PRESENTATION, ANALYSIS AND DISCUSSION...38

4.0 Introduction.....	38
4.1 Results from Credit Officers	38
4.2 Causes of Nonperforming Loans from the View Point of Credit Officers.....	40
4.2.1 Moral Hazard and Insider Learning.....	40
4.2.2 Inefficient Appraisal and Monitoring Techniques.....	42
4.2.3 Rapid Credit Expansion.....	44
4.2.4 Corruption and Fraud.....	46
4.2.5 The Most Important Causes of Nonperforming Loans	48
4.3 Results from Loan Defaulters.....	50
4.4 Causes of Loan Default from the View Point of Defaulters.....	52

4.4.1 Fraud and Corruption.....	53
4.4.2 Natural Calamity.....	54
4.4.3 Macroeconomic Factors.....	56
4.4.4 The Most Important Macroeconomic Factor.....	57
4.4.5 The Most Important causes of Loan Default by Defaulters.....	59

CHAPTER FIVE: SUMMARY, CONCLUSION, RECOMMENDATION AND SUGGESTIONS.....63

5.0 Introduction.....	63
5.1 Summary.....	63
5.2 Conclusion.....	66
5.3 Recommendation.....	66
5.4 Suggestion for further Research.....	68
References.....	70
Appendix 1 Tables.....	75
Appendix 2 Questionnaires (Staff).....	81
Appendix 3 Questionnaires (Loan Defaulters).....	86

LIST OF FIGURES

Figure 1: Background of Selected Staff.....	39
Figure 2: Moral Hazard and Insider Lending.....	41
Figure 3: Inefficient Appraisal and Monitoring Techniques.....	43
Figure 4: Rapid Credit Expansion.....	45
Figure 5: Corruption and Fraud.....	47
Figure 6: Most Important causes of Nonperforming Loans.....	49
Figure 7: Background Loan Defaulters.....	51
Figure 8: Gender Representation of Loan Defaulters.....	52
Figure 9: Fraud and Corruption.....	53
Figure 10: Natural Calamities.....	55
Figure 11: Macroeconomic Factors.....	56
Figure 12: Most Important Macroeconomic Factor.....	58
Figure 13: The Most Important causes of Loan Default.....	60
Figure 14 Trend of Sectorial Nonperforming Loans.....	61

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Banking industries around the world have experienced the occurrence of banking crisis as a result of the accumulation of nonperforming loans which can account for a sizeable share of insolvent banks and financial institutions. The banking crisis which affected a large number of Sub-Sahara African countries in 1990s was accompanied by a rapid accumulation of nonperforming loans. (Caprio and Klingebiel, 2002)

A loan is termed nonperforming as soon as part or whole of a loan installment is due and has not been paid according to the loan agreement. Concerning non-performing loans, the bottom line is the international statistics manual seems to be that loans are good unless there is absolute certainty that a loan is not going to be repaid under existing arrangements. Thus loans remain in the balance sheet until a debt cancellation or write off has taken place. To improve the liability to make comparison between banks across countries, the Institute of International Finance report proposes that, for a worldwide external reporting, the following categories should be used:

Standard, watch, substandard, doubtful and loss. Non-performing loans are those that are complete loss and loans whose quality is significantly impaired (substandard and doubtful).

The criteria for identifying non-performing loans have been standardized by the Bank of Ghana, who has the regulatory and supervisory authority and has established minimum qualifying criteria for all banks which include:

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Current (1-30 days), other loans especially mentioned (30-90), substandard (90-180 days), doubtful (180-360 days), and loss (360 days & above).

For the purpose of this study, non-performing loans are those which are in default for the past 90 days or more (thus 30–90) days.

The accumulation of nonperforming loans is largely characterized by both endogenous and exogenous factors. These factors include economic down turns and macroeconomic volatility, high interest rate, insider lending and moral hazard.

One of the major reasons for non-performing loans is lack of adequate credit history of customers and prospective customers which is aggravated under the umbrella of confidentiality, other reasons for non-performing loans are an inevitable number of wrong economic decisions by individuals and plain bad luck (Inclement weather, unexpected price changes for certain products etc.) and less predictable incidence such as when the cost of fuel prices, of key export product, foreign exchange and interest rate changes abruptly (Bloem and Gorter, .2002)

The effect of non-performing loans is the inability of banks to provide credit and the resulting liquidity crunch may suffocate otherwise good creditors. The economic and financial costs of these loans are significant, potentially, these loans may negatively affect the level of private investment and constraint the scope of the bank credit to the private sector through a reduction of bank's accumulation of losses and correlative increased provisions to compensate for these losses. These loans also have potential for reducing private consumption and in the absence of deposit guarantee mechanism to

protect small depositors can be a source of economic contraction especially when couple with declining capital formulation in erosion of banks equity and assets.

(Cortavarria et al 2000).

The issue of non-performing loans has gained increasing attention in the last few decades. The immediate consequence of large amount of non-performing loans in the banking system is bank failure. Many researches on the cause of bank failures find that assets quality is statistically significant predictor of insolvency and that failing banking institutions always have high level of nonperforming loans prior to failure. It is argued that nonperforming loans are one of the major causes of economic stagnation problems.

Each nonperforming loan in the financial sector is view as an obverse mirror image of an ailing unprofitable enterprise. From this point of view the eradication of nonperforming loans as a necessary condition to improve the economic status. If the nonperforming loans are kept existing and continuously rolled over, the resources are locked up in unprofitable sectors (Dermirque-Kunt et al 1998).

Bosomtwe Rural Bank Limited has effective credit organization framework which indicate various authority levels for approval of credit as well as areas of responsibility and also regulations governing credit administration.

In spite of this procedure to reduce the possibility of those debt not being repaid, there is also a likelihood of a risk that some debt will become impaired, no matter how rigorous the systems.

1.2 Statement of the Problem

The Banks creates assets when loans are granted. The inability of borrowers to pay back credit extended to them and which result in the creation of nonperforming loans resulting in the deprivation of scope of the bank credit to private sector due to liquidity constraint. The provisioning of bad and doubtful debt further reduces profitability hence shareholders value and aggravate the existing credit crunch. There is therefore the need to research into the causes of nonperforming loans at Bosomtwe Rural Bank because of its persistency and the need to overcome them.

1.3 Objectives of the Study

The main objective of this study is to investigate the micro and macroeconomic factors that causes nonperforming loans at Bosomtwe Rural Bank Limited: Specifically,

1. To identify and examine the causes of nonperforming loans at Bosomtwe Rural Bank Limited from the viewpoint of credit officers.
2. To identify and examine the causes of loan default from the view point of defaulters.
3. To determine the impact of inflation, interest rate, exchange rate depreciation, gross domestic product and money supply on the prevalence of nonperforming loans.
4. To formulate recommendation aimed at reducing nonperforming loans at all banks and most importantly Bosomtwe Rural Limited.

1.4 Research Question

- What are the causes of nonperforming loans from the viewpoint of credit officers and loan defaulters?

1.5 Significance of the Study

There are a number of banks that have collapsed as a result of accumulation of nonperforming loans. For instance in Indonesia where over sixty (60) banks collapsed during the 1997 East-Asian financial and banking crisis, non-performing loans represented about 75% of the total loan portfolios (Caprio and Klingebiel, 2002).

First, the significance of the study was to inform readers on the causes of nonperforming loans and measures to be taken to correct such occurrence in the future.

Furthermore, the study has helped to unravel the areas of lending where default rate will be minimal and build a strong public confidence.

It would saved time and resource in legal tussle to retrieve impaired loans.

1.6 Scope of the Study

The study examined the causes of nonperforming from 2002 to 2008. The researcher was unable to produce the absolute figures of nonperforming loans due to their sensitivity.

The named period was chosen due to the availability and reliability of data.

1.7 Methodology

To investigate the causes of nonperforming loans at Bosomtwe Rural Bank Limited, Data was generated from both primary and secondary sources. Primary data was developed from two main sources:

- Questionnaire was developed based on the causes of nonperforming loans to every credit officer. Questionnaires were sent to a sample frame and a sample size of 13 credit officers.
- Another questionnaire was sent to a cross section of the bank loan defaulters with a sample frame of 500 loan defaulters and a sample size of 50 loan defaulters. A stratified sampling was used where a population of 500 people was divided into five strata. A simple random sampling was used to select a number of people from each stratum to make up a sample size of 50.

Secondary data on nonperforming loans was based on the bank quarterly ageing analysis for the past seven years (2002-2008), thus twenty eight (28) periods, published account and management report.

The questionnaires had their focus on the causes of nonperforming loans under six main headings:

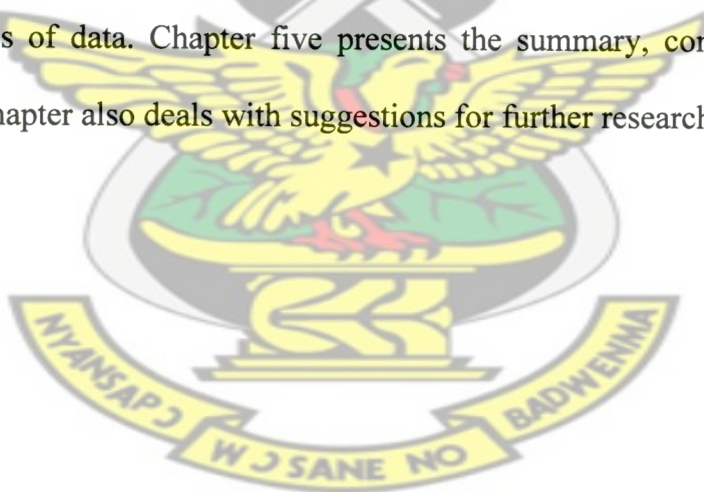
- Moral Hazard and Insider Lending
- Inefficient Appraisal and Monitoring Techniques
- Corruption and Fraud
- Rapid Credit Expansion
- Natural Calamity
- Macroeconomic Variables

1.8 Limitations of the Study

One of the limiting factors was the inability to get access to data and financial information from other Rural Banks due to their sensitivity and has been limited to Bosomtwe Rural Bank Limited where access has been granted. This made it difficult to generalize the results.

1.9 Organization of the Study

The study has five chapters. The preceding section which is chapter one deals with introduction which includes background information, statement of the problem, objective of the study, research question, significance of the study, scope of the study, limitation of the study, organization of the study. Chapter two deals specifically with the literature review. Chapter three presents the methodology of the study. Chapter four deals with presentation and analysis of data. Chapter five presents the summary, conclusion and recommendation. This chapter also deals with suggestions for further research.



CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

The purpose of this chapter is to provide a review of the literature relevant to the research objectives of this thesis. This chapter is devoted to providing a comprehensive background underlying the causes of nonperforming loans. It seeks the views of other peoples and bodies about the problem under discussion.

2.1 Definition of Nonperforming Loans

There is no single definition of nonperforming loans, country definition differs and it is recognized that, it is possible that what is appropriate in one country may not be so in another. There is however some convergence of opinion on this issue.

In the context of International Monetary Fund from paragraph 4.84-4.85 of its compilation Guide on financial soundness Indicators (2004) a loan is non-performing when payment of interest and or principal are past due by 90 days or more, or payment are less than 90 days overdue, but there are other good reasons to doubt that payment will be made in full.

This definition conforms to that of Caprio and Klingebiel (2002). According to them, non-performing loans generally refers to loans which for a relatively long period of time do not generate income, that is, the principal and or interest on these loans has been left

unpaid for at least 90 days. This was also supported by Asian Development Bank, 2004; Ernst and Young, 2004.

2.2 Causes of Nonperforming Loans

The causes of nonperforming loans include: inefficient appraisal and monitoring techniques, macroeconomic (instability) variable, lending to high risk borrowers, weak internal, external control and risk management, moral hazard and insider lending, corruption and fraud, rapid credit expansion, natural calamity and politically connected/ related lending are explained below.

2.2.1 Inefficient Appraisal and Monitoring Techniques

An investigation by Ahmad (1997), mentioned some important factors as causes of loan default which include: lack of willingness to pay coupled with diversion of fund, willful negligence and improper credit appraisal.

This was corroborated by Brownbridge (1998) that high level of non-performing loans asserts that bank managers have little incentives to monitor borrowers. He argued that lenders do not expect their loans to be collectible and borrowers know they will not have to pay. This means there is little incentive to monitor loans.

It is also undisputable that some of the credits to the high risk borrowers were of a quality; he noted that lending to such sectors required very strong loan appraisal techniques. The expertise to carry out screening and monitoring of borrowers were

lacking in most instances. Consequently determining the difference between good and bad credit risks were a problem for most of the banks.

Mamman and Oluyemi (1994) supported these findings of Brownbridge by observing that in most of the Nigerian banks with huge non-performing loans, the Managers and Directors often lacked the necessary expertise and experience in credit appraisals. Information imperfection were noted to be quite acute in addition to the fact that the quality of borrowers financial accounts were poor, while at the same time most of these borrowers lacked a track record of managing businesses successfully.

Brownbridge (1998) also observed lots of shortfalls with the credit procedures of most of the banks. Documentation of loans and loan securities were quite poor while internal controls were frequently missing or poorly arranged.

2.2.2 Macroeconomic Variables

The dramatic increase in non-performing loans is largely driven by macroeconomic volatility and reflects the vulnerability of undiversified African economies which remain heavily exposed to external shocks. Similar results show that macroeconomic stability is associated with declining level of nonperforming loans, where as adverse macroeconomic shocks is associated with rising scope of non-performing loans. These results are supported by long-term estimate of non-performing loans derived from pseudo panel based prediction model, World Bank (2005).

Bercoff, Meloni, and Nongues (2000) also examined the fragility of Argentinean Banking System over the 1993 – 1996 period, they argued that non-performing loans are affected by macroeconomic factors.

Keeton and Moris (1987), present one of the earliest studies to examine the causes of loan losses. They examined the losses of 2470 insured commercial banks in the United States over the period 1979 to 1985. They showed that local economic conditions along with the poor performance of certain sectors explained the variation in loan loss recorded by the banks. The study showed that commercial banks with greater risk appetite tend to record higher losses.

Sinke and Greenwald (1991) on the other hand reported that depressed economic condition also explained the loan loss rate of commercial banks. They used data for large Commercial banks in the United States from 1984 to 1987; and estimated their model by ordinary least squares. They argued that external factors explained loan loss and concluded that there was a significant positive relationship between loan loss rate and high interest rate.

In another development Kaminsky and Reinhart (1996), also reported that real exchange rate appreciation may limit growth prospects by squeezing profit margins, especially in export oriented industries and ultimately lead to economic contraction with direct implication on loan performance.

Jimenez and Saurian (2005) also supported this argument, after examining the Spanish banking sector over the period 1984 to 2003; they provided evidence that non-performing loans were determined by high interest rate.

Furthermore, the impact of macroeconomic instability on the creation of non-performing loans was also examined by Brownbridge (1998). He noted that high and very volatile inflation further compounded the problem of non-performing loans creation.

Collier (1993) also noted during his study of some banks in Africa countries that, in 1990's inflation in Zambia reached 191 per cent at one time, 70% in Nigeria, 230% in Uganda and 46% in Kenya. He observed that with interest rates being liberalized in the afore-mentioned countries with the exception of Nigeria nominal lending rates were very high with the rate fluctuating in a very unpredictable manner.

