KWAME NKRUMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY, KUMASI

CAUSES AND EFFECTS OF LOAN DEFAULTS ON THE PROFITABILITY OF OKOMFO ANOKYE RURAL BANK

BY

Isaiah Ameyaw-Amankwah

PG-3033909

JUNE 2011

CAUSES AND EFFECTS OF LOAN DEFAULTS ON THE PROFITABILITY OF OKOMFO ANOKYE RURAL BANK

BY

Isaiah Ameyaw-Amankwah

PG-3033909

A thesis submitted to the Institute of Distance Learning,

Kwame Nkrumah University of Science and

Technology

in partial fulfilment of the requirements for the degree

of

COMMONWEALTH EXECUTIVE MASTERS IN BUSINESS ADMINISTRATION

Institute of Distance Learning

JUNE, 2011

CERTIFICATION

I hereby declare that this submission is my own work towards the Commonwealth Executive Masters in Business Administration (CEMBA) and that, to the best of my knowledge, it contains no material previously published by another person nor material which has been accepted for the award of any other degree of the University, except where due acknowledgement has been made in the text.

ISAIAH AMEYAW-AMANKWAH (20103239)	…………………….	…………………
Student Name & ID	Signature	Date

Certified by;

MR. GORDON NEWLOVE ASAMOAH	……………………	………………….
Supervisor's Name	Signature	Date

Certified by

…………………………………………….	………………….	………………….
Dean, IDL	Signature	Date

ABSTRACT

The study aimed at addressing the following issues: identifying the causes of loan defaults in Okomfo Anokye Rural Bank and its impact on profitability, determining ways of reducing loan defaults in financial institutions, and identifying the category of clients who default to enable the bank takes decisions. Stratified random sampling and purposive sampling techniques was employed to select respondents to provide answers to questionnaires. SPSS and Excel were used to analyze the data from which frequency tables were separately constructed for each item alongside graphs. The results of the study show that, the major causes of loan default by clients of Okomfo Anokye Rural Bank are failure by the banking staff (Credit Officers) to effectively monitor the loans they grant to customers and the delay in the approval and disbursement of loans. It was also established that, loan defaults causes the Bank to make huge loan loss provisions which negatively impacted on the financial performance of the bank through reduction in loan interest income, profits, and creating liquidity problems for the Bank which can lead to liquidation of the Bank. The following recommendations were made to reduce loan default by clients: simplified credit appraisal report to reduce the delay in appraising loans, training of Credit and Agency Managers on credit management, and regular monitoring of loans by Credit Officers.

DEDICATION

This write up is dedicated to my entire family especially my lovely daughters Jochebed, Joanna, Tryphena and Phebe Ameyaw-Amankwah.

ACKNOWLEDGEMENT

I thank the Almighty God for His protection, guidance, strength and direction throughout my education.

I wish to express my profound gratitude and appreciation to my supervisor, Mr. Gordon Newlove Asamoah, of the KNUST School of Business, for his fatherly love, guidance, and suggestions toward the achievement of this dissertation.

My sincere thanks also go to all lecturers of the Institute of Distance Learning for their suggestions toward the success of this work.

Special thanks go to my mother, Mrs Sarah Konadu-Ameyaw, for her love and advice. I wish also to express my heartfelt appreciation to my brothers and sisters and all my family members for their spiritual and material support.

I also thank my wife Emelia Ameyaw-Amankwah, my two brothers Elijah Ameyaw-Sarpong and Joses Ameyaw-Ofori for their financial, spiritual and moral support.

Mention must also be made to the entire staff of Okomfo Anokye Rural Bank Limited, especially the General Manager, Peter Abako Goriya for their assistance and support.

Finally, special thanks go to Mr. Andrew Adjei-Holmes of Institute of Economic Statistical and Social Research, who analysed the questionnaires for me.

TABLE OF CONTENTS

Cover page……………………………..……………………………………………i

Title Page…………………………………………………………………………….ii

Certification…………………………………………………………………………iii

Abstract……………………………………………………………………………..iv

Dedication…………………………………………………………….……………v

Acknowledgement…………………………………………………..……………vi

Table of Contents………………………….……………………….....…………vii

List of Tables…………………………………………………………..…….....xi

List of Figures…………………………………………………………..……..xii

CHAPTER ONE: GENERAL INTRODUCTION

1.1Background to the Study……….………………………………………….…..1

1.2 Statement of Problem…………………………………..…………………………2

1.3 Objectives of the Study…………………………………..……………………….3

1.4 Research Questions………………………………………………………………4

1.5 Justification of the Study………………………………………………….………4

1.6 Scope of the Study…………………………………………………….………….5

1.7 Limitations of the Study……………………………………………….….…...5

1.8 Organisation of the Study…………………………………………………...……6

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction………………………………………………………………………7