Macro-economic instability had two important consequences for loan quality of the banks. First high inflation increases the volatility of business profit because of the unpredictability of the profits and because it entails a high degree of variability in the rates of increases in the prices of goods and services. (Harvery and Jenkins, 1994).

The second consequences of inflation is that it makes loan appraisal difficult for the bank, because the viability of potential borrowers depend upon unpredictable development in the overall rate of inflation, its individual components, exchange rates and interest rates.

Moreover, asset prices are also likely to be highly volatile under such conditions. The future real value of loan security is also very uncertain.

Moreover, Hurt and Fesolvalyi (1998) found that corporate loan default increases as real gross domestic product growth decline, and that the exchange rate depreciation directly affects the repayment ability of borrowers.

Vandel, (1993) also found that high interest rates tend to facilitate default by borrowers.

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2.2.3 Lending to High Risk Borrowers

In the opinion of Brownbridge (1998) the second major factor contributing to bank failure was lending at interest rate to borrowers in the high risk segment of the credit market. This involved elements of moral hazard on the part of both the banks and their borrowers and adverse selections of borrowers. The above was in part motivated by the high cost of mobilizing funds. Because some of the banks were perceived to be less safe than the well established banks by depositors, local banks had to offer depositors higher interest rate.

The local banks also had difficulty in attracting non-interest bearing current account because they could offer few advantages to current account holders which could not also be obtained from the established banks. Some of the banks also relied heavily on high

cost inter-bank borrowings from other banks and financial institutions on which very high real interest rates were common.

The high cost of funds meant that the banks had to generate high earning from their assets for example by charging high lending rates, with consequences for the quality of their loan portfolio.

The local banks almost inevitably suffered from the adverse selection of borrowers, many of whom had been rejected by the foreign banks because they did not meet the strict credit worthiness criteria demanded of them.

Because the local banks had to charge higher lending rates to compensate for higher cost of funds, it was very difficult for the local banks to compete with the foreign banks for 'prime' borrowers or the most credit worthy, customers.

The credit market as a result became segmented with the local banks dealing mainly with the borrowers, serving the high lending rates because they could access no alternative source of credit.

2.2.4 Weak Internal, External Control and Risk Management

The quantum of non-performing loans was indicative that, the system of controls, both external and internal and risk management by Japanese banks were less than adequate (Nanto, 1998).

He cited an instance where a trader in the New York Branch of the Daiwa Bank over a period of 11 years, in September duped the bank into the tune of 1.1 billion through transactions.

2.2.5 Moral Hazard and Insider Lending

In the opinion of Goldstein and Turner (1996) the accumulation of non-performing loans is generally attributed to a number of factors including insider lending and moral hazard. Moral hazard in the banking sector context refers to the adverse incentives created by the prospects of implicit coverage of banks losses by governments. It can be particularly high when banks capital is low, in such cases, it often leads to adoption of imprudent lending strategies with direct implication for bank's loan portfolio's which lend to be highly skewed towards high risk projects. When those projects are owned by investors and entrepreneurs directly or indirectly connected with the lenders, the financial transaction is termed as insider lending.

Indeed, moral hazard was pervasive in the practice of banking in the nineties and such was singled out as one of the leading causes of dramatic increase of non-performing loans.

In Nigeria for instance, moral hazard which fueled insider lending is believed to have accounted for over 65% of impaired loan in four banks liquidated in 1995. Similarly, most of the large local banks failures in Kenya involved extensive insider leading (Brownbridge 1998).

Insider leading is not specific to sub-Saharan Africa; however, over the years it has been single out as the major cause of bank failure around the world (Caprio, 1997).

Insider leading accounted for 65% of the total loans of the four local banks in Nigeria liquidated 1995. All the loans were deemed irrecoverable (Ikhede, 1996).

In Uganda half the loan portfolio of one of the local banks that was taken over by Bank of Uganda in 1995 had been extended to directors and employees. He also noted that the threat posed by insider leading to the soundness of the bank was worsened by the fact that many of the insider loans were invested in speculative projects such as real estate development, as well as project which could not generate short term returns (such as Hotels, and shipping canter's) the end result was a serious mismatch in the maturities of the bank assets and liabilities (Brownbridge, 1998).

2.2.6 Corruption and Fraud

One of the reasons for nonperforming loans is corruption and fraud. A previous Bank of Thailand audit of 150 cases of the state bank showed 27 strategic non performing loans or client who intentionally defaulted on their loan despite the financial ability to pay. Data studies showed small and medium enterprise bank was plagued with bad loans due in part to internal fraud and corruption by bank officials in collusion of borrowers (DARANA CHUDASRI, Bangkok Post, Economic Business 05/11/08).

Shaffer (2008), a paper presented at the NPSAS Annual National Conference Palmer Hotel, Hilton, IL), shows that corruption turn to cause accumulation of non performing loans using canal data from 2000–2005, it shows that corruption indeed build up non-performing loans.

Corruption and fraud also contributed to the scale of the banks losses with politically connected borrowers been able to access unsecured loans which would not have been given to them on commercial grounds (Tanner, 1995).

2.2.7 Rapid Credit Expansion

The rapid credit expansion is also one of the causes of nonperforming loans. Keeton, (1999) uses data from 1992–1996 and a vector auto regression model to analyze the impact of credit growth and loan delinquencies in the USA. It reports evidence of a strong relationship between credit growth and impaired loans.

Specifically, Keeton (1999) shows that rapid credit growth which was associated with lower credit standards, contributed to higher loan losses in certain banks in the United States.

2.2.8 Natural Calamity

Ahmad (1997) based on an investigation, mention some important factors as a cause of nonperforming loans which includes natural calamities such as bad weather.

2.2.9 Politically Connected and Related Lending

Khwaja and Mian (2005) have found that loans made to politically connected firm by state owned banks have 50% higher default rates than regular loans in Pakistan, costing 0.3 –1.9% of GDP every year.

Brownbridge and Gockel (1998) identify a number of causes of the high quantum of nonperforming assets. A main reason identify was that the public sector banks had been pressurized into extending finance to unbankable projects to meet developmental and political objectives. The banks were very vulnerable to political pressure because the government had the authority to appoint and dismiss the bank executives and members. They also observed that a sizeable proportion of about 53% of the NPAS were to medium and small scale companies in import substituting industries. Most of the projects were not properly appraised by the bank providing the finance. Some were clearly marginally viable, if viable at all while the collateral provided had little resale value. Loan documentation was inadequate as was loan monitoring and little effort was made to recover most of the bad loans.

In addition to the above some of the bank staff lack the necessary qualification and experts because recruitment was influence by nepotism and political influence.

2.3 Classification of Loans

In accordance with section 53(1) of the Banking Act 2004 (Act 673) loans should be submitted and classified into the following five categories which will determine the level of provisions required;

- Current;
- Other loans especially mentioned (“OLEM”);
- Substandard;
- Doubtful
- Loss

2.3.1 Current facilities

Facilities in this category are those for which the borrower is up to date (ie. current) with repayment of both principal and interest. Indications that a facility is still current would include regular activity on the account with no sign that a hard – core debt is building up.

2.3.2 Other Loans Especially Mention

Facilities in this category are currently protected by adequate securities as to principal and interest but they are potentially weak and constitute an undue credit risk, although not to the point of justifying the classification of substandard. This category would include unusual facilities due to the nature of the facility, customer or project, facilities where there is a lack of financial information or any other facility where there is more

than a normal degree of risk. (All overdue loans from 30 to 90 days are covered by this category).

2.3.3 Substandard Facilities

Substandard facilities display well-defined credit weaknesses that jeopardize the liquidation of the debt. Substandard facilities include loans to borrowers whose cash-flow is not sufficient to meet currently maturing debt, loans to borrowers which are significantly undercapitalized and loans to borrowers lacking sufficient working capital to meet their operational needs. Substandard facilities are not protected by the current network and paying capacity of the customer.

Non-performing loans and receivables, which are at least 90 days overdue but less than 180 days overdue, are classified substandard.

2.3.4 Doubtful Facilities

Doubtful facilities exhibit all the weaknesses inherent in facilities classified as substandard with the added characteristics that the facilities are not well secured and the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonable specific pending factors, which may work to the advantage and strengthening of the facilities, its classification as an estimated loss is deferred until its more exact states may be determine.

Non-performing loans and receivables, which are at least 180 days overdue but less than 360 days overdue, are classified as doubtful.

2.3.5 Loss Facilities

Facilities classified as a loss are considered uncollectible and of such little value that their continuation as recoverable facilities is not warranted. This classification does not mean that the facility has absolutely no recovery value, but rather, it is not practical or desirable to defer writing off this basically worthless advance even though partial recovery may be effected in the future facilities classified as a loss include bankrupt companies and loans to insolvent firms with negative working capital and cash flow Banks should not retain facilities on the books while attempting long-term recoveries. Losses should be taken in period in which they surface as uncollectible.

Non-performing loans and receivable which are 360 days more overdue are classified as a loss. (Bank of Ghana guide, 2005).

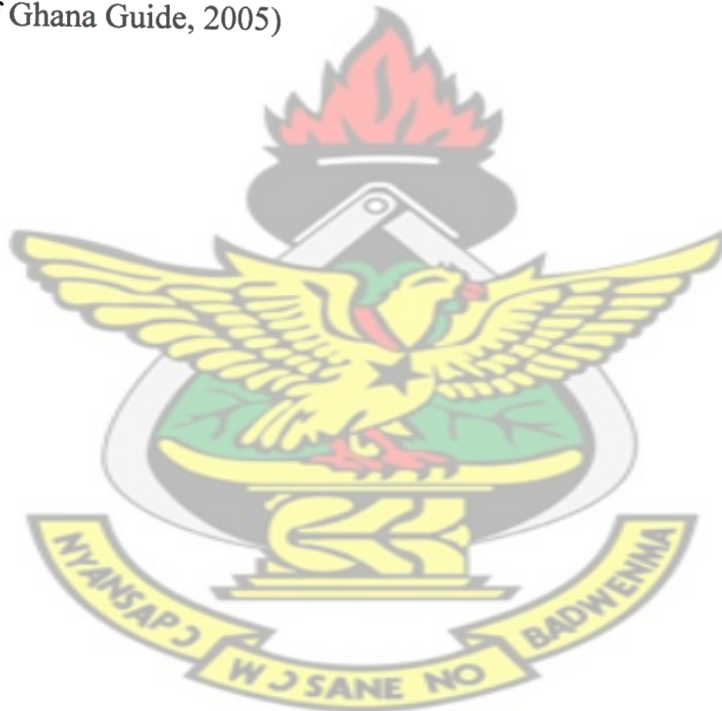
2.4 Provision for Bad and Doubtful Debt

The provisions to be made against the advances/facilities are dependent on the classification into which each advances falls. Minimum provisions should be made as follows:

- 1% of aggregate outstanding balances of all current facilities (0 to less than 30 days)

- 10% of aggregate net unsecured balances for OLEM; to be determining on an individual (30 days to less 90 days)
- 25% of the aggregate net unsecured balance of all substandard facilities (90 days to less than 180 days)
- 50% of all the aggregate net unsecured balance of all doubtful facilities (180 days tom less than 360 days) and
- 100% of the aggregate net unsecured balance of all loss facilities (360 days and above)

The net unsecured balance is the principal outstanding less the value of readily realized security field. (Bank of Ghana Guide, 2005)



CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter explains how data was gathered for this thesis, the population, sampling techniques and the instrument used. It shows the orderly presentation and analysis of the data, and the validity and reliability of the instrument used.

3.1 Research Design

The research focuses on correlation analysis on a number of micro, macro and macroeconomic variables. At the micro and macro levels, researcher designed questionnaires were used to collect data from credit officers and bank loan defaulters on causes of nonperforming loans at Bosomtwe Rural Bank Limited.

At Macroeconomic level, the study investigates the correlation between nonperforming loans and economic variables such as inflation, interest rate and exchange rate depreciation, gross domestic product and money supply using questionnaire. It further looks at the sectorial breakdown of nonperforming loans.

3.2 Population

The population for the study was chosen from Bosomtwe Rural Bank Limited to include credit officers and bank loan defaulters due to the availability of data and financial information.

Loan defaulters were chosen from every sector of the nonperforming loan portfolio. These include Agriculture, Microfinance, Transport, Trading and Others.

Due care was taken to choose a representative population on the causes of non-performing loans.

3.3 Instrument for Data Collection

For the purpose of this study, two different questionnaires were administered to gather the needed data. Data on nonperforming loans were also gathered from the Bosomtwe Rural Bank Limited quarterly ageing analysis.

First both broad classes of questionnaires close-ended and open-ended were used to collect the data from bank staff due to their high level of literacy. The questionnaire contained twenty (24) items; The first five were on how insider lending and moral hazard have contributed to nonperforming loans at Bosomtwe Rural Bank, the next five (5) were to find out how inefficient appraisal and monitoring techniques cause nonperforming loans. The next five (5) were to find out how rapid credit expansion causes nonperforming loans. The next five (5) were to find out if credit officers were involved in fraud and corruption in credit delivery. The next four (4) were to find out the most important causes of nonperforming loans.

Secondly, close-ended and open-ended questionnaire were used to collect the data from bank loan defaulters due to their level of education (literate, semi-literate, illiterate).

The questionnaire contained twenty seven items. The first five (5) were to find out if loan clients and staff were involved in fraud and corrupt practices.; the next three (3) were to arrange bad weather, swine fever and bird flu in order of importance, the next five (5) were to find out if macroeconomic variables cause loan default, the next five (5) is to select the most important macroeconomic variable that causes loan default, the next nine (9) is to select in order of importance inflation, corruption and fraud, bad weather, swine fever, bird flu, interest rate, exchange rate depreciation, gross domestic product and money supply that contribute to loan default.

3.4 Sampling

A simple random sampling was used where every credit officer was included. Thus a sample size and sample frame of thirteen (13) credit officers were used. All the thirteen (13)) respondents responded.

Secondly the choosing population of loan defaulters was stratified, thus dividing the population into a number of non-overlapping groups called the strata. Due to the nature of the study and the heterogeneous nature of the population coupled with the time schedule of the respondents, stratified random sampling, thus selecting a simple random sample from each group separately was considered more appropriate. Tryfor (1996) in his sampling methods, approximately heterogeneous, stratified random sampling can be expected to be better than simple random sampling”.

A population of 500 people was divided into five strata, representing 110 people for trading, 100 people for microfinance, 100 people for agric. 90 people for transport and 100 people for others.

. A simple random sampling was used to select 11 people, 10 people, 10 people, 9 people and 10 people respectively from each stratum to make up a sample size of 50. The five distinct groups include:

Agriculture loan defaulters, microfinance loan defaulters, transport loan defaulters, trading loan defaulters and other loan defaulters. 35 respondents responded.



3.5 Institutional Profile of Bosomtwe Rural Bank

Bosomtwe Rural Bank Limited was incorporated in Nov.1981 and was authorized to carry on the business of banking under the Banking Act, 1970 (Act 339) in Dec.1982 in the then Bosomtwe Atwima Kwanwoma District now Bosomtwe District with its headquarters at Kuntanase in the Ashanti Region. The main aim of the bank is to bring banking services to the door step of the rural people in which the commercial banks are reluctant to operate.

Mission Statement

The Bosomtwe Rural Banks mission is to be a reputable and reliable rural financial capable of mobilizing idle funds to support viable economic ventures in its catchments area as a way of promoting growth to improve the standard of living of its clients and its communities within which it operates.

Bank Location

The head office of the bank is located at Kuntanase –Ashanti, the capital of Bosomtwe District. Kuntanase is about 24.5 kilometers from Kumasi and 6 kilometers to the Lake Bosomtwe, the largest Lake in Ghana. The Bank operates Six (6) agencies, and two mobilization centres in the following towns:

Atonsu–Agogo, adjacent Kumasi Atonsu trotro station.

Jachie, Lake Road.

Kokofu, near Bekwai

Trede, off Santase– Obuase Road.

Kokoben –Santase– Obuase Road.

Atonsu – Bokro Last Stop

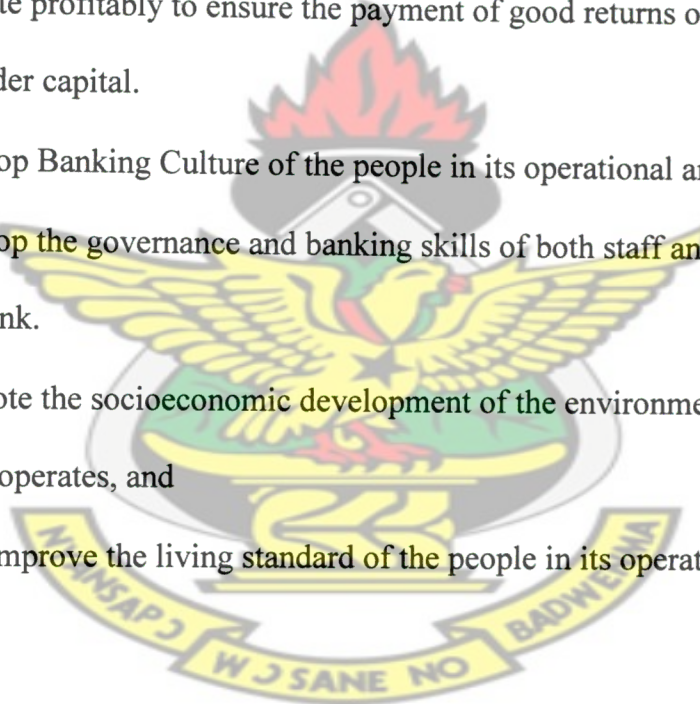
Dadiesoaba, adjacent Asafo Ahmadiya Mosque and

Atwima Amamfrom (Agric Nsema)

Strategic Plan

The strategic plans of the bank are:

- To provide quality, prompt, effective and efficient banking Services to its clients and the public at large.
- To operate profitably to ensure the payment of good returns on shareholder capital.
- To develop Banking Culture of the people in its operational area.
- To develop the governance and banking skills of both staff and directors of the Bank.
- To promote the socioeconomic development of the environment in which the bank operates, and
- To help improve the living standard of the people in its operational areas.



Social Responsibilities

Bosomtwe Rural Bank is very conscious of its social responsibilities' and has over the years contributed immensely towards the development of the communities in which it operates. Notable among these contributions had been:

- Granting of full scholarship to brilliant, but needy shareholders children in secondary / Technical schools in Ghana.
- Provision of financial assistance in cash and kind to the District Education Directorate Best Teacher / Worker awards, and supply of furniture for the District Examination Centre.
- Rehabilitation of school libraries / classrooms.
- Provision of cement and roofing sheets to support classroom construction projects.
- Provision of farming inputs and other award items to support annual District Farmer's day celebration.
- Financial support for village Bore-hole water and Electrification projects.
- Financial support for village health and sanitation improvement projects within its catchments area.

Achievement

Association of Rural Banks / Apex Bank Ranking:

- Bosomtwe Rural Bank Ltd. is making a steady progress. In March 2005, the ARB / Apex Bank rated it as the third strongest Rural / Community Bank in Ghana. In June 2005, it moved upwards to the second position nationwide.

Prestigious club 100:

- The Bank was for the first time admitted into the prestigious club 100 in 2002.
- In that year, the Bank ranked 76th among the list of top 100 companies in Ghana and 13th among Rural / Community Banks.
- In 2003, the Bank was ranked 47th and placed 6th among the twelve (12) Rural / Community Banks in the club in that year. In 2004 it was ranked 49th and 1st among the 13 Rural / Community Banks in the same year.

The Three Key Functions

Bosomtwe Rural Bank essentially performs three key functions. These include buy money, sell money and make money.

Bosomtwe Rural Bank buys money through vigorous deposit mobilization effort in the face of keen competition in today's market place. It competes not only with Commercial Banks but also with other non-financial institutions such as savings and loans companies and microfinance institutions.

The bank sells the money mobilized through loans and advances to its customers and investment in Government of Ghana Treasury Bills to meet the 30% Secondary reserve requirement of the Bank of Ghana. Most of these loans and advances go to farmers, fishermen, traders, local contractors and businessmen both in the rural areas and cities.

Based on the bank activities, it makes money through interest on these loans and advances and investments. Like all financial institutions, Bosomtwe Rural Bank Limited operates in complex environments, forces from which determine the large extent the success, growth and sustainability of the bank. These forces which include macroeconomic environment determine by Government policies (inflation, interest rate etc.), the regulatory environment set by Bank of Ghana (Minimum capital adequacy ratio of 10%) and competition by player such as rural banks, commercial banks and non-bank financial institutions such as savings and loans in the financial market place for customers money.

Services as Rendered by the Bank

Besides the current accounts, Savings accounts, Susu accounts and fixed deposit it facilitates, there are other services that the Bank provides, which include:

- Purchase of Akuafo cheques
- Apex Link Domestic Money Transfer
- NAB International Money Transfer
- Western Union Money Transfer
- Acceptance of items / Valuables for safe custody
- Acting as Executors of Trustees of Wills
- Agriculture / Technical / commercial Advisory Services and
- Investment Advisory Services

Board of Directors

The Bank is under the management of eight – member crop of directors with adverse backgrounds and rich experience who offer policy directions for the growth and development of the Bank.

Management Team

The management team of the Bank is made up of a list caliber and exuberant staff who are committed to the growth of the Bank.

The team which includes the General Manager, Finance and Operation's manager, Human Resource manager, Credit manager, Audit manager and Six (6) head of Agencies meets regularly to review and evaluate operations of the Bank and make appropriate recommendations for the consideration of its Board of Directors'.

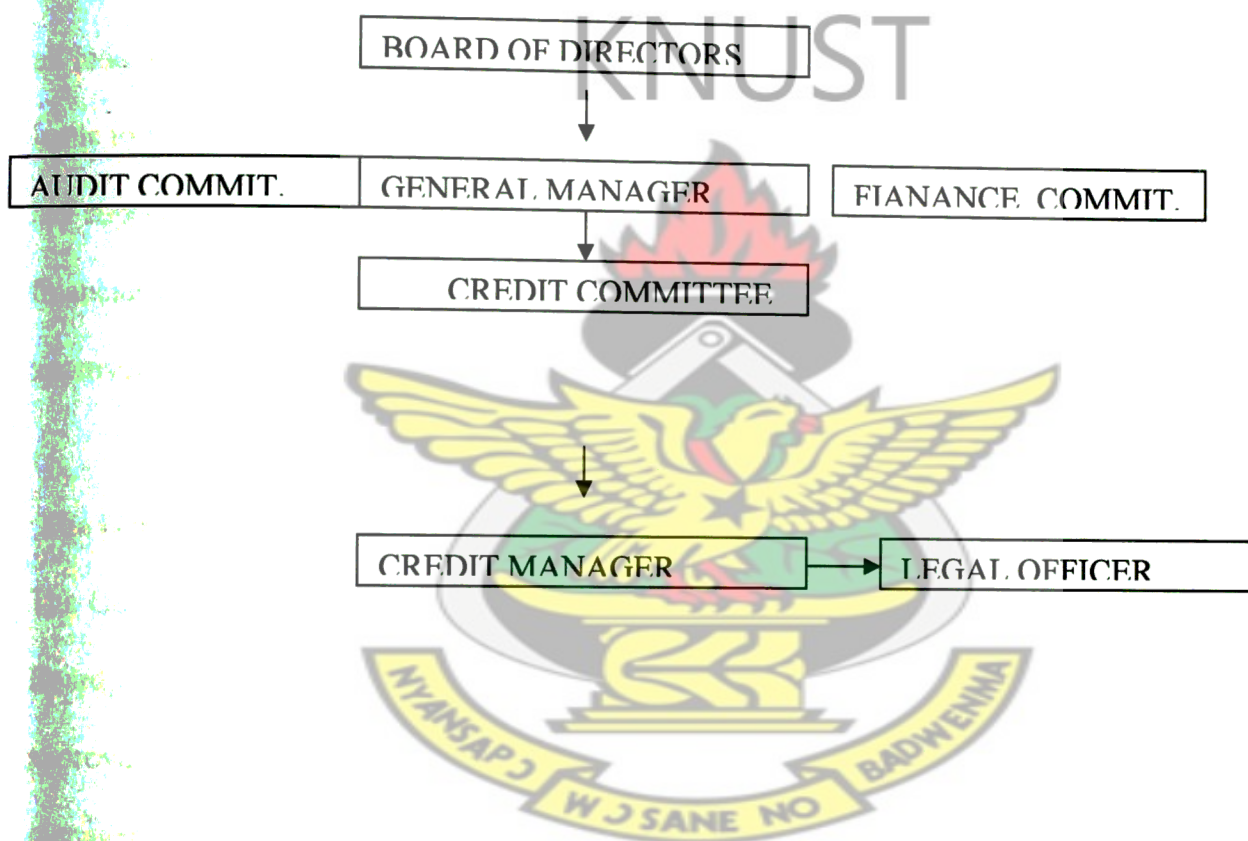
Ownership Structure

The Bank of Ghana administers registration of Rural Community Banks which are required to organize legally as a community-based limited liability company. Ownership must be mainly community-based but there is no explicit exclusion of foreigners. Restriction on ownership includes shareholding restriction of 30% to the individual and 50% of groups (banking Act 2004). The shares are wholly owned by individual Ghanaian and are not traded on the Ghana Stock Exchange. The bank has more than double the stated capital requirement of One hundred and fifty thousand Ghana cedis by the Bank of Ghana.

Credit Structure

Bosomtwe Rural Bank Limited has effective credit organizational framework which indicate the various authority levels for approval of credit as well as areas of responsibility and also regulations governing credit administration are documented in the bank's policy.

The Credit structure of the Bank is made up of the following:



Board of Directors

The Board of Directors are the final approving authority of credit by the Bank. The Board is dedicated and committed to duty and are meticulous and selective in their approach to work of any kind.

Credit Committee

The Board of Directors appoints among its members and management staff to steer the affairs of the matters relating to credit on behalf of the Board. The Committee approves all loan applications exceeding the mandate of the General Manager. It also approves all loans to staff and management and supervises loans to Board Members. The Committee has supervisory authority to recover loans in arrears on behalf of the Board. It has basic financial analysis skills and understands and appreciate credit request brought to it for approval.

The General Manager

The General Manager is the highest-ranking official of the bank and liaises between the Board, staff and customers of the Bank. He refers all significant matters to the Board for approval. He provides the necessary leadership and motivation towards the quality credit management being expected in the bank: He has the authority to approve certain loan limits without reference to the credit committee and the Board but with scrutiny by the audit manager. He also ratifies all loans approved by the credit committee on behalf of the Board.

Credit Manager

The Credit Manager is a critical Management Staff in the process of credit Management. The Manager processes all credit request with the support of credit officers and recommend to credit committee for approval. The Credit Manager's decision is always based on the impact of the economic and regulatory influences. His judgment is always based on the expected return, expected risks and alternative opportunities.

Legal Officer

The Legal Officer like the Credit Officer occupies a critical position in the process of quality Credit Management. He sees to it that assets submitted by applicants as collateral are with good title. He ascertains the veracity of all statements made and documents submitted by clients. He is the one who pursue any loan defaulter to the law courts where the need arises.

Finance Committee

The Finance Committee sees to it that there is enough money for disbursement and that the bank will not have any liquidity problem in the future. Pressure is always put on the loan committee for the recovery of due and overdue loans.

Audit Committee

The Audit Committee ensures quality Credit. It makes sure that internal control introduced by the Board is working as intended. It periodically inspects the books to see whether every transaction of the bank has followed a laid down procedures and where

procedures have been flouted, the reasons for the deviation and the source investigated for appropriate management action.

In spite of this procedure to reduce the possibility of those debt not being repaid, there is also a possibility of a risk that some debt will become impaired, no matter how rigorous the systems.

The bank loan portfolio is made up of agriculture loans, microfinance loans, transport loans, trading loans and others (salaried loans, funeral loans, and school fees loans). Most of the nonperforming loans at Bosomtwe Rural Bank Limited have been skewed toward microfinance loans, trading loans and other loans.

3.6 Data Collection

As causes of nonperforming loans at Bosomtwe Rural Bank Limited, critical examinations of both primary and secondary data were undertaken. The primary data was gathered with opened and closed ended questions and the interview conducted both at the bank premises and on the field.

The Secondary data was taken from published account, management report, quarterly returns and researcher own experience.

3.6 Validity and Reliability

The respondents gave reliable and valid answers to the questions in the questionnaire because their identities were not disclosed. Enough rapport took place because the questionnaires were directly handed over to the respondents. Further explanation was given to the respondents.

Based on the above facts, it can be concluded that the data collected is valid and reliable.

KNUST



CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND DISCUSSION

4.0 Introduction

The results were based upon the data gathered from the questionnaires administered at Bosomtwe Rural Banks' credit officers and loan defaulters. The results from the questionnaires were analyzed using Stata Software and Excel

In this chapter, the data are presented in a sequence that parallels the order of the research questions as they were presented in chapter one. The same order is reflected in the themes of these questionnaires. For clarity, the information in various tables was also presented in charts in order as the tables were presented.

4.1 Results from Credit Officers.

Questionnaires were distributed to 13 credit officers who have rich experience in credit delivery. All the credit officers furnished with questionnaires responded.

Background of Selected Staff.

All the 13 bank Staff were credit officers with experience ranging from 1- 15 years. The responses of the respondents can be said to be from individuals who have had appreciable experience in credit delivery. It can be concluded that 100% of the bank Staff selected are Credit Officers.

Figure: 1 shows the background of selected staff drawn using table: 1 in appendix 1

Figure 1:Background of Selected Staff



Source: Field Survey

4.2 Causes of Nonperforming Loans from the View Point of Credit Officers

In an attempt to answer the research question on the causes of nonperforming loans from the view point of credit officers at Bosomtwe Rural Bank Limited, a questionnaire was administered and the responses from thirteen (13) respondents are presented.