2.2 Meaning of Loan Default…………………………………………..………..7

2.3 Causes of Loan Defaults……………………………………………..…………………9

2.4 Ways of Reducing Loan Defaults………………………………..………………..12

2.5 Lending…………………………………………………………..…………………..13

2.6 Loan Repayment…………………………………...…………………………17

2.7 Pre-Lending Information………………………………..………………………...18

2.8 Interest Rates……………………………………………………………………19

2.9 Security…………………………………………………..………………………..22

2.10 Monitoring of Loans…………………………………..………………………23

2.11 Credit Analysis…………………………………………..……………………….24

2.12 Regulatory Authority…………………...………………………….……………………..26

2.13 Classification of Loans……………..…………………………………………26

2.14 Loan Provisioning……………………..…………………………………………29

2.15 Competition in the Banking Industry……..……………………………………… ….30

CHAPTER THREE: METHODOLOGY AND ORGANISATIONAL PROFILE

3.0 Introduction……………………………………………………………………….32

3.1.0 Research Methods…….…………………………………………………………32

3.1.1 Research Design…………………………………………………………………33

3.1.2 Population…………………………………………………………………………..34

3.1.3 Sample and Sampling Procedure for Data Collection…………………………………34

3.1.4 Research Instruments……………………………………………………………….35

3.1.5 Procedure for Data Collection…………………………………………………37

3.1.6 Data Collection…………………………………………………………………...37

3.1.7 Data Analysis……….……………………………………………………………37

3.2.0 Organisational Profile……………………………………………………..………..…….39

3.2.1 The Bank and its environment……………………………………………………..39

3.2.2 Bank's Corporate Vision and Mission……………………………………………..39

3.2.3 Bank's Products and Services……………………………………………………...39

3.2.4 Brief Background of Microfinance Operations in the Bank…………………………40

3.2.5 Existing Products and their Performance…………………………………………...41

3.2.6 Strategic Plan for the Microfinance Department………………………………...…41

CHAPTER FOUR: DATA PRESENTATION, ANALYSIS AND DISCUSSION

4.1 Introduction……………………………………………………………………………42

4.2 Characteristics of Respondents…………………………………………………………42

4.2.1 Age Distribution of Respondents……………………………………………………..42

4.2.2 Educational Background of Respondents……………………………………………43

4.3 Causes of Loan Defaults………………………………………………………………..43

4.3.1 Factors that cause loan by clients……………………………………….................43

4.3.2 Interest rate and loan default…………………………………………………………45

4.3.3 Why ineffective monitoring of loans by Credit Officers……………………………..46

4.3.4 Factors that cause delayed loan approval……………………………………………..47

4.3.5 Non-Compliance of Credit Policy and Loan Default……………………..................48

4.3.6 Factors accounting for non compliance of Credit Policy by Officers…………………49

4.4 Impact of Loan Default on the Profitability of Okomfo Anokye Rural Bank…………..50

4.4.1 Analysis of the trend of Loan Default Rate in the Bank………………………………50

4.4.2 Analysis of the effect of loan default on Interest Income……………………………..52

4.4.3 Analysis of the effect of loan default on profitability…………………………………53

4.4.4 Relationship between the rate of default and its effect on the Bank's operations……..56

4.4.5 Analysis of the effect of Overdue loans on income and profit………………………..56

4.5 Ways of Reducing Loan Default…………………………………………………………...57

4.5.1 How Bad loans are recovered……………………………………………………….57

4.5.2 Reducing Loan Default by Clients…………………………………………………….58

4.5.3 Improving Loan Recovery……………………………………………………………..59

4.6 Category of Loan Clients who default………………………………………………..60

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1Introduction……………………………………………………………………..………..62

5.2 Summary of Findings…………………………………………………………..……...62

5.3 Conclusion…………………………………………………………………………….63

5.4Recommendations…………………………………………………………………..64

REFERENCES…………………………………………...…………………………….69

LIST OF TABLES

TABLE		PAGE
2.1	Classification of Loans……………………………………………………….	29
4.1	Age Distribution of Respondents………………………………………..	42
4.2	Educational Background of Respondents………………………………...	43
4.3	Factors that cause loan default from the view point of Management ……..	44
4.4	Causes of Loan default from the view point of Clients……………………	45
4.5	Why ineffective monitoring by Credit Officers……………………………	47
4.6	Causes of Delayed Loan Approval………………………………………..	48
4.7	Loan Default Rate………………………………………………………	51
4.8	Effect of Loan Default on Interest Income………………………………..	52
4.9	Correlation analysis on the effect of Loan Default on interest income……..	53
4.10	Effect of Loan Default on Profitability…………………………………….	54
4.11	Correlation analysis on the effect of loan default on profitability…………..	55
4.12	Loan default and its effect on the Bank's operations……………………..	56
4.13	Analysis of the effect of overdue loans on income and profit……………..	57
4.14	Correlation analysis on the effect of overdue loans on profit and income….	57
4.15	Ways of Recovering Bad Loans………………………………………….	58
4.16	Ways of reducing loan defaults by clients………………………………..	59
4.17	Improving Loan Recovery………………………………………………	60

LIST OF FIGURES

FIGURE		PAGE
4.1	High Interest Rates and Loan Defaults……………………………………	46
4.2	Non Compliance of Credit Policy and Loan Default …………………….	49
4.3	Factors Accounting for non compliance of Credit Policy………………..	50
4.4	Category of clients who Defaults……………………………………….	61

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND TO THE STUDY

The Oxford Advanced Learners Dictionary defines default as, “a failure to do something that must be done by law, especially paying a debt”. The National Credit Act (No. 34 of 2005) does not explicitly define default per se, but the use of the term throughout the Act would seem consistent with this dictionary definition.

Thus, in simple terms the purpose of this study has been to determine why people do not pay micro loan obligations. Admittedly, any delay in the repayment of a loan obligation, even if only once and by one or two days, adds to lenders’ costs, and may signal serious problems with the borrowers or the environment in which the lenders and borrowers interact.

A financial statement by Okomfo Anokye Rural Bank Limited (OARB) in 2009 shows that, of the GHS925,821.00 income earned for the year, GHS792,755.00 came from interest on loans and overdrafts which forms 80% of the total income. It therefore implies that, the healthy the portfolio, the higher will be the profit made by the Bank.

The same financial statement of OARB 2009 shows that, the portfolio of the Bank is worsening. Total provision for bad and doubtful debts rose from GHS50,621.00 to GHS114,137.00 respectively in 2008 and 2009.

The latest data from the Bank of Ghana (BoG) show that loan defaulting rate has increased.

According to the Monetary Policy Committee (MPC) of the Bank of Ghana latest report on the economy, the Non-Performing Loans (NPL) ratio of the country deteriorated from 16.2 percent in December 2009 to 17.6 percent as at December 2010. (Myjoyonline, 2011)

In view of the above, the issue of loan defaults has raised some concerns among stakeholders and there is therefore the need to tackle the issue of loan defaults with seriousness. The study therefore seeks to find out how loan defaults affect the profitability, liquidity, and net worth of financial institutions. It also seeks to offer some suggestions to minimize loan defaults with special emphasis on Okomfo Anokye Rural Bank Limited.

1.2 STATEMENT OF THE PROBLEM

According to Aballey (2009), Loan portfolio is typically the largest asset and the predominant source of income for banks. In spite of the huge income generated from their loan portfolio, available literature shows that huge portions of banks loans usually go bad and therefore affect the financial performance of these institutions.

The causes of loan defaults among group members and individuals have gained notoriety from both the donor community and the non-governmental organizations (NGOs) in the past decade and this has been criticized by many financial institutions of which Okomfo Anokye Rural Bank is not an exception. Also some financial institutions have also suffered due to the inability of their customers to pay back the facility contracted from their bankers. In view of the significant contribution of loans to the financial health of banks through interest income earnings, these assets are considered the most valuable assets of banks. In Ghana, the banking industry plays an important role in the development of the economy. Huge bad loans could therefore affect banks in the performance of this important role.

Yet, ironically, causes of loan defaults among groups and individuals issues does not have a commiserate level of formal academic study. In view of the above, it is important to find out the causes of loan defaults among groups and individuals and its impact on the bank's profitability.

Therefore, critical examination is crucial to determine the possible causes of loan default and to find appropriate remedies to prevent a 'run' on the bank as well as liquidation. There is the need therefore to know why customers are not paying monies advanced to them.

1.3 OBJECTIVES OF THE STUDY

The study is intended to find out the causes and effects of loan defaults on the profitability of rural banks.

The specific objectives of the study are;

1. To identify and examine the causes of loan defaults in OARB and its impact on profitability of OARB
2. To determine ways of reducing loan defaults in financial institutions
3. To identify the categories of clients who normally defaults and why they default to enable the Bank take decisions.

1.4 RESEARCH QUESTIONS

1. What are the causes of loan defaults in financial institutions?
2. What can regulators of financial institution do to reduce it?
3. What category of customers normally defaults?

1.5 JUSTIFICATION OF THE STUDY

There have been limited studies on loan defaults in financial institutions in Africa and Ghana in particular, the reason being that, developing countries such as Ghana suffer from the absence of data on relevant information. Other reason could be lack of skilled researchers from countries who are interested in undertaking research work.