The questionnaire was designed to examine the causes of nonperforming loans in five (5) basic areas. These include:

- Moral hazard and insider lending
- Inefficient appraisal and monitoring techniques
- Rapid credit expansion
- Corruption and fraud
- Most important causes of nonperforming loans

4.2.1 Moral Hazard and Insider Lending

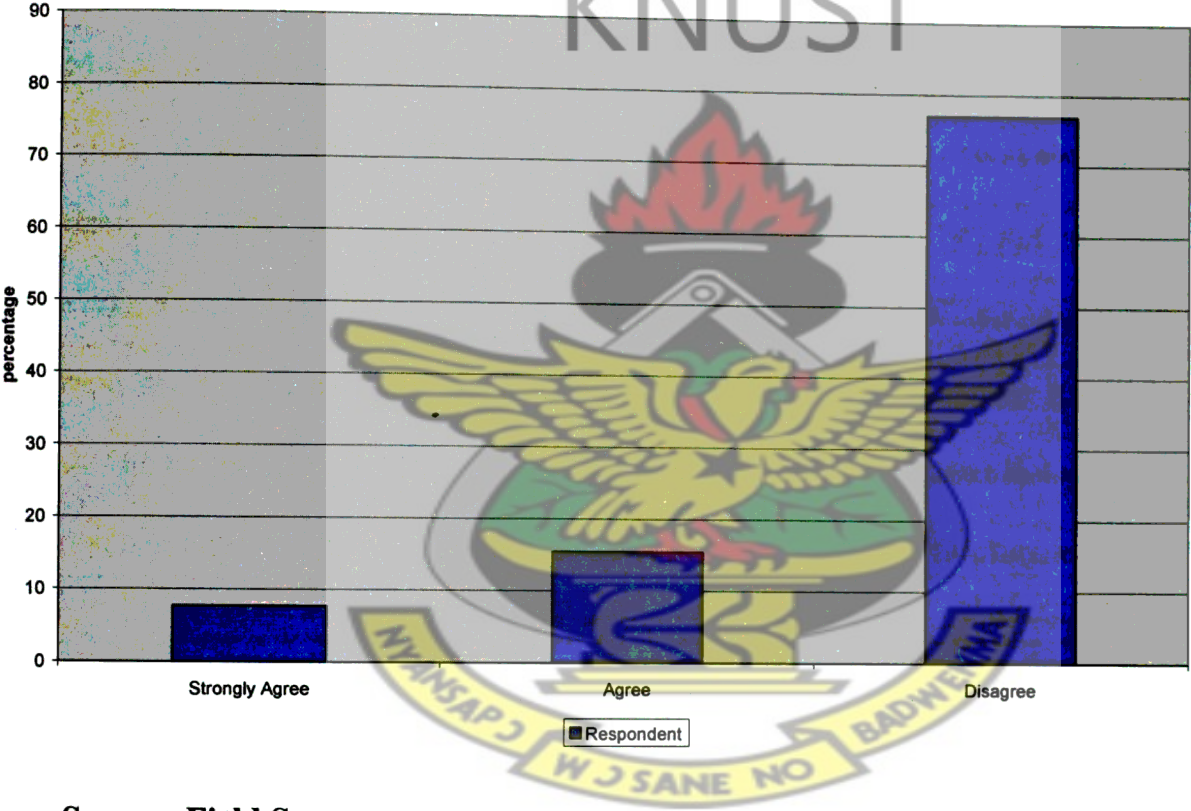
Moral hazard refers to the adverse incentives created by the prospects of implicit coverage of banks losses by government. When projects are owned by investors and entrepreneurs directly or indirectly connected with the lenders, the financial transaction is term insider lending.

As shown in table 2 in appendix 1, one (1) respondent constituting (7.7%) agreed strongly that, the accumulation of nonperforming loans at Bosomtwe Rural Bank is due to moral hazard and insider lending. two (2) respondents constituting (15.38%) also agreed on the above assertion but believe that, there are other main causes of nonperforming loans. However, ten (10) respondents, representing 76.92% disagreed on the assertion that moral hazard and insider lending are the causes of non-performing

loans at Bosomtwe Rural Bank Limited. This contradict the opinion of (Goldstein and Turner, 1996) that the accumulation of nonperforming loans is generally attributed to insider lending and moral hazard.

The figure 2, below shows the bar chart of moral hazard and insider lending and was drawn using table 2 in appendix 1.

Figure 2:Moral Hazard and Insider Lending



Source: Field Survey

4.2.2 Inefficient Appraisal and Monitoring Techniques

This is a situation where expertise to carry out screening and monitoring of borrowers are lacking in most instances. Consequently determining the difference between good and bad credit risk are a problem for most of the banks.

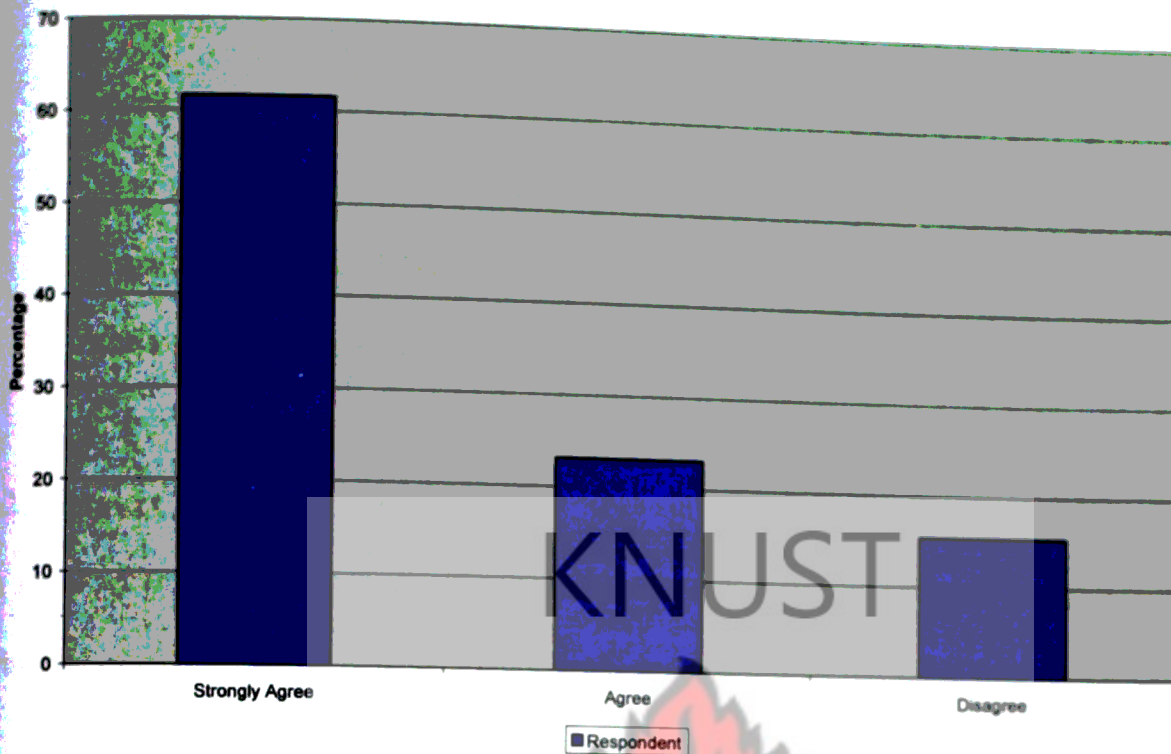
The responses gathered from respondents on the second basic area to answer the research question; inefficient appraisal and monitoring technique as a cause of nonperforming loans at Bosomtwe Rural Bank are presented in table 3 in appendix 1

Table 3 in appendix 1 indicates that eight (8) respondents standing for 61.54% strongly admitted that, the accumulation of nonperforming at Bosomtwe Rural Bank Limited is mainly due to inefficient appraisal and monitoring techniques. Another three (3) respondents (23.08%) saw some evidence in the above assertion but not very much leaving only six (2), (15.38%) of the respondents to disagree on inefficient appraisal and monitoring techniques as a cause of nonperforming loans at Bosomtwe Rural Bank Limited. Thus a greater percentage, (84.62%) of the respondents agreed to the fact that inefficient appraisal and monitoring techniques is the cause of nonperforming loans.

This is in line with the opinion of Mamman and Oluyemi (1994) that most of the Nigeria banks with huge nonperforming loans, the Managers and Directors often lacked the necessary expertise experience in credit appraisal and monitoring

Pictorial view of the responses on the inefficient appraisal and monitoring technique as a cause of non-performing loans is presented below in figure 3.

Figure3: Inefficient Appraisal and Monitoring Techniques



Source: Field Survey

Those who believed that inefficient appraisal and monitoring techniques were the main cause of non-performing loans were based on four parameters. These include:

- Most credit officers rely on cash flow projection when assessing the creditworthiness of the borrower, which means, borrowers build a good cash flow to suit the needs of the bank, collect the money and vanish.
- Credit Officers also rely on collateral, the value of which cannot pay for the debt if it is to be realized.

- There is also some lack of independence of credit officers and sometimes have to appraise and recommend loans to suit the whims and caprices of their bosses hurriedly.
- They also asserted that credit officers sometimes do not monitor borrower's projects after disbursement of loans to find out if the loans were used for the intended purposes or diverted but waited till overdue.

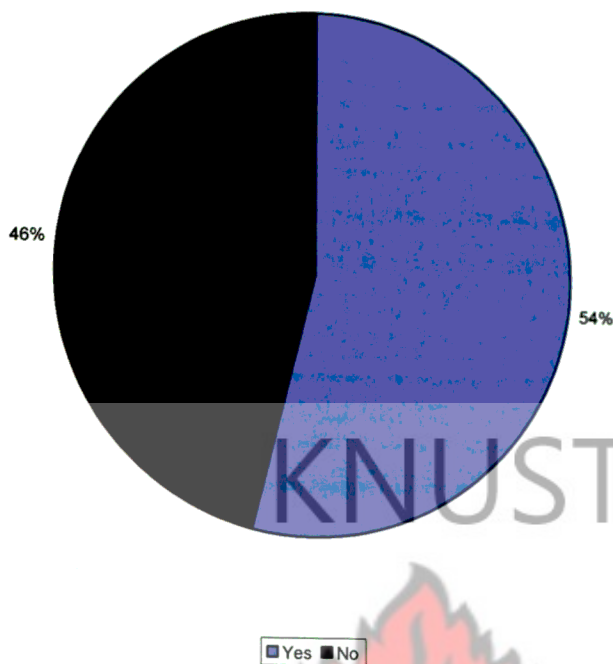
4.2.3 Rapid Credit Expansion

In order to maintain customers due to competition, banks increase their credit rapidly which is associated with lower credit standards and contributes to higher loan loss.

Table 4 in appendix 1 represents the responses on the rapid credit expansion as a cause of nonperforming loans at Bosomtwe Rural Bank Ltd.

From table 4 in appendix 1, seven (7) out of thirteen (13) respondents, and representing 53.85% accepted greatly that rapid credit expansion contribute to the accumulation of non-performing loans. Six (6) respondents, representing 46.15% refuted the assertion that rapid credit expansion contributes to nonperforming loans. This is represented by the Pie chart in figure 4 below:

Figure 4: Rapid Credit Expansion



Source: Field Survey

Those who greatly accepted that rapid credit expansion contributes to non-performing loans revealed that, Credit Officers in order to meet their target and also maintain customers due to competition sometimes ignore credit delivery procedures which facilitate easy access to credit and exceed their target before they realized. The ignorance of credit delivery procedure makes it difficult to retrieve due loan leading to overdue loans. This is also connected to inefficient appraisal techniques.

This also conform to Keeton (1999) assertion that rapid credit expansion is one of the causes of nonperforming loans

4.2.4 Corruption and Fraud

This is where bank officials collude with borrowers to take credit at the expense of the bank. It is the abuse of public authority for personal gain.

Table 5 in appendix 1 represents the responses on the corruption and fraud as a cause of nonperforming loans at Bosomtwe Rural Bank as represent in figure 5 below.

Five (5) respondents out of the thirteen (13) respondents' representing, 38.46% strongly agreed that corruption and fraud is a cause of nonperforming loans at Bosomtwe Rural Bank. Another 15.38% which constituted two (2) respondents also admitted, but not strongly, that corruption and fraud is also a cause of nonperforming loans.

However, six (6) respondents (46.16%) did not agree to the assertion. Thus a greater number of seven (7) respondents representing 53.84% agreed without reservation that corruption and fraud contribute to the existing of nonperforming loans.

The result agreed with that of Tanner (1995) that corruption and fraud contribute to the scale of bank losses.

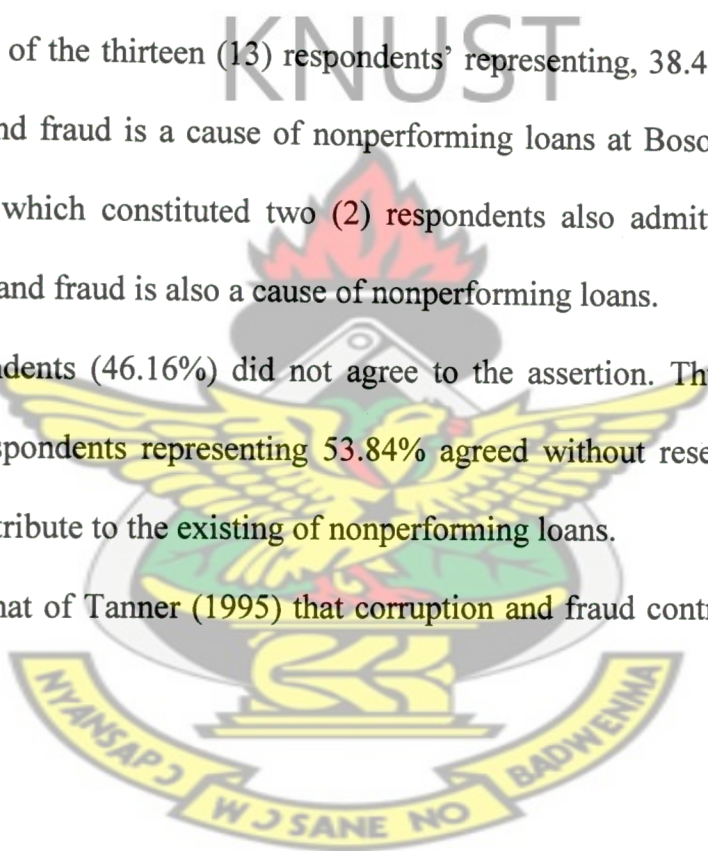
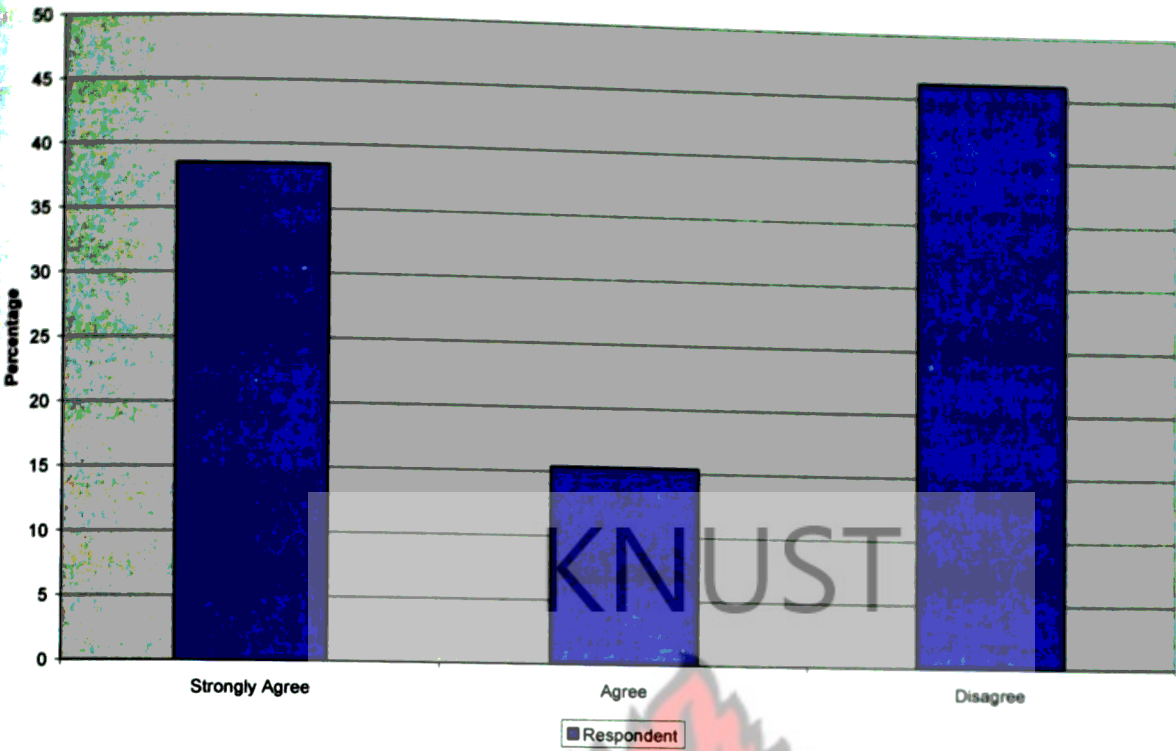


Figure 5: Corruption and Fraud



Source: Field Survey

This assertion was based on the fact that, some credit officers consider their self interest supreme to that of the organization, meaning that some credit officers used front men and fictitious documents to assess loans on their own behalf. This was attributed to microfinance loans especially Adwumapa loans. It is therefore difficult to trace some loan defaulters.

Some credit officers are also corrupted by the gifts received from loan clients either in cash or kind while others also asked for those gifts before clients loans are appraised and processed. Once it happened, no proper appraisal would be made.

Credit officers discriminate against loan clients who are not prepared to part with something leading to a mismatch between the time the loan is needed and the time of disbursement. Thus a possibility that, the loan would be diverted and defaulted.

4.2.5 The Most Important Causes of Nonperforming Loans

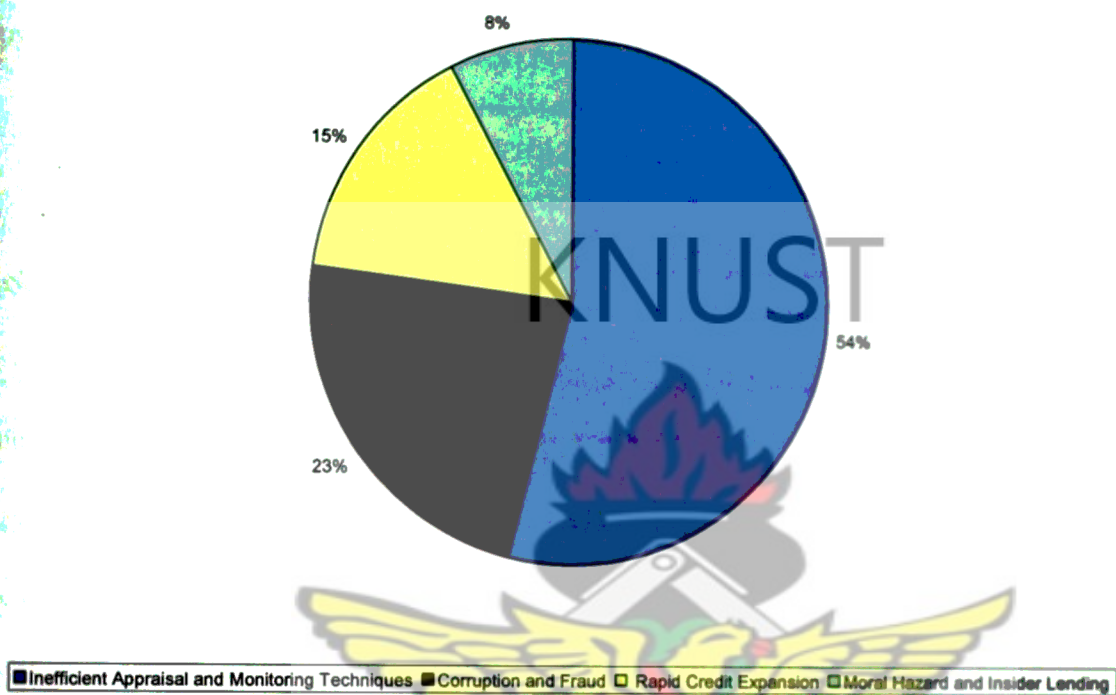
The relative importance of the parameters was ascertained from the questionnaire with the respondents being requested to rank the parameters in order of importance. Once again inefficient appraisal and monitoring technique were deemed most important, followed by corruption and fraud, then rapid credit expansion and finally moral hazard and insider lending.

A total of seven (7) respondents representing 53.85% indicated that inefficient appraisal and monitoring techniques was the most important cause of nonperforming loans.

Next to inefficient appraisal and monitoring technique was corruption and fraud which was also deemed to be the prime cause of nonperforming loans represent 23.07% of the respondents. Rapid credit expansion was also deemed to be important consideration by 15.38% of the respondents. Competition may compel banks to increase credit without following due process. 7.7% of the respondents' chose moral hazard and insider lending as the least important consideration for causes of nonperforming loans.

Table 6 in appendix 1 shows the most important causes of nonperforming as represent in Figure 6

Figure 6: Most Important Causes of Nonperforming Loans



Source: Field Survey

4.3 Results from Loan Defaulters

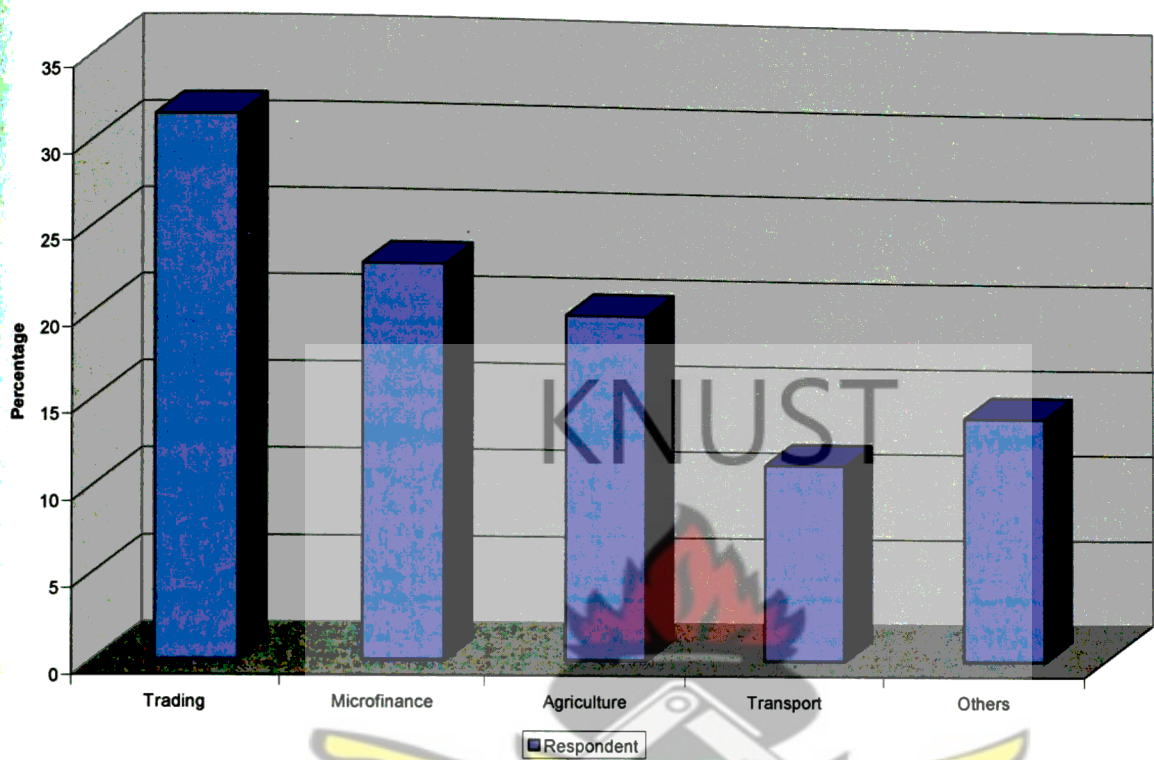
Questionnaires were distributed to fifty (50) loan defaulters of various operating sectors which include Agriculture, Microfinance, Transport, Trading and Others. Out of the total of 50 respondents furnished with questionnaire thirty five (35) responded.

Background of Loan Defaulters

Out of the 35 loan defaulters responded to the questionnaire 32 percent were trading loan defaulters with 2 to 10 years working experience with their ages ranging between 25-40 years, 23% had 4—8 years experience in microfinance with their ages ranging from 25-40 years, 20% also had 3-18 years experience in the agric sector with their ages from 40 and above. The other loan defaulters' ages range from 25- 40 years with 1- 6 years experience representing 14% of the respondents. The least sector is the transport defaulters representing 11% of the respondents with their ages ranging from 40 and above with 10-20 years experience in the transport sector.

Table 7 in appendix 1 shows the frequency and the percentage of the background of loan defaulters. Representing table 7 in appendix 1 in the form of a diagram we obtained figure 7 below:

Figure 7: Background of Loan Defaulters



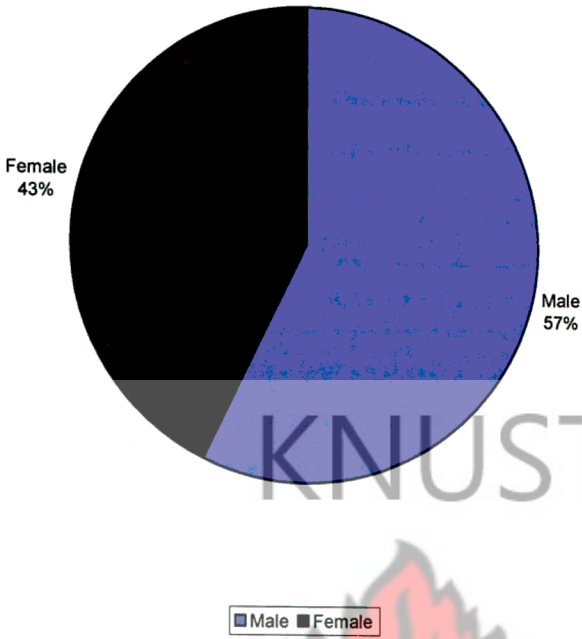
Source: Field Survey

Gender Representation of Loan Defaulters

Out of the thirty-five (35) respondents, fifteen (15) representing 42.86% were women while twenty (20) representing 57.14% were men.

Table 8 in appendix 1 shows gender representation of loan defaulters and is represented in figure 8 below.

Figure 8: Gender Representation of Loan Defaulters



Source: Field Survey

4.4 Causes of Loan Default from the View Point of Defaulters

In an attempt to answer the research on the causes of loan default from the view point of defaulters; a questionnaire was administered and the responses from thirty- five (35) respondents are presented.

The questionnaire was designed to examine the causes of loan default from the view point of defaulters in five basic areas and include:

Fraud and Corruption

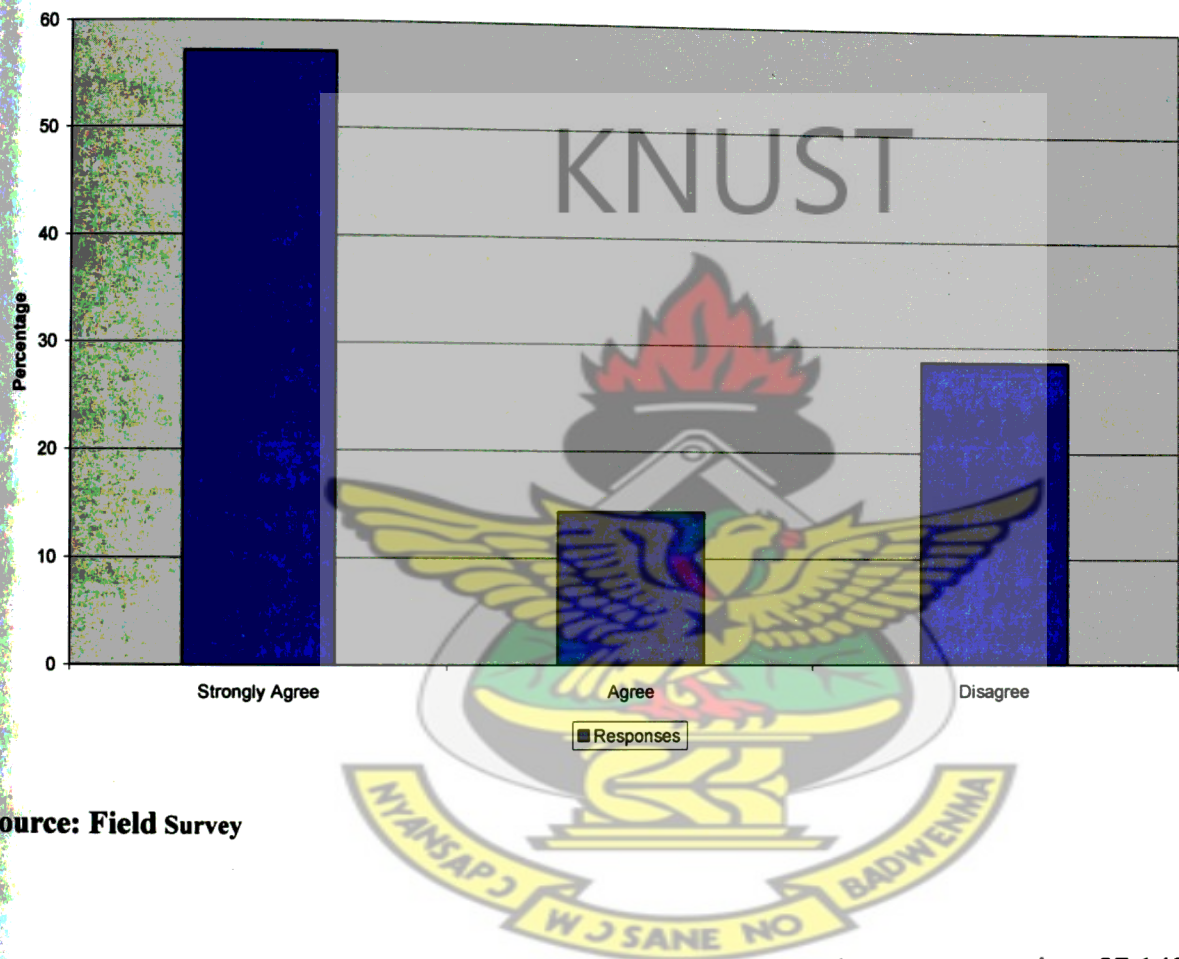
- Natural Calamities
- Macroeconomic Factors
- The Most Important Macroeconomic Factor

- The Most Important Causes of Loan Default by Defaulters

4.4.1 Fraud and Corruption

Figure 9 below shows fraud and corruption as a cause of loan default is represented in table 9 in appendix 1

Figure 9: Fraud and Corruption



Source: Field Survey

As shown in table 9 in appendix 1 twenty (20) respondents representing 57.14% strongly agreed that, the cause of default by defaulters is mainly due to corruption and fraud with 14.29% representing five (5) respondents also agreed but 28.57% representing ten (10) respondents totally disagree. This means that 71.43% agreed

that corruption and fraud contribute to loan default rate. Their assertion was based on the following three parameters:

- **Fronting :** This include those who agreed that corruption and fraud contribute to default revealed that loan clients collect loans on behalf of bank officials specifically credit officers, their friends and families.
- **Inefficient monitoring techniques:** This is the situation where credit officials intentionally refuse to monitor connected lending while loan clients also intentionally refuse to pay.
- **Reward System:** This refers to the demands of bank officials either in cash or kind also make it difficult to repay the loan on the due date.