In general terms, this study is expected to increase our knowledge of the importance of loan defaults in developing countries and add to the limited literature available in Ghana. In addition, the research will help to suggest alternatives to improve the operation of financial institutions in Ghana.

The study will also bring to the fore the extent of bad debts suffered by the financial institutions, and the result of non-payment of loans on the bank's profitability.

It is also expected to throw light on the weaknesses in the lending practices adopted by the banks to guide policy markers.

1.6 SCOPE OF THE STUDY

The study focuses on OARB because, OARB was granted a licence to provide banking services which includes the granting of loans to its clients. OARB has been granting credit facilities to players of the various sector of the economy such as agriculture, trading, transportation, cottage industries and the service sectors.

The main work will be on loan defaults in the bank as reported in the financial statement of the bank. The period of the study will span from 2005 to 2009 for the various types of loans applicable in the bank.

The purpose of choosing rural bank is that, they are required to lend to small and medium scale businesses that do not have collateral.

1.7 LIMITATIONS OF THE STUDY

There were a number of limitations to this study. Firstly, due to time constraints, not all the loan clients were interviewed. Secondly, the data collection was restricted to only the catchment areas of Okomfo Anokye Rural Bank, which may fail to represent the actual scenario of the whole country.

In dealing with these limitations, the study adopted objective questionnaires and interview guides for all respondents to reduce their personal perceptions. Again, respondents were assured of their confidentiality in order to enable them give information that represented the facts and figures on the ground.

1.8 THE ORGANISATION OF THE STUDY

The structure of the study encompasses five chapters. The chapter one is an introduction, statement of problem, objectives of the study, research questions, justification of the study, scope of the study, limitations of the study and organisation of the study.

The chapter two discussed the review of available literature on the topic. Chapter three introduced the methodology employed in these studies to achieve the research objectives. The chapter four is the data presentation and analysis. Chapter five presented a summary of issues covered in the dissertation as well as the empirical and theoretical conclusion and recommendations.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

This chapter focuses on the review of relevant literature on causes and effects of loan defaults and other core aspects of the topic under study.

2.2 MEANING OF LOAN DEFAULT

In finance default occurs when a debtor has not met his or her legal obligations according to the debt contract, example has not made a scheduled payment, or has violated a loan covenant (condition) of the debt contract. A default is the failure to pay back a loan. Default may occur if the debtor is either unwilling or unable to pay their debt. This can occur with all debt obligations including bonds, mortgages, loans, and promissory notes. (Wikipedia, 2011)

A loan default occurs when the borrower does not make required payments or in some other way does not comply with the terms of a loan. (Murray, 2011)

BusinessDictionary.Com gives five definitions of default as follows:

1. General: Failure to do something required by an agreement, in the performance of a duty, or under a law.

2. Borrowing: Failure to meet the terms of a loan agreement. Its two types are (1) Fiscal: Failure to make repayment on the due date. Generally, if a payment is 30 days overdue, the loan is in default. (2) Covenantal: Failure to live up to one or more covenants of the loan agreement such as exceeding the prescribed total borrowings.

3. Computing: Attribute, option, or value assumed by a computer when a user has not chosen or supplied any. Computer's choice is based on how the elements of software or the settings of hardware have been arranged by the manufacturer, or customized by the user.

4. Contractual: Failure to comply with the terms of a contract. Most contracts make provisions for handling defaults by including the conditions or procedures for arbitration, compensation, or litigation.

5. Legal: Failure to do something required under legislation or as ordered by a court, such as not making an appearance to answer charges.

Default is the inability to repay the loan by either failing to complete the loan as per the loan agreement or neglect to service the loan. (Wakuloba, 2003).

Consultative Group to Assist the Poor (CGAP) 2009 also defined loan default as when a borrower cannot or will not repay a loan, and the Microfinance Institution (MFI) no longer expects to be repaid (although it keeps trying to collect).

Moreover, Pearson and Greeff (2006) defined default as a risk threshold that describes the point in the borrower's repayment history where he or she missed at least 3 instalments within a 24 month period. This represents a point in time and indicator of behaviour, wherein there is a demonstrable increase in the risk that the borrower eventually will truly default, by ceasing all repayments. The definition is consistent with international standards, and was necessary because consistent analysis required a common definition. This definition does not mean that the borrower had entirely stopped paying the loan and therefore been referred to collection or legal processes; or from an accounting perspective that the loan had been classified as bad or doubtful, or actually written-off.

Loan default can be defined as the inability of a borrower to fulfil his or her loan obligation as at when due (Balogun and Alimi, 1990).

2.3 CAUSES OF LOAN DEFAULTS

Ahmad, (1997), mentioned some important factors that cause loan defaults which include; lack of willingness to pay loans coupled with diversion of funds by borrowers, wilful negligence and improper appraisal by Credit Officers.

In addition, Hurt and Fesolvalyi (1998), cited by Kwakwa, (2009) found that, corporate loan default increases as real gross domestic product decline, and that the exchange rate depreciation directly affects the repayment ability of borrowers.

Balogun and Alimi (1988) also identified the major causes of loan default as loan shortages, delay in time of loan delivery, small farm size, high interest rate, age of farmers, poor supervision, non profitability of farm enterprises and undue government intervention with the operations of government sponsored credit programmes.

Moreover, Akinwumi and Ajayi (1990) found out that farm size, family size, scale of operation, family living expenses and exposure to sound management techniques were some of the factors that can influence the repayment capacity of farmers.

According to Olomola (1999), loan disbursement lag and high interest rate can significantly increase borrowing transaction cost and can also adversely affect repayment performance.

Berger and DeYoung, (1995) indicated that, one major problem which the banks in India are facing is the problem of recovery and overdue of loans. The reasons behind this may vary for different financial institutions as it depends upon the respective nature of loans. Here an attempt is made to find out some of the causes of default of loans due to which financial institutions are facing the problems of overdue of loans. The recovery officers of different banks are interviewed for finding out the causes of defaults. These reasons may be useful for the Banks for the better recovery of loans in future. After surveying different banks, the following were identified to be the main causes of default of loans from industrial sector: improper selection of an entrepreneur, deficient analysis of project viability, inadequacy of collateral security/equitable mortgage against loans, unrealistic terms and schedule of repayment, lack of follow up measures and default due to natural calamities.

Many factors have been identified as major determinants of loan defaults. Okorie (1986) shows that the nature, time of disbursement, supervision and profitability of enterprises which benefited from small holder loan scheme in Ondo State, contributed to the repayment ability and consequently high default rates. Other critical factors associated with loan delinquencies are: type of the loan; term of the loan; interest rate on the loan; poor credit history; borrowers' income and transaction cost of the loans.

Poor academic performance is the number one reason for student departure, and departure before degree completion is the number one reason for student loan default (Volkwein and Cabrera, 1998).

Moreover, in a recent study of Mortgage loan defaults, the most frequently cited causes of defaults were curtailment of income (36%), excessive obligations (19%), unemployment (8%), illness of principal mortgagor or family member (6%) and marital difficulties (3%). (Merritt, 2009).