This also in line with Tanner (1995) that corruption and fraud contributed to the scale of the bank losses with politically connected borrowers been able to access unsecured loans which would not have given to them on commercial grounds.

4.4.2 Natural Calamity

This is unexpected event that causes great damage to borrowers' properties and which is beyond their control.

Loan clients were asked to select among the following three factors the most important that lead to loan default:

- **Bad Weather**
- **Swine Fever**

- Bird Flu

Figure 10 below represented in table 10 in appendix 1 shows natural calamity as a cause of loan default from the view point of defaulters.

Figure 10: Natural Calamity



Source: Field Survey

From the above diagram a total of eighteen (18) respondents representing 51.43% indicated that Bad weather (inadequate rains and fire outbreak) contribute to loan default followed by Swine Fever representing ten (10) respondents 28.57% with Bird Flu as a least factor representing seven (7) respondents with a lower percentage of 20%.

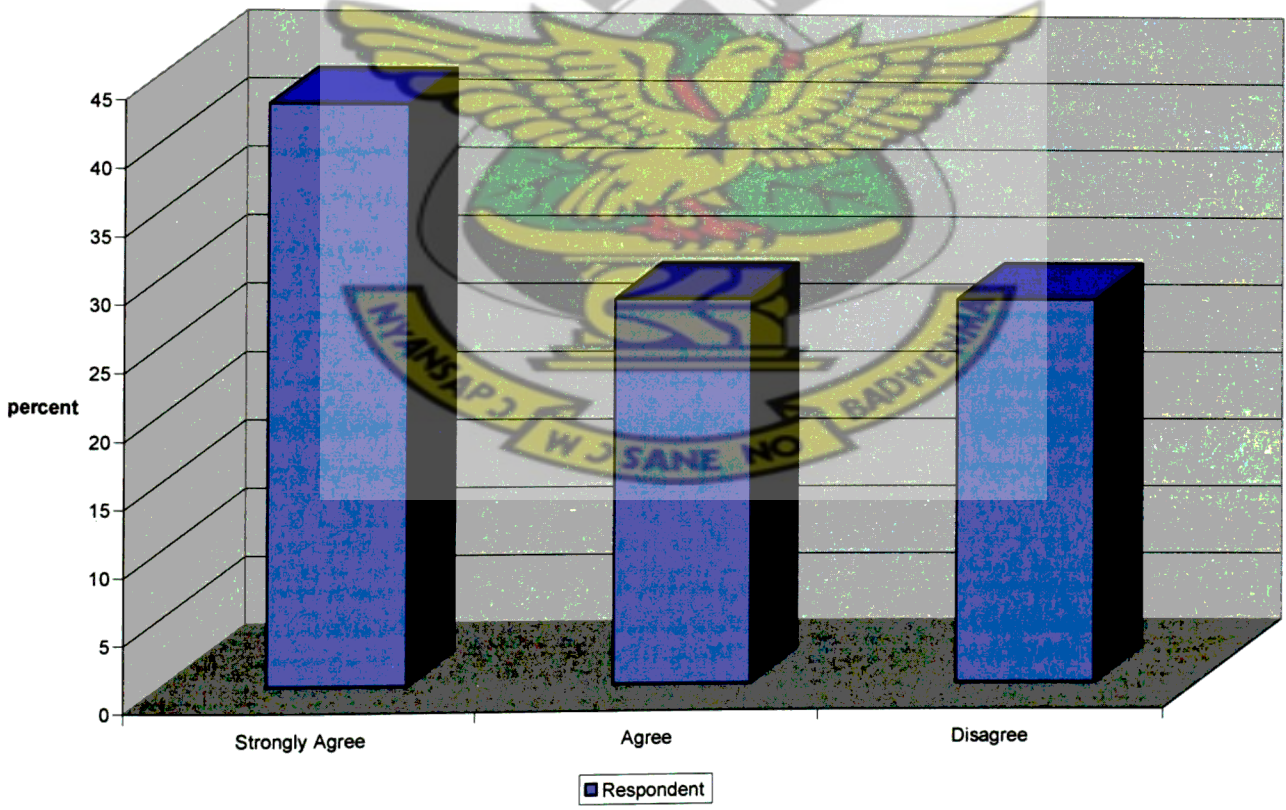
Ahmad (1997) confirmed the my findings that bad weather as one of the causes of nonperforming loans

4.4.3 Macroeconomic Factors

These are forces that drive the economy of every country either upwards or downwards and may affect the loan repayment of borrowers. These include; inflation, interest rate, exchange rate depreciation, gross domestic product and money supply.

Table 11 in appendix 1 represents figure 11 below show macroeconomic factors as a cause of loan default.

Figure 11: Macroeconomic Factor



From table 11 in appendix 1, it was shown that fifteen respondents(15) representing 42.86% strongly agreed that macroeconomic factors lead to loans default while 28.57% representing ten (10) respondents agreed , but ten (10) respondents standing at 28.57% totally disagree.

Those who agreed asserted that, they deal in imported goods and as such foreign exchange depreciation shrinks their capital since elasticity of imports is inelastic. They also affirmed that inflation and interest rate affected them on the latter part of 2008 when they began to go up.

This result is similar to that of a World Bank paper 3769 (2005) that macroeconomic stability is associated to declining level of nonperforming loans and the vice versa

4.4.4 The Most Important Macroeconomic Factor

Respondents were asked to choose most important macroeconomic factors that affect their loan repayment. This is represented in table 12 in appendix 1 and shown figure 12 below:

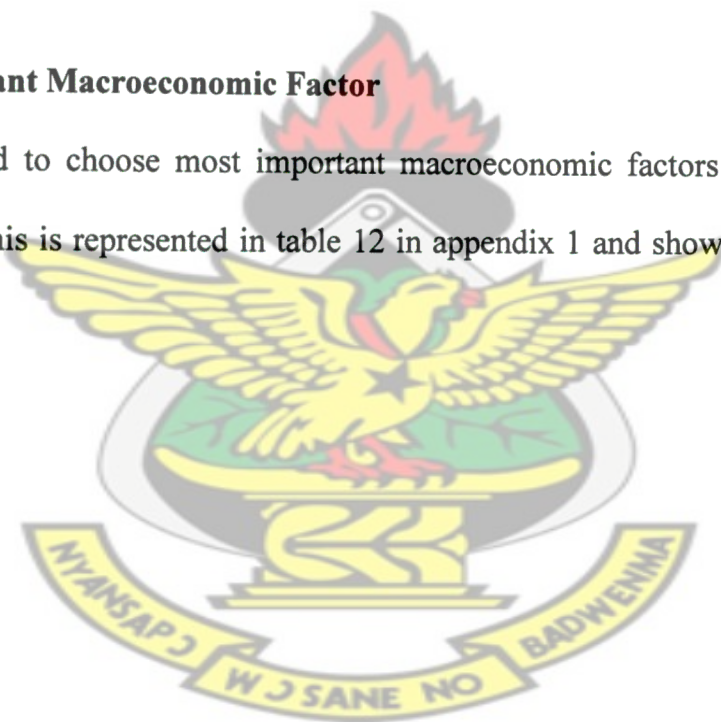
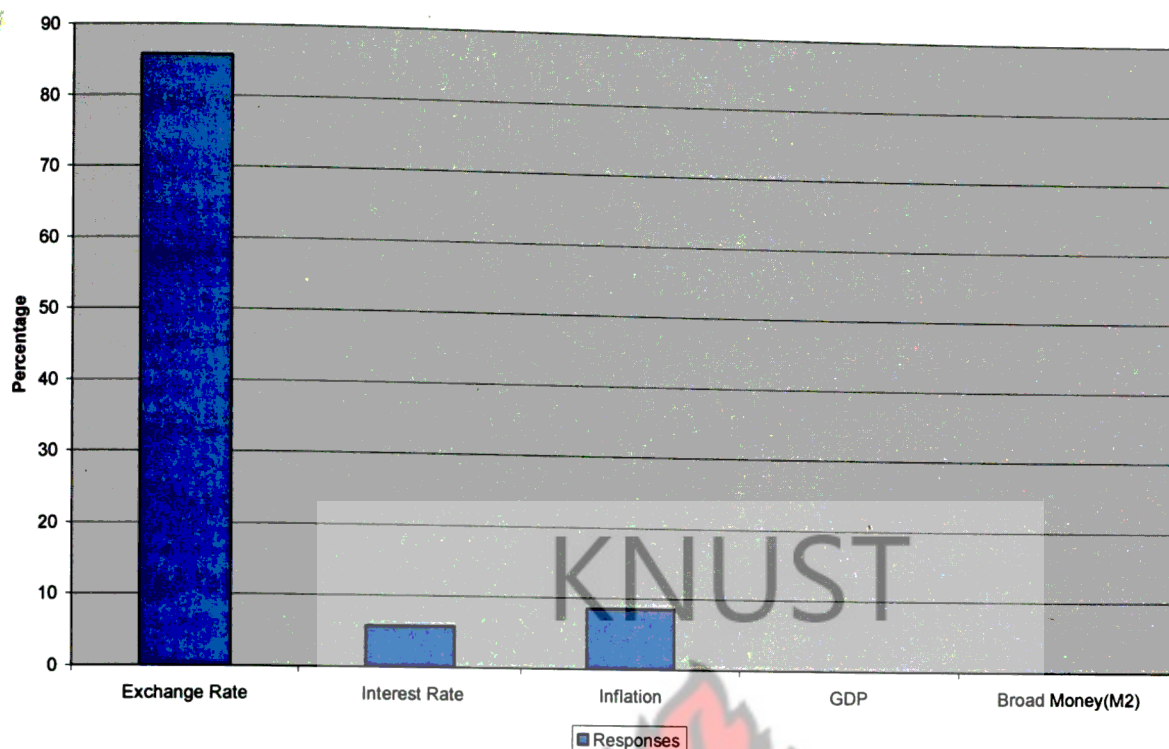


Figure 12: Most Important Macroeconomic Factor



Source: Field Survey

From table 12 in appendix 1, thirty (30) respondents representing 85.71% unreservedly agree that foreign exchange depreciation affected their loan repayment, since they have to exchange huge sums of cedis for few dollars. They also asserted that, they purchased imported goods at higher prices due to inelasticity of imports. These factors shrink their capital.

On the other hand, 8.57% representing three (3) respondents also agreed that inflation lead to loan default with two (2) respondents representing 5.72% went in for interest rate as a contributing factor of loan default. They asserted that interest rate and inflation have not affected loan repayment due to their downward trend from the year 2001 until latter part of year 2008. Surprisingly no respondent selected gross domestic product (GDP) and Money supply even though they were explained to them.

4.4.5 The Most Important Causes of Loan Default by Defaulters

Loan defaulters were asked to choose among a number of parameters that mostly lead to loan default in order of importance. These include:

- Inflation
- Interest rate
- Exchange rate depreciation
- Bad weather
- Swine fever
- Bird flu
- Corruption and fraud
- Gross domestic product
- Money supply

Table 13 in appendix 1 shows the most important causes of loan default, representing it in a diagram we obtained figure 13 below.

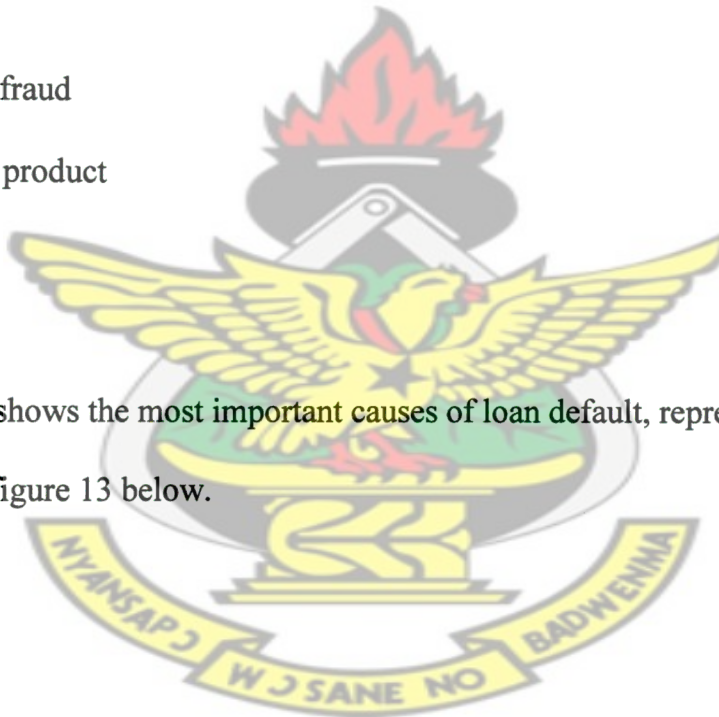
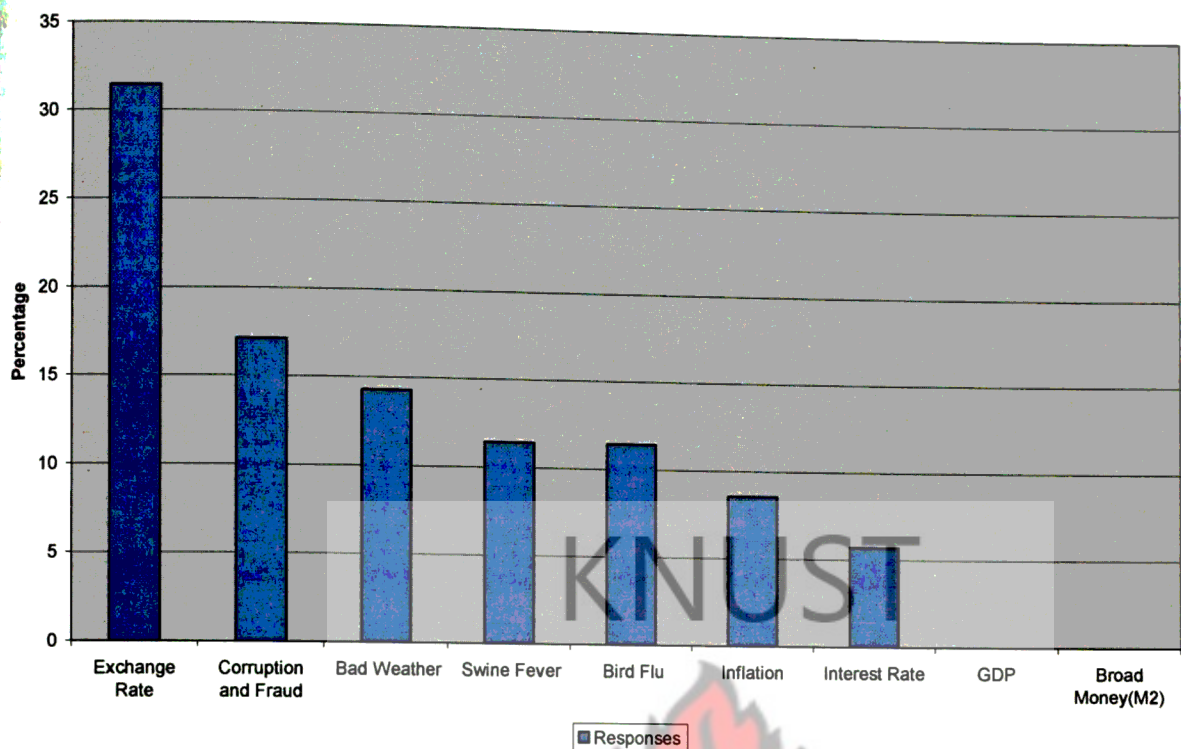