Okpugie (2009) also indicated that, high interest charged by the microfinance banks has been discovered to be the reason behind the alarming default. A microfinance loan is a facility granted by a microfinance bank to an individual or a group of borrowers, whose principal source of income is derived from business activities involving the production or sale of goods and services.

This was also confirmed by Vandel (1993), who also found that high interest rates charged by Banks tend to facilitate default by borrowers.

According to Gorter and Bloem (2002) non-performing loans are mainly caused by an inevitable number of wrong economic decisions by individuals and plain bad luck (inclement weather, unexpected price changes for certain products, etc.). Under such circumstances, the holders of loans can make an allowance for a normal share of non-performance in the form of bad loan provisions, or they may spread the risk by taking out insurance.

The problem of non performing loans is widespread. Nishimura, Kazuhito, and Yukiko, (2001) state that one of the underlying causes of Japan's prolonged economic stagnation is the non-performing or bad loan problem. They explain that some of the loans made to companies and industries by financial institutions during the bubble era became non-performing when the bubble burst. This delayed structural reforms and prevented the financial intermediary system from functioning properly.

Most of the defaults arose from poor management procedures, loan diversion and unwillingness to repay loans, Kohansal and Mansoori (2009). According to them a number of factors can cause loan defaults some of which are;

1. Interest rate ceilings usually imposed by the government
2. Monopoly power in credit markets often exercised by informal lenders
3. Large transaction costs incurred by borrowers in applying for loans
4. Moral hazard problems

2.4 WAYS OF REDUCING LOAN DEFAULTS

Kohansal and Mansoori (2009) are of the view that, lenders devise various institutional mechanisms aimed at reducing the risk of loan default (i.e. pledging of collateral, third-party credit guarantee, use of credit rating and collection agencies, etc.).

Kay Associates Limited (2005) cited by Aballey (2009) states that bad loans can be restricted by ensuring that loans are made to only borrowers who are likely to be able to repay, and who are unlikely to become insolvent. Credit analysis of potential borrowers should be carried out in order to judge the credit risk with the borrower and to reach a lending decision.

Loan repayments should be monitored and whenever a customer defaults action should be taken. Thus banks should avoid loans to risky customers, monitor loan repayments and renegotiate loans when customers get into difficulties.

2.5. LENDING

Lending is defined as the offer of money to a person or entity with the expectation that repayment would be made with interest either by installments or in one amount by a specified date, where necessary a lender will protect himself, by asking the borrower to provide some collateral (Ribeiro 2006). From the point of view of the writer on the collateral, some banks grant credit without taken any collateral with the intention to win customers for the bank. This trend has emerged as a result of competition amongst banks when lending issues arise.

The legal framework has not changed much but as the years go by the laws which regulate lending continue to be revised, amended or even replaced entirely to make way for more current and relevant ones.

Rouse (1989) perceives lending as an art rather than science because it involves experience and common sense. This assertion to some extent is true. These two factors alone can perfect some aspect of lending, but not to its entirety. It is through science that lenders come out with accounting procedures, credits and risk's analysis to assess customer's ability to pay, regulatory framework etc. He explained that a lender lends money and does not give it away. There is therefore a judgment that on a particular future date repayment will take place. The lender needs to look into the future and ask whether the customer will repay by the agreed date. He indicated that there will always be some risk that the customer will be unable to repay, and it is in assessing this risk that the lender needs to demonstrate both skill and judgment.

The lender should aim at assessing the extent of the risk and try to reduce the amount of uncertainty that will exist over the prospect of repayment. The lender must therefore gather all the relevant information and then apply his or her skills in making judgement. Though there might be pressures from customers and elsewhere which may sway away the lender's judgement, the lender must seek to arrive at an objective decision.

In view of these credit risks that might lead to bad loans, banks have some loan request procedures and requirements contained in their credit policy documents to guide loan officers in the processing of loans for customers. The following are some of the factors considered in granting loans:

1. Applicant's background.
2. The purpose of the request.
3. The amount of credit required.
4. The amount and source of borrower's contribution.
5. Repayment terms of the borrower.
6. Security proposed by the borrower.
7. Valuation of the security by a professional
8. Location of the business or project.
9. Technical and financial soundness of the credit proposal.

Biney (1995), also defines lending as an amount of money provided by a lender and taken by a borrower, payable at some future date on specific terms and conditions and governs by legal contract.

The ability of the bank to lend depends on its deposit mobilization. The higher the deposits mobilized, the better the position of the bank to give out loans. Incoom (1998) indicates that the requirements of lenders and borrowers are diverse and conflicting. Lenders expect high returns on the loanable funds whilst borrowers expect to pay less on monies advanced to them. Depositors expect to earn higher income in the form of interest. For the bank to balance these conflicts of interest is to ensure profit maximization while taking into accounts the potential environment risk as well as the liquidity of the bank.

It is worth examining whether the abolition of secondary reserve on 1st August, 2006, a requirement of the banks by Bank of Ghana will impact on bank lending due to increase in bank's assets or they will be reluctant to expand their lending, instead of investing in government securities where risk is perceived to be lower.

In the view of Anaman, Bank of Ghana decision would allow banks to gain access to additional funds that could be channeled into the private sector to accelerate economic growth. (Business and Financial Times, 2006)

The abolition of the secondary reserve rather comes with mix feeling from financial chieftains. Dwumah (2006) maintains the view that, the abolition of the secondary reserve was a piece of good news, for the banks considering the fact that most banks will still invest in government securities. Lending is core in banking activities and the riskiest aspect of banking business.

Banks have over the years helped customers to augment capital for most businesses and make them financially strong to accelerate nation building. Anaman (2006) maintains that much as banks lending help business to flourish banks also have its fair share in the forms of fees and incomes to sustain its operations.

Bank lending has been a major source of funding for most businesses. There is the need therefore for banks and other financial institutions to be careful in their loan administration to prevent the inherent risk associated with the product in order to maximize shareholders returns and enhance the image of the institution. Awuah (2007) cited by Agyemang, (2010) argues that due to the risk nature of the bank lending, a thorough appraisal needs to be done to establish the true position of the state of affair before a decision is taken. It is against this background that most banks are unwilling to fund small scale businesses with the reasons such as; lack of collateral, weak and inexperience management and lack of proper book keeping and physical remoteness of many informal sector enterprises.

With regards to big companies, records are easily accessible because of tax purpose and for loan appraisal. This however, is subject to scrutiny because in some cases customers prepare separate accounts for different purposes which do not give the true picture of the affairs of the entity. The historical cost used in the preparation of accounts makes it difficult to predict the success of bank lending.

Although a project cash flow is requested to serve as a measure of the overall well being of an entity, other factors such as social, economic, legal and political environment affecting the systems makes it difficult to predict repayment.

2.6 LOAN REPAYMENT

Loan repayment determines the bank's ability to grant further loans, the profitability and suitability of depositors. Banks must therefore be cautions in its loan administration. Though customers' records are used to determine the ability to service the loan; some customers have the tendency of hiding real position at hand. This makes it different for the banks to determine the true position as well as possible repayment.

Some corporate bodies, small and medium scale enterprises repayment depends largely on collection period from debtors which determines the repayment pattern. The bank should be guided by the trend and the business lines of clients when granting credits. Bruck (1997) contends that the administration of loan extend beyond the approval of loans. It requires control and supervision of outstanding loans to ensure their repayments.

Personal loans granted to salaried workers, records a higher percentage of repayments. Nyarko (2005) perceives to employees guarantee given to the lender by the employers and due to the fact that deduction is effected at source, provided the necessary pre-lending procedures are adhered to

Agricultural credit delivery to farmers should be clearly monitored to avoid decision of loan for social and acquisition of other assets at the expense of servicing the loan on maturity.

Repayment on group lending is made possible because the joint and several liability clauses which serves as a respite for a lender and mandates the lender to severally take an action against the group and to the extent of their personal estates to recover the loaned funds.

2.7 PRE-LENDING INFORMATION

To ensure loan repayment and guard against non-payment of loan, certain information about clients need to be known prior to the granting or disbursement of the loan. These are personal and business details which determine the ability and willingness of the borrower to repay.

Rouse (1989), outlines seven cannon of lending: character, ability, margin, purpose, amount, repayment and insurance. In short 'CAMPARI', the mnemonic is analyzed as follows:

Character - Can the customer be trusted? What is the track record? Historical actions will be considered.

Ability - What key skills does the organisation's management possess for the proposal presented? Are there areas of weaknesses in the management team?

Margin - Refers to the Interest, commissions and fees to reflect the risk involved in the lending. The banker should remember that to make money, it is important to consider the rate of interest at which you are prepared to lend.

Purpose - The customer must specify the purpose of the loan. This is a requirement for both personal and business loans. A banker should not lend money, unless he knows what is going to be used for.

Amount - Refers to the amount requested for by the borrower. The question here is, is the borrower asking for either too much or too little? A good borrower would have allowed for contingencies. The amount requested for should be in proportion to the customers' own resources.

Repayment - Refers to the source of repayment. The lender needs projections to ensure that there are surplus funds to cover repayment after meeting other commitments.

Insurance/Security - Refers the security that the banks needs to take against the possibility that the loan will not be repaid.

Kay Associate Limited (2005) cited by Aballey 2009 identified five techniques of credit vetting known as the five Cs framework used in assessing a customer's application for credit. Firstly, the character of the customer is assessed. This determines the willingness of the customer to pay the loan and may include the past credit history, credit rating of the firm, and reputation of customers and suppliers. Secondly, the capacity of the customer which is described as his or her ability to pay in terms of cash flow projection is critically assessed. Besides, the capital or soundness of the borrower's financial position in terms of equity is assessed. The conditions such as the industry and economic conditions of the business are also assessed. These are important because such conditions may affect the customer's repayment ability. The last C is collateral. This is referred to as the secondary source of repayment. This is considered in appraising the customer's request.

2.8 INTEREST RATES

Interest rate is the price that borrowers pay in order to consume resources now rather than in the future (Incoom, 1998). It is appropriate to look at cost and return on lending. The classical theorist focuses on the supply and demand for loanable funds to determine interest rate. The monetarist focuses on liquidity preference theory; supply and demand for money to determine interest rates.

Ghana has in recent times seen new developments in interest rate determination. After years of controlled interest rates which culminated in a regime of financial regression, interest rates are now de-regulated and are allowed to be influenced by market forces recognised (Sowa, 1996).

Banks pay interest on depositors funds used to grant loans to the deficit units and as such an appreciable amounts of rates needs to be charged in order to cater for Deposits Liability (interest cost) as well operational cost for the bank to stay in business. Interest rates are also determined by the risk factors associated with the loan, such as default, duration cost of funds, other operational cost, and maturity pattern of deposit and the probability of default overtime. Essentially, any profit motivated financial institution will mostly try to widen the gap between lending and deposit rates of interest to make a margin or to break-even. Normally interest charges for high risk area may be higher due to the risk of non payment of principal and interest.

Bruck (1997) claims that to be able to cover the cost of mobilizing funds and pay for their cost of operation, financial institutions have to charge higher rate on their loan than what it pays on borrowed funds. Theoretically, loan defaults occur when borrowers are not willing and or able to repay loans (Hoque 2004). This paper focuses on the borrowers' ability to repay loans. Among the many factors, high interest rates are the most important one which influences borrowers' ability to repay loans. It widely reported (that high interest rates has devastating effect on investment and growth of an economy though McKinnon (1973) and Shaw (1973) underscored the important of higher real interest rates during inflationary pressure to promote savings and investment in financially repressed economies. Rittenburg (1991) found that too high interest rate was detrimental to investment and growth. Keynesian economists recommended that interest rates should be kept low in order to speed the growth of investment and economy at large (Roe 1982). The virtues of low interest rates are: it will increase borrowing, reduce inflation, increase job opportunities and stimulate national economy. The opposite happens with high interest policy though Roe (1982) found that South Korea and Taiwan immensely benefited from high interest rates (which were as high as 20% on deposit) policy during 1950s and 1960s.High interest rates cause inflation which increases the cost of production or costs of goods sold.

Generally, banks do charge high interest rates in developing countries where financial market is imperfect as information asymmetry between borrower and lender prevails, credit-worthiness of borrowers is doubtful, value of collaterals is overstated and inefficiency is the common features at institutional level. Nobody precisely knows the degree of such imperfection but all banks are addicted to the policy of high interest rates. This is counter-productive as high interest rates may contribute to loan default. This indicates that banks should determine appropriate lending rates on the basis of proven, not hypothetical, degree of market imperfection.

Again, lending rates should be lowered or adjusted very frequently with the level of real-world imperfection which decreases with pace of economic development and growth of an economy. Roe (1982) suggested that real rate of interest must be lower than real return on capital. It means that as the financial market becomes more and more efficient with the process of development, lending rates should be lowered than before which may contributes towards reduced level of loan defaults. Failure to do this may result in persistent loan defaults in developing countries.

2.9. SECURITY

Security which is another prerequisite of lending serves as a cushion for financial institution in case of non-payment of loan. The banks insist on security because of unrealistic nature of some financial statement presented for the loan. This is due to the fact that different financial statements are prepared by borrowers depending on the purpose. This renders the statement unreliable for managers during loan appraisal and makes decision making by managers very difficult and therefore demand security. Care must also be taken when taking collateral for loan especially the legal aspect governing it in order to accurately perfect the security. The demand for security has the tendency to discourage borrowers who have no security to back their demand and also to minimize the rate of default.

Tshribi (1996) cited by Agyemang (2010) is of the view that the prominence of security as an ingredient for bank lending emphasizes the circumspection with which banks treat security matters in the knowledge that security for any particular loan should not only be safe but must on realization generates proceeds to fully settle the outstanding debts. Apart from security been legally perfect, it is necessary to consider other factors like accessibility, valuation, realization in case of default, ownership title and controls. Banks lend against security not only out of business sense but also in compliance with regulatory requirements.