Figure 13: Most Important Factor

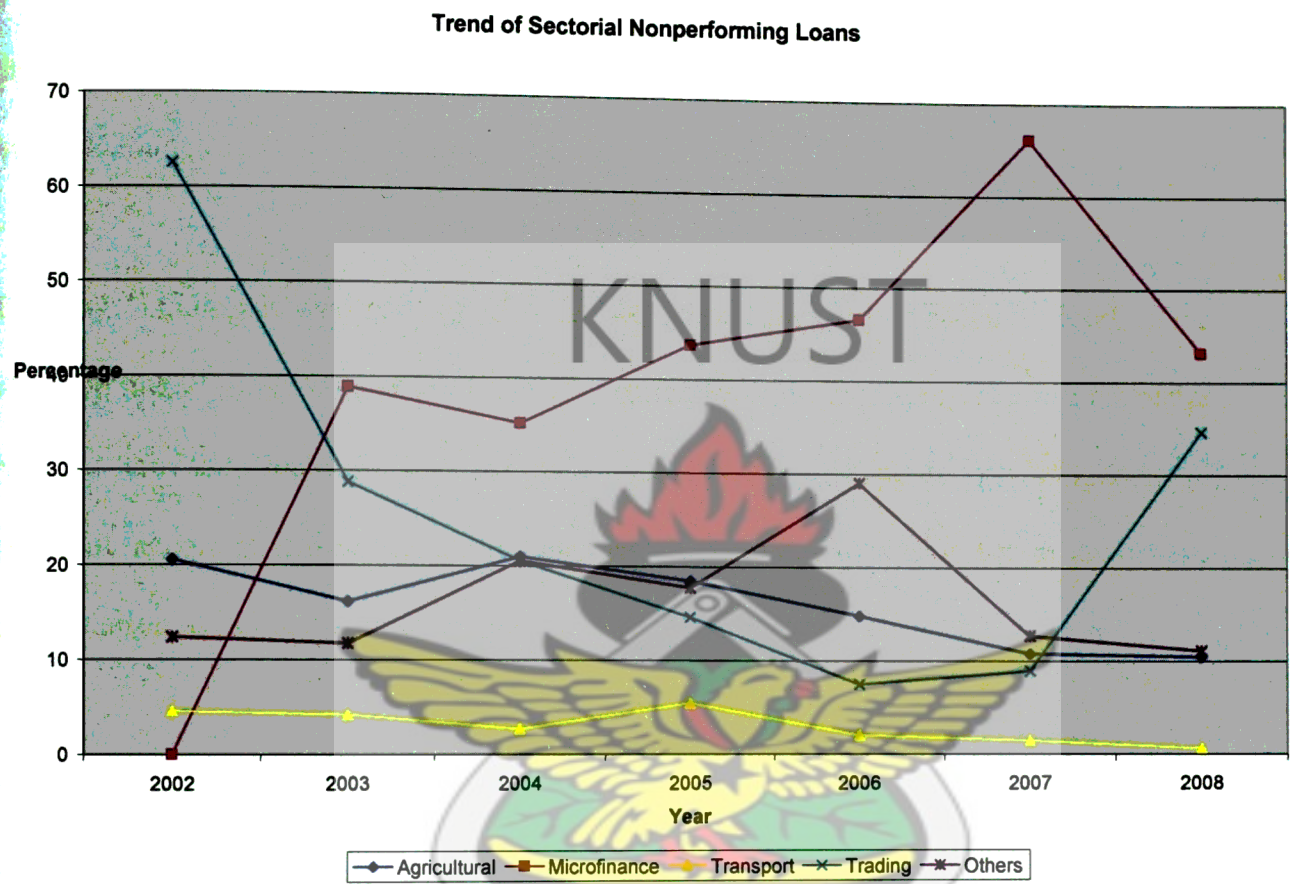


The relative importance of the parameters of loan default were ascertained from questionnaire, exchange rate depreciation was deemed most important factor by 31.43% of the respondents, followed by corruption and fraud with 17.14%, bad weather with 14.28%, then both bird flu and swine fever with a tier of 11.43% of the respondents, inflation had 8.57% of the respondents and the least fact was interest rate with 5.72 percent. Once again gross domestic product (GDP) and Money supply did not get any mark.

Kaminsky and Reinhart (1996) reported that exchange rate appreciation may limit growth prospects by squeezing profit margin especially in export oriented countries and ultimately lead to economic contraction with direct implication of loan default which

confirmed my findings that exchange rate depreciation also causes loan default in import oriented country like Ghana.

Figure 14: Trend of Sectoral Nonperforming Loans



The figure 14 above represents the trend of sectoral breakdown of nonperforming loans as shown in the data in Table 14 appendix 1. From the diagram Microfinance is the most risky sector, followed by Trading.

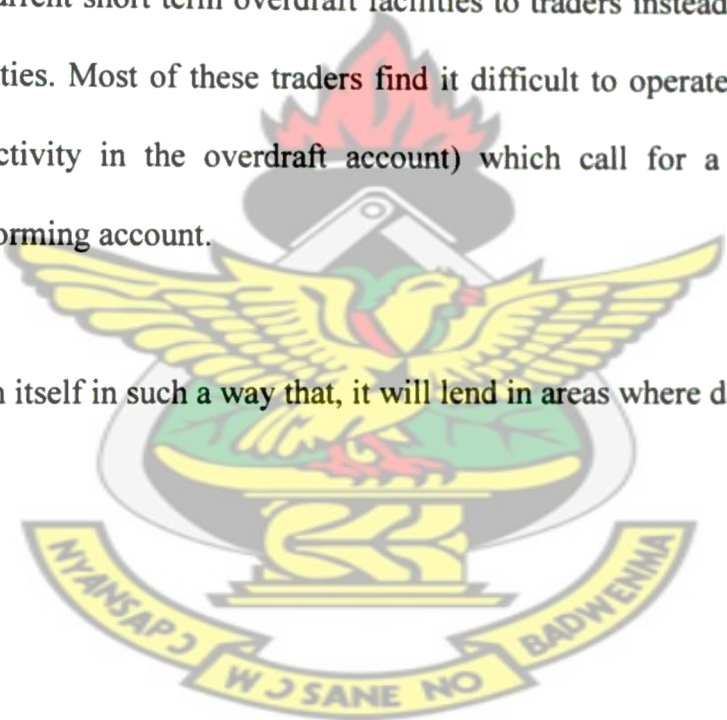
Microfinance: Microfinance as the most risky sector to lend stem from the fact that, there are weaknesses in the appraisal, disbursement and monitoring of such loans.

Specifically mentioned is the Adwumapa loan which is disbursed to the groups through the group executives on the field which could easily lead to fraud.

Further more, these groups are not properly formed, trained and monitored; therefore it becomes very difficult if not impossible to trace these loan beneficiaries to fulfill their obligation as and when they fall due and call for the classification of their loans as nonperforming.

Trading: Trading is also considered to be the second most risky sector to lend. This could be linked to the current short term overdraft facilities to traders instead of a better medium term loan facilities. Most of these traders find it difficult to operate successful overdraft accounts (inactivity in the overdraft account) which call for a downward classification as nonperforming account.

The bank should position itself in such a way that, it will lend in areas where default will be minimal



CHAPTER FIVE

SUMMARY, CONCLUSION, RECOMMENDATION AND SUGGESTIONS

5.0 Introduction

This chapter summarizes the findings of the study, make recommendations and draw conclusion in line with the main objectives of the study and finally make appropriate suggestions on the findings of the study.

5.1 Summary

This research work sought to investigate the causes of nonperforming loans at Bosomtwe Rural Bank Limited. To investigate the causes of nonperforming loans at Bosomtwe Rural Bank Limited, questionnaires were administered to bank staff and loan defaulters. In the case of the bank staff the questionnaire covered the causes of nonperforming loans in areas such as moral hazard and insider lending, inefficient appraisal and monitoring technique, rapid credit expansion, corruption and fraud and most important cause of nonperforming loans.

Concerning loan defaulters, questionnaires were administered on fraud and corruption, natural calamities and macroeconomic factors as causes of loan default.

The main findings from the study include the following:

First, 7.7% of the respondents strongly agreed that the accumulation of nonperforming loans at Bosomtwe Rural Bank was due to moral hazard and insider lending. Another

15.38% of the respondents agreed the assertion. 76.92% of the respondents did not agree that moral hazards and insider lending was the cause of nonperforming loans at Bosomtwe Rural Bank.

Furthermore, 61.54% strongly agreed and 23.08% agreed that the buildup of nonperforming loans at Bosomtwe Rural Bank is mainly due to inefficient appraisal and monitoring techniques. 15.38% of the respondents refuted that inefficient appraisal and monitoring techniques as a cause of nonperforming loans at Bosomtwe Rural Bank Limited.

In addition, 53.85% of the respondents accepted greatly that rapid credit expansion is the cause of accumulation of nonperforming loans at Bosomtwe Rural Bank. Another 46.15% of the respondents disproved the assertion that rapid credit expansion contributes to nonperforming loans.

With regard to corruption and fraud 38.46% of the respondents strongly agreed that it is the cause of nonperforming loans at Bosomtwe Rural Bank Limited. Another 15.38 admitted, but not strongly that corruption and fraud is also the cause of nonperforming loans at Bosomtwe Rural Bank Limited.

Moreover, 53.85% of the respondents indicated inefficient appraisal and monitoring techniques as the most important cause of nonperforming loans at Bosomtwe Rural Bank Limited. 23.07% of the respondents disclosed corruption and fraud as the next most

important cause of nonperforming loans. Another 15.38% of the respondents also rated rapid credit expansion as the next most important cause of nonperforming loans. Only 7.7% declared moral hazard and insider lending as the least important cause of nonperforming loans.

57.14% of the respondents strongly agreed that, the cause of default by defaulters is mainly due to corruption and fraud. 14.29% of the respondents also agreed on this assertion, however, 28.57% of the respondents totally disagreed.

Again, 51.43% of the respondents indicated that bad weather is a cause of loan default. 28.57% revealed that Swine Fever is also a cause of loan default. Only 20% admitted that Bird Flu is the cause of loan default.

42.86% of the respondent strongly agreed that macroeconomic factor lead to loan default. 28.57% agreed on the assertion, however, 28.57% completely disagreed.

85.71% of the respondent agreed that foreign exchange depreciation affected their loan repayment, since they have to exchange huge sum of cedis for few dollars hence loan default.

Concerning the relative importance of the parameter of loan default, 31.43% of the respondent believed exchange rate as the most important factor. Corruption and fraud was rated second cause of loan default with 17.14%. Next was bad weather with 14.28%

and 11.43% each for Bird Flu and Swine Fever came next. This was followed by inflation with 8.57%. Interest rate was the least cause of loan default and accounted for only 5.72%. No respondent chose gross domestic product and money supply.

5.2 Conclusion

In view of the findings made from the study it can be concluded that the causes of nonperforming loans is endogenous factors with little exogenous factors such as exchange rate depreciation which is beyond the control of the bank.

The endogenous factors are interrelated which include inefficient appraisal and monitoring technique, corruption and fraud, and rapid credit expansion. Corruption and fraud, and rapid credit expansion boil down to inefficient appraisal and monitoring techniques. The bank should be very critical about the accumulation of the nonperforming loans because most banks have collapsed as a result of accumulation of nonperforming loans.

5.3 Recommendation

Credit officers should therefore be motivated, otherwise nonperforming loans will continue to rise, and the bank should also change its recovery strategy.

Credit officers should strictly adhere to credit policy of the bank. Every credit officer should manage and recover its' own loan portfolio as and when they are due. Failure to do so should lead to severe sanction.

On the other hand the bank can set up an independent unit, the purpose of which is to monitor and recover loans differently from the credit department. The purpose of the credit department would be only for loan appraisal and recommendation. Once a loan is approved, it will find its way to monitoring and recovering unit, which will continue the monitoring and recovery process.

All group loans specifically, microfinance (Adwumapa) should be disbursed at the bank premises through individual accounts rather than group accounts for easy check and balances. Disbursing individual loans through group account and outside the bank premises is recipe for fraud.

The bank should also take a regular monitoring of macroeconomic factors that affect certain sectors of the economy as a guide to which sectors to support and which sectors to do away.

Credit officers with different background should be employed and trained to handle specialized sectors. Those with agricultural background should handle agricultural related projects while those with economic background also handle projects related to trading.

This will help to make appropriate suggestion and reduce the accumulation of nonperforming loans.

The bank should give a huge credit to a single borrower only when the financial statement of the borrower has been prepared and audited by a professional accountant and auditor.

Regular professional courses should be organized for the credit committee to abreast themselves with the current economic situation to reduce wrong credit decisions.

The credit committee together with the newly created recovery department should constantly and continuously monitor the first fifty largest of credit instead of the current twenty largest before it becomes too late.

The bank should also set its own loan classification standards different from the regulatory requirement by the bank of Ghana as a challenge to the bank. The Bank of Ghana classifies all overdue loans 360 days and above as a loss. The bank can classify all overdue loans 300 days and above as a loss.