2.10 MONITORING OF LOANS

Monitoring is an integral part of loan administration processes. This enables the bank to acquaint itself with the progress of work. Monitoring is important. It guides credit officers to know the status whether repayments are made as contained in the loan agreement. Constant monitoring prevents loan diversion.

Rouse (1989) recognises that regular monitoring of loans enhances the lenders image in the eyes of the customer but it is an area where many lenders ignore but if carried out properly, the occurrence of loan defaults will reduce drastically.

Small Business Administrations proposed a loan monitoring system that would use technology and new processes to manage its loan portfolios, identify and effectively mitigate risks incurred through loans guaranteed by SBA, implement oversight of internal and external operations, and calculate subsidy rates (Koontz, 2001).

Muller (1987) cited by Agyemang (2010) maintains that loans should be monitored during the repayment period of the loan. The banks should ensure that the loan is being used for eligible purposes; the quality of the loan will be maintained in the future and its repayment sources are protected in order to guard against unacceptable deterioration of the credit and the corpus of the bank. Should a borrower show signs of such deterioration, the Bank should be able to take action before a loss would result.

Aballey, (2009) observed that, monitoring of loans can minimize the occurrence of loan defaults through the following major purposes that it serves:

1. Ensure the utilization of the loan for the agreed purpose.
2. Identify early warning signals of any problem relating the operations of the customer's business that are likely to affect the performance of the facility.
3. Ensure compliance with the credit terms and conditions.
4. It enables the lender discusses the prospects and problems of the borrower's business.

2.11. CREDIT ANALYSIS:

Investorwords.Com (2011) defined credit analysis as the process of evaluating an applicant's loan request or a corporation's debt issue in order to determine the likelihood that the borrower will live up to his/her obligations.

The Credit Policy of Okomfo Anokye Rural Bank, (2010) identifies Credit analysis to be in two-phases: phase one is a preliminary credit evaluation to determine whether the applicant will be able to qualify for a loan of the desired amount. This phase includes a review of preliminary plans and specifications, project cost breakdown, feasibility studies, financial projections for the completed project, and an analysis of the borrower's most recent budgets, financial statements, bond ordinances/resolutions, and rate structure. Various factors are considered during the preliminary credit review. These factors include the feasibility of the project, the borrower's financial condition, its ability to cover its existing and potential debt payments, current and projected user rates, and other revenue sources and the economic stability of the borrower.

While bank has final responsibility to determine whether the loan applicant's credit history and security is sufficient to be able to approve the loan, it works closely with the stakeholders on the project cost estimates and the economic pro-formal for the proposed project. In some situations, projects are modified so the loan applicant can handle the project and still meet the minimum credit requirements. Applications passing the preliminary credit review move on to the second phase of the credit approval process. Borderline applicants are advised of their status and are free to continue in the process if they so choose, with the understanding that the bank has concerns that need to be addressed. There are no guarantees at this point that any of the projects will be granted a loan. That decision only comes after a more detailed final credit evaluation is completed.

Phase two of the credit evaluation takes a closer look at the project and the borrower. The banks also complete a more extensive analysis of the financial status of the applicant. This will include additional financial information such as the last four years' financial statements (audited, if available), detailed debt information, budgets, system data, local economic characteristics and other information deemed necessary. Staff will prepare ratio and trend analyses, projections, review rate structures, and review the local industry information to determine the borrower's ability to repay the loan. While all applicants are subjected to the preliminary credit review, communities with existing loans that are being repaid according to the loan terms can quickly pass through review process. For those communities, the credit analyses will simply be updated to ensure that the community can repay the increased debt service.

2.12 REGULATORY AUTHORITY

The Bank of Ghana is mandated to supervise the banks and ensure good financial practices. The Bank of Ghana sets regulatory capital for the financial institutions. The financial institutions are mandated to keep a mandatory reserve with the Bank of Ghana primary reserve. The regulator sets a limit within which the bank can grant credit according to the proportion of capital and assets held by the bank or a financial institution. The primary reserve for the bank is 8% of its regulatory capital. Any financial institution which violates the regulation will be sanctioned or have its license withdrawn. (Bank of Ghana Act 2002, Act 612)

The supervisory review process of the regulator is to in still financial discipline and sound banking practices. This is to boast depositor confidence as well as to prevent excessive use of bank's capital.

2.13 CLASSIFICATION OF LOANS

Loan classification refers to the process banks use to review their loan portfolios and assign loans to categories or grades based on the perceived risk and other relevant characteristics of the loans. The process of continual review and classification of loans enables banks to monitor the quality of their loan portfolios and, when necessary, to take remedial action to counter deterioration in the credit quality of their portfolios. It is often necessary for banks to use more complex internal classification systems than the more standardized systems that bank regulators require for reporting purposes and that are intended to facilitate monitoring. (Laurin et al, 2002)

Loan portfolios of banks are classified into various classifications to determine the level of provisions to be made in line with banking regulations. Loans are classified into five categories including Current, other loans especially mentioned (OLEM), substandard, doubtful and loss (Kone, 2006)

The Bank of Ghana has the following classifications of loans:

Current: Advances in this category are those for which the borrower is up to date (i.e. current) with repayments of both principal and interest. Indications that an overdraft is still current would include regular activity on the account with no sign that a hardcore of debt is building up.

Other Loans Especially Mentioned (OLEM): Advances in this category are currently protected by adequate security, both 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 advances due to the nature of the advance, customer or project, advances where there is a lack of financial information or any other advance where there is more than a normal degree of risk.

Substandard: Substandard advances display well-defined credit weaknesses that jeopardise the liquidation of the debt. Substandard advances 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 operating needs. Substandard advances are not protected by the current sound worth 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 also classified substandard. In this context advances become overdue when the principal or interest is due and unpaid for thirty days or more.

Doubtful: Doubtful advances exhibit all the weaknesses inherent in advances classified as substandard with the added characteristics that the advances 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 reasonably specific pending factors, which may work to the advantage and strengthening of the advance, its classification as in estimated loss is deferred until its more exact status may be determined. Non-performing loans and receivables which are at least 180 days overdue but less than 365 days overdue are also classified as doubtful

Loss: Advances classified as a loss are considered uncollectible and of such little value that their continuation as recoverable advances is not warranted. This classification does not mean that the advance 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. Advances classified as a loss include bankrupt companies and loans to insolvent firms with negative working capital and cash flow. Banks should not retain advances on the books while attempting long-term recoveries. Losses should be taken in the period in which they surface as uncollectible. Non-performing loans and receivables which are 365 days or more overdue are also classified as a loss.

2.14 LOAN PROVISIONING

Farlex Financial Dictionary (2009) defined loan provisioning as a non-cash expense for banks to account for future losses on loan defaults. Banks assume that a certain percentage of loans will default or become slow-paying. Banks enter a percentage as an expense when calculating their pre-tax incomes. This guarantees a bank's solvency and capitalization if and when the defaults occur. The loan loss provision allocated each year increases with the risks of the loans a given bank makes. A bank making a small number of risky loans will have a low loan loss provision compared to a bank taking higher risks.

Bank of Ghana regulations requires Banks to make provisions on the aggregate outstanding loan balance of all current loans and aggregate net unsecured balance of all other categories as shown in the table below.

Table 2.1 Provisions required for various classifications of loans

LOAN CATEGORY	PROVISION REQUIRED	NUMBER OF DAYS OVERDUE
Current	1%	0-30
OLEM	10%	31-90
Substandard	25%	91-180
Doubtful	50%	181-365
Loss	100%	Over 365

Source: Section 53(1) of the Banking Act 2004

A review of the above literature on classifications and provisioning implies that the higher the non-performing loan category, the higher the provisions and charges for such bad loans and the higher its effect on the operations of the Bank.

2.15 COMPETITION IN THE BANKING INDUSTRY

The banking industry in Ghana has seen very strong competition in the last decade. This competition is mainly as a result of the entry of banks from the sub-region, particularly Nigeria, which brought very innovative ways of banking never experienced before on our shores. There has been an intense scramble to attract a large number of the unbanked population.

There is a big contest among banks, securities firms, supermarkets, computer companies, post offices, etc. The reason is that non-bank institutions are moving increasingly into providing banking services. Financial sector is transforming. Building societies are converted into banks. The traditional barriers between banks, building societies, insurance companies, are melting away.

Another competition for banks is due to the consolidation of the banking industry. Due to the fierce competition in the financial sector, the newcomers in the retail industry force the others to become bigger and consequently more competitive. (Blanden, 1996). By consolidation, not only they can face the growing competition more effectively, but the participants can also cut costs and achieve a broader spread of their risks.

There is now little that banks can provide exclusively. Most of the banking services are now offered by non-bank financial institutions. One of the main competitors is, without a doubt, the capital market. Many banks' best corporate customers deserted them, preferring to raise money directly from the capital markets by issuing bonds and shares, (Giles, 1996).

Generally, competition has great impact on any industry. But in this case, it is easier for non-bank financial institution to diversify into banking than for banks to diversify in areas different than traditional financial services. This is mostly due to the developments in technology that enable a variety of institutions to enter into the banking industry.

According to Colgate (1997), deregulation has been the main catalyst for today's increasing competition in this industry, for example, a few restrictions on product offerings.

Day (1997) argues that it is a little wonder that banks are facing intense competition from this new breed of competitors which are taking advantage of the strength of their brand names and their understanding of customers, to gain a growing share of the market. Meanwhile, the majority of banks are neglecting their brand images and missing the opportunity to project strong brand values.

Banks are expected to focus on the areas that they feel to have a competitive or comparative advantage. What is extremely likely is that services will break into component parts, so as to be able to be supplied by different institutions. Each component will be priced and different banks will be specialized in different services.

Many changes in the environment of banking will take place. Non-banking institutions such as supermarkets or big stores will use more the strength of their network and their name's liability for promoting their products, such as consuming loans, credit cards, insurance etc. Some examples are the Marks & Spencer and Virgin Direct.

CHAPTER THREE

METHODOLOGY AND ORGANISATIONAL PROFILE

3.0 INTRODUCTION

The purpose of this research is to understand the issues related to loans default among clients in the financial institutions with specific reference to Okomfo Anokye Rural Bank and its effects on the profitability of the company. The study was addressed through single case study. The chapter dealt with research design, population for the study, sample and sampling procedure, the research instrument and its administration. It also indicated the statistical tools for the analysis of the data. The second part also discussed the bank and its environment, entire profile of the bank, legal capacity of the bank, bank's product and services, background of micro finance operations and the strategic plan for the micro finance department of the bank.

3.1.0 RESEARCH METHODS

There were mainly two kinds of research methods that the researcher employed for the work. These are quantitative and qualitative methods. According to Saunders et al (2007), these two methods differ in terms of the numeric (numbers) or non-numeric. Quantitative method is predominantly used for any data collection technique (such as a questionnaire) or data analysis procedure, such as: graphs or statistics that generates or uses numerical data. On the other hand, qualitative method is predominantly used as a synonym for any data collection technique (such as an interview) or data analysis procedure (such as categorizing data) that generates or uses non numerical data. Therefore, the other difference between qualitative and quantitative data is that, the qualitative data refers to words, such as pictures and video-clips, rather than numerical results. It is not easy to express the causes and effects of loan defaults on the profitability of the bank with the help of few sentences. On one hand, some effects can be shown only in numerical figures like, interest rates and its effect on loan default, while on the other hand, other impacts can be expressed only in descriptive ways, like, business experience, ways of reducing loan default, etc.

The questionnaire made was fully structured to get most of the people to find out from them why people default in loan repayment and its effects on the business profitability and what can be done to combat such situation. In the questionnaire, the researcher combined the numerical questions as well as some non-numerical questions. Thus, the result of the research will base on numerical and non-numerical analysis, using both quantitative and qualitative methods.

3.1.1. RESAERCH DESIGN

The primary research objectives have been ‘‘To identify and examine the causes of loan defaults in OARB and its impact on profitability of OARB; To determine ways of reducing loan defaults in financial institutions and identify the categories of clients who normally defaults and why they default to enable the Bank take decisions”.

A descriptive survey design was used because it dealt with questions and opinions of existing issues. In this part both qualitative and quantitative information were needed to answer the research questions mentioned. Both primary and secondary data were consulted.

This design involves the collection of data in order to understand research objectives on the subject of the study.

Awoyemi and Quartey (2002), also indicate that the descriptive survey design does more than merely uncover data for its synthesis but integrates data and points to implication and interrelationships. Both further stated that this design focuses on people – the vital facts of people and their beliefs, opinions, attitudes, motivations and behaviour. The study was basically a fact finding exercise and so the researcher drew samples from the populations of interest and make generalizations, taking into consideration the responses. The research design helped the researcher to collect evidence to describe the issue, mentioned above in the case of Okomfo Anokye Rural Bank Limited.

3.1.2. POPULATION

The population for the study encompasses the people who have been benefiting from our various loan facilities for at least five years (2005- 2009). It also included management and the entire staff in the Credit Department of the bank. The researcher chose these categories of people because; most of them have been working with the bank for a long time and therefore have rich experience in loan default by clients and its effects on the performance of the bank and can respond better to the questionnaires.

3.1.3 SAMPLE AND SAMPLING PROCEDURE FOR DATA COLLECTION

Stratified Random Sampling technique was used to select the respondents (clients of the Bank) whereas purposive sampling technique was used to select management members for the study. The data collection procedure started from Wiamoase, where the bank has its headquarters and continued to other agencies such as Pankrono, Agona and Ashanti New Town. The sample size of 70 respondents which comprises 50 clients and 20 management members were selected. The selection of these beneficiaries were done in consultation with the Credit Officers in the credit management of the bank and the selection of the interviewee clients was done by random sampling as already mentioned. The researcher did not use an interpreter because the Credit Officers who assisted me to interview the clients could speak the local language fluently. They were therefore able to interpret everything to those who neither could read nor write in responding to the questionnaire.