5.4 Suggestion for Further Research

The study will not be completed without making some useful suggestions for future research. The objective of this study was to find out the causes of nonperforming loans at

Bosomtwe Rural Bank Limited. The analysis gathered so far indicate that the main problem is within the bank with little from outside the bank.

I suggest that any future research should include about three to five rural banks so that their findings can be compared with this study and draw a general conclusion.

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Bosomtwe Rural Bank Limited. The analysis gathered so far indicate that the main problem is within the bank with little from outside the bank.

I suggest that any future research should include about three to five rural banks so that their findings can be compared with this study and draw a general conclusion.

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APPENDICES

APPENDIX 1

Table 1: Background of Selected Staff

Group	Frequency	Percent
Credit Officers	13	100
Total	13	100

Source: Field Survey

Table 2: Moral Hazard and Insider Lending

Respondents	Frequency	Percent
Strongly Agree	1	7.70
Agree	2	15.38
Disagree	10	76.92
Total	13	100.00

Table 3: Inefficient Appraisal and Monitoring Techniques

Respondents	Frequency	Percent
Strongly Agree	8	61.54
Agree	3	23.08
Disagree	2	15.38
Total	13	100.00

Source: Field Survey

Table 4: Rapid Credit Expansion

Respondents	Frequency	Percent
Yes	7	53.85
No	6	46.15
Total	13	100.00

Source: Field Survey

Table 5: Corruption and Fraud

Respondents	Frequency	Percent
Strongly Agree	5	38.46
Agree	2	15.38
Disagree	6	46.16
Total	13	100.00

Source: Field Survey

Table: 6 The Most Important causes of Non-Performing Loans.

Important Reason	Frequency	Percent
Inefficient appraisal and monitoring techniques	7	53.85
Corruption and Fraud	3	23.07
Credit Expansion	2	15.38
Moral Hazard and Insider Lending	1	7.70
Total	13	100.00

Source: Field Survey

Table 7: Background of Loan Defaulters

Respondent	Frequency	Percent
Trading	11	31.43
Microfinance	8	22.86
Agric	7	20.00
Transport	4	11.43
Others	5	14.29
Total	35	100.00

Source: Field Survey

Table 8: Gender Representation of Loan Defaulters

Gender	Frequency	Percent
Male	20	57.14
Female	15	42.86
Total	35	100.00

Source: Field Survey

Table 9: Fraud and Corruption

Respondents	Frequency	Percent
Strongly Agree	20	57.14
Agree	5	14.29
Disagree	10	28.57
Total	35	100.00

Source: Field Survey

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Table 10: Natural Calamity

Natural Calamity	Frequency	Percent
Bad Weather	18	51.43
Swine Fever	10	28.57
Bird Flu	7	20.00
Total	35	100.00

Table 11: Macroeconomic Factors

Respondents	Frequency	Percent
Strongly Agree	15	42.86
Agree	10	28.57
Disagree	10	28.57
Total	35	100.00

Source: Field Survey

Table 12: The Most important Macroeconomic Factor

Macroeconomic Factors	Frequency	Percent
Exchange Rate	30	85.71
Interest Rate	2	5.71
Inflation	3	8.57
GDP	-	-
Broad Money	-	-
Total	35	100.00

Source: Field Survey

Table 13: The Most Important Causes of Loan Default by Defaulters

Most Important Factor	Frequency	Percent
Exchange Rate	11	31.43
Corruption and Fraud	6	17.14
Bad Weather	5	14.29
Swine Fever	4	11.43
Bird Flu	4	11.43
Inflation	3	8.57
Interest Rate	2	5.71
Gross Domestic Product (GDP)	-	-
Broad Money (M2+)	-	-
Total	35	100

Source: Field Surve

Table: 14 Ratio of Sectoral Nonperforming Loans to Total Nonperforming Loans at BRB

2002	Agriculture	Microfinance	Transport	Trading	Others
March	32	3.82	6.53	48.12	9.53
June	34	-	5.86	42.04	18.10
September	38.07	2.80	5.78	43.91	9.44
December	20.06	-	4.96	62.53	12.45
2003					
March	22.46	-	4.7	57.29	15.55
June	22.09	23.83	33.33	36.91	13.84
June	21.08	24.84	3.88	35.64	14.56
December	16.20	38.90	4.23	28.87	11.80
2004					
March	13.60	36.85	4.37	26.13	19.05
June	19.34	25.76	4.61	29.83	20.46
September	22.41	16.98	2.96	25.91	31.74
December	21.00	35.19	2.73	20.52	20.56
2005					
March	22.70	31.70	3.00	23.60	19.90
June	25.22	35.21	1.81	19.76	18.00
September	22.76	34.16	3.45	20.73	18.90
December	18.47	43.70	5.46	14.62	17.75

2006	Agriculture	Microfinance	Transport	Trading	Others
March	17.70	42.40	6.65	12.55	20.61
June	15.19	55.44	3.28	10.61	15.48
September	19.51	52.22	3.28	8.9	16.09
December	14.77	46.62	2.03	7.50	29.08
2007					
March	15.45	39.65	1.84	8.64	34.42
June	21.20	40.39	1.67	7.34	29.40
September	18.52	61.14	1.69	7.47	11.18
December	10.77	66.15	1.43	8.97	12.68
2008					
March	12.32	55.33	1.71	15.43	15.21
June	11.29	54.56	2.00	13.73	18.42
September	16.52	45.31	1.02	8.68	28.47
December	10.49	43.12	0.61	34.67	11.11

Source: Bosotwe Rural Bank Quarterly Ageing Analysis from 2002 to 2008

KWAME NKURMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY
FACULTY OF SOCIAL SCIENCES
SCHOOL OF BUSINESS
(MASTER OF BUSINESS ADMINISTRATION)
QUESTIONNAIRE (Credit Officers)

The purpose of this study is to analyze the reasons behind non-performing loans at Bosomtwe Rural Bank Limited. The rational behind this study is purely academic and that any information so gathered will be given a strict confidentiality.

Please provider answers to the following questions. Tick where applicable and give short answers where necessary.

A. Personal record

- 1 .Number of years at post
2. Are you a credit officer? Yes ☐ No ☐

B. Moral hazard and insider lending.

3. Credit officers appraise and recommend loans connected to risky projects.

Always ☐ Sometimes ☐ Not at all ☐

4. Credit committee approves loans connected to risky projects.

Very much ☐ Not much ☐ Not at all ☐

5. Lenders are connected to some of these risky projects.

Strongly agree ☐ Agree ☐ Disagree ☐

6. Provision is made for bad and doubtful debt every year.

Yes ☐ No ☐

7. Is bad debt written off from the books of accounts?

Always ☐ Not always ☐ Not at all ☐

C. Inefficient appraisal and monitoring technique.

8. Cash flow projects are most important when assessing credit worthiness of a loan client.

Always ☐ Sometimes ☐ Not at all ☐

9. Credit officers hurriedly appraise and recommend loans.

Always ☐ Sometimes ☐ Not at all ☐

10. The credit officer is independent to appraise and recommend clients loans.

Strongly agree ☐ Agree ☐ Disagree ☐

11. Credit officers rely on collateral of borrowers.

Strongly agree ☐ Agree ☐ Disagree ☐

12. Credit officers do not monitor loan client's projects.

Always ☐ Sometimes ☐ Not at all ☐

C. Rapid credit expansion.

13. Management states its target at the beginning of every year.

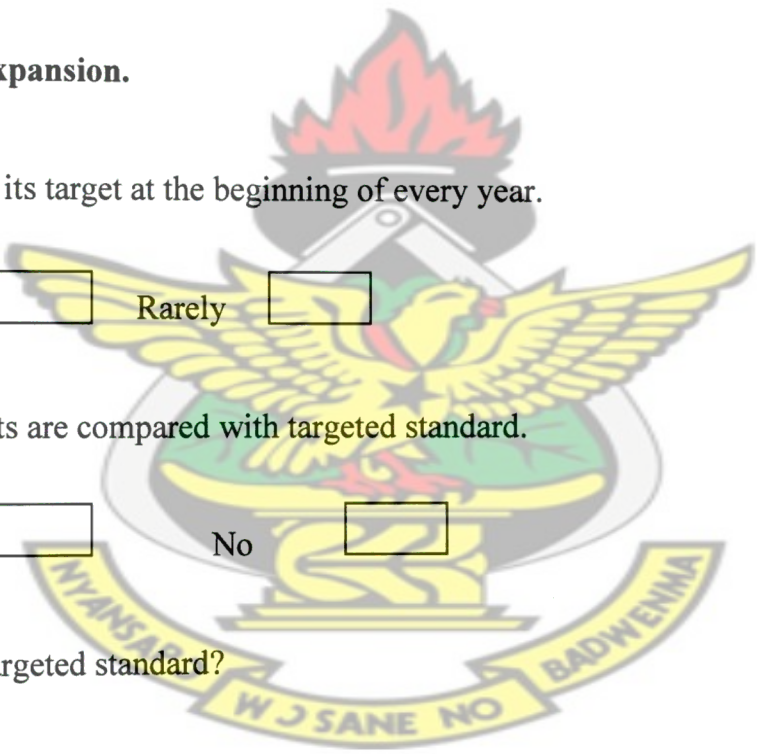
Frequently ☐ Rarely ☐

14. Actual achievements are compared with targeted standard.

Yes ☐ No ☐

15. Do actual exceed targeted standard?

Always ☐ Sometimes ☐ Not at all ☐



16. Do credit officers ignore credit delivery procedure?

Yes ☐ No ☐

If yes give reason

.....

17. Competitors will poach clients if credit is delayed.

Strongly agree ☐ Agree ☐ Disagree ☐

D. Corruption and fraud.

18. It is difficult to trace some loan defaulters.

Always ☐ Sometimes ☐ Not at all ☐

19. Credit officers self interest are supreme.

Always ☐ Sometimes ☐ Not at all ☐

20. Credit officers receive gifts either in kind or cash from clients.

Always ☐ Sometimes ☐ Not at all ☐

21. Clients reward credit officers after credit delivery.

Strongly agree ☐ Agree ☐ Disagree ☐

22. Do credit officers discriminate in client credit delivery?

Yes

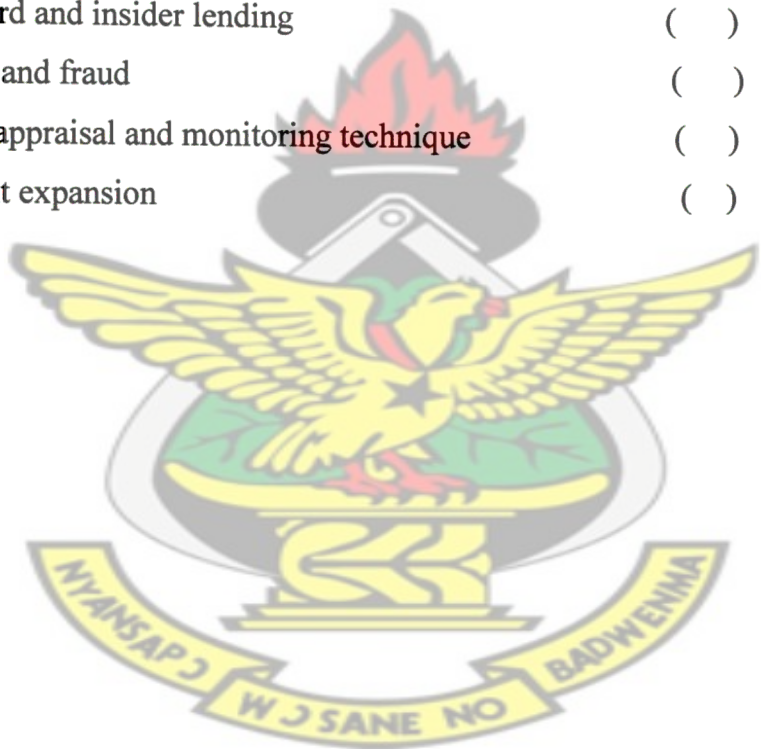
No

Give either reason

.....

E. Please number each of the factors listed below in order of importance to you in your choice as a reason behind nonperforming loans.

22. Moral hazard and insider lending
- ()
23. Corruption and fraud
- ()
24. Inefficient appraisal and monitoring technique
- ()
25. Rapid credit expansion
- ()



APPENDIX 3

KWAME NKURMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY
FACULTY OF SOCIAL SCIENCES
SCHOOL OF BUSINESS
(MASTER OF BUSINESS ADMINISTRATION)
QUESTIONNAIRE (LOAN DEFAULTERS)

The purpose of this study is to determine the causes of nonperforming loans at Bosomtwe Rural Bank Limited. The rational behind this study is purely academic and that any information so gathered will be given a strict confidentiality.

Please provide answers to the following questions. Tick where applicable and give short answers where necessary.

A. Personal record

1. Sex

Male☐

Female☐

2. Number of years of experience

3. Age

Below 25☐

25- 40☐

40 and above☐

4. What type of loan client are you?

Agricultural☐

Microfinance☐

Transport☐

Trading☐

Other☐

B. Corruption and Fraud

5. Clients collect loans on behalf of a third party

Always ☐ Sometimes ☐ Not at all ☐

6. Loan clients reward credit officers after their services

Always ☐ Sometimes ☐ Not at all ☐

7. Credit officers refuse to monitor and collect clients' debt

Always ☐ Sometimes ☐ Not at all ☐

8. Do loan client intentionally refuse to pay their debts?

Always ☐ Sometimes ☐ Not at all ☐

9. Credit officers are related to loan clients in one way or the other

Strongly agree ☐ Agree ☐ Disagree ☐

C. Natural Calamity

Please arrange the following natural calamities in order that affect your loan repayment

- 10. Swine Fever
- 11. Bad Weather
- 12. Bird Flu

D. Macroeconomic Variables

13. The bank interest rate is very high and has affected your loan repayment.

Strongly agree ☐ Agree ☐ Disagree ☐

14. Inflation in a country is very high and has affected your loan repayment.

Yes ☐ No ☐

15. Do loan clients trade in imported goods?

Yes ☐ No ☐

16. Exchange rate depreciation shrinks loan clients' capital

Strongly Agree ☐ Agree ☐ Disagree ☐

17. It is very difficult to get foreign currency to import goods

Always ☐ Sometimes ☐ Not at all ☐

E. Please number each of the macro economic factors listed below in order of importance in your choice as causes of your loan default hence nonperforming loans.

- 18. Inflation
- 19. Exchange rate depreciation
- 20. Interest rate
- 21. Gross domestic product
- 22. Money supply

F. Please number each of the following factors below in order of importance to you in your choice as a reason behind loan default.

23. Corruption and Fraud

24. Bad Weather

25. Swine Fever

26. Bird Flu

27. Inflation

28. Interest rate

29. Exchange rate depreciation

30. GDP

31. Money supply

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F. Please number each of the following factors below in order of importance to you in your choice as a reason behind loan default.

23. Corruption and Fraud

24. Bad Weather

25. Swine Fever

26. Bird Flu

27. Inflation

28. Interest rate

29. Exchange rate depreciation

30. GDP

31. Money supply

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