3.1.4. RESEARCH INSTRUMENTS

The questionnaire consisted of background questions about clients' gender, age, educational background and activity or work. Structured questions and some dichotomous question were asked to collect the information from the respondents. The same contexts of questions shall be given to all interviewees so as to get the same interview stimulus. Questions were specific with a fixed range of answers. The structured questionnaire was multiple-choice questions in which the researcher provided a choice of answers and respondents are asked to select one or more of the alternatives, and dichotomous questions that had only two response alternatives, yes or no to measure the respondents' perceptions based on few statements to analyze the causes and effects of loan defaults on the profitability of OARB. The points of the scale indicate the degree of satisfaction or agreement level of the clients after he or she has received questionnaire. Though the entire management and staff in the Credit Office or Department are few in the bank; an attempt was made to cover all such categories of staff.

The distribution of questionnaires was aimed at covering at least 70% of all staff within the Credit Department and other key Management persons for both the head office and the above branches mentioned. The selection of clients for both interviews and questionnaire were selected from the identified groups in order to give each member of each group equal and an independent chance of expressing their views on the subject. Most of the clients were visited at their shops and market centres and questionnaire were administered to them. Also the researcher booked an appointment for interviews with some of the clients and collection of the responded questionnaires.

INTERVIEW- the most common type of interviewing individual is face to face verbal communication through self administered questionnaire. The purpose of employing interview is that it allows participant to probe for more detailed information (Saunders et al, 2007). Although the result of the research is highly dependent on the primary sources that will be gathered from the structured interview, yet, it also required some secondary sources to understand the various views that were shared by respondents. The researcher used, Financial Times, Country reports, Government publications, Magazines and Articles that have been written about loan defaults in financial institutions, articles and thesis, as secondary sources for the study. Internet sources were used as a secondary source for the thesis. Further, annual financial report of the Bank was of great help to the researcher. Even though, it is not easy to find out the appropriate research materials for the thesis, many studies have been conducted on loan defaults over the last few decades. Nevertheless, from them, the researcher chose the most appropriate literature for the thesis. For this reason, the researcher went through numerous references related to the topic, to find the suitable materials. These materials were mainly collected from the university library and available search tool. Besides these, Google Scholars were used to find the suitable research material.

3.1.5 PROCEDURE FOR DATA COLLECTION

The data gathering done by the researcher included selecting, identifying and gathering documents and interview conducted with the help of people selected by the researcher to assist him in his work. The designed questionnaires were pre-tested with (15) people to enable the researcher iron out any problem that could cause the results to be a failure. It was aimed at finding out whether respondents needed further classification or re-statement of some of the items.

3.1.6 DATA COLLECTION

The management of the four branches was informed of the study and therefore pose no threat to the work when it was time to grant management and staff interviews. The researcher personally, arranged and met the management. But for the various clients it will take the form of visitation. The distribution of the prepared questionnaires to clients was sent to the bank officers personally since the researcher is a staff of the Bank.

3.1.7 DATA ANALYSIS

The secondary data obtained were scrutinized to determine their suitability, reliability, adequacy and accuracy. The figures contained in the 2005 and 2006 financial statements were in old Ghana cedis. To ensure consistency, these figures were converted into the new Ghana cedis with the help of an excel software on currency conversion.

The responses from the questionnaire for various clients as well as the staff and management were coded. Statistical Package for Social Sciences (SPSS) and Excel were used to analyze data. Tables and statistical diagrams like bar charts, and pie charts also aided in the data presentation.

Presentation of the data on these statistical tools made the analysis very easy. The statistical tools used conveyed the meaning of the figures captured and as such made the analysis straight forward.

3.2.0 ORGANIZATIONAL PROFILE

3.2.1 THE BANK AND ITS ENVIRONMENT

Okomfo Anokye Rural Bank (OARB) Limited was incorporated as a limited liability company and issued a certificate of incorporation (No 21,793) under the Companies Code 1963(Act 179) on January 18, 1983. On February 7, 1983 the bank of Ghana issued the license to operate Business of Banking to OARB. The bank received its Certificate to Commence Business on July 6, 1983 from the Registrar of Companies.

The bank has its Head Office at Wiamoase in the Ashanti Region and five other branches at Ashanti Newtown (Kumasi), Boamang, Pankrono, Tetrem and Agona. The bank has two mobilization centres located at Bepoase and Asaman. The bank has plans to establish five more additional branches in Suame, Mamponteng, Kronum, Kodie and Asokwa all in the Ashanti region. (OARB Five Year Strategic Plan, 2008 – 20012)

3.2.2 BANK'S CORPORATE VISION AND MISSION

The bank's corporate vision is to be the world class rural Bank for wealth creation. OARB's mission is to "facilitate socio-economic and development of its clients in the catchments area through the provision of customer–oriented and innovative financial products and services through well-motivated and competent personnel to meet the interest of stakeholders.

3.2.3 BANK'S PRODUCTS AND SERVICES

The bank provides the following products and services to its numerous clients; savings accounts, fixed deposits accounts, current accounts, door to door Susu deposit accounts, Overdraft, Susu loan, Salaried Worker loan, Self Employed Commercial loans, Church and

School Development loans, Funeral loans, Micro finance loan and Credit Relief scheme loan. Other financial products of the bank include ARB Apex Bank Money Transfer, Western Union Money Transfer, and Efie ne Efie.

3.2.4 BRIEF BACKGROUND OF MICRO FINANCE OPERATIONS IN THE BANK

The micro finance unit of the bank started in 2004. Its objective was to help the economically active poor in engaging in income generating activities to better their lives. The micro finance product target petty traders, cash crop farmers, kente weavers, service (drinking and food bars) operators, dressmakers, hairdressers and small-scale farmers. The unit's products and services are Group Loans, Individual loans, Micro insurance, Susu Savings and Susu loans.

Under the group loans, clients are horizontally grouped, trained and offered loans to support their businesses. The loan term is twelve months and beneficiaries pay monthly installments. Beneficiaries of individual loans also have a loan term of 12 months. The OARB has mobile bankers who identify customers and mobilize savings from them. Susu loan is available for customers of OARB who have contributed or saved for two months or more. The bank offers such customers' loan sizes trice their savings and the loan term is six month. According to them this approach has been used to inculcate the culture of savings in the people. OARB has collaborated with Ministry of Women and Children's Affairs and the JICA to provide micro finance services to its clients. The bank's success stories under the micro finance unit include positive impact on the lives of clients and immediate family, improved savings habit, improved knowledge in banking, increased ability to pay school fees of wards, improved access to health care facilitates and emerging micro and small enterprises(MSEs).

3.2.5 EXISTING PRODUCTS AND THEIR PERFORMANCE

The bank has problems with micro finance products such as Special Farmers' Loans (Group Loans), MASLOC Loans and MOWAC funds. Loan recovery rate has been less than 50% because of political label on loans, weak monitoring and inappropriate timing in recovery by staff.

3.2.6 STRATEGIC PLAN FOR THE MICRO FINANCE DEPARTMENT/UNIT

The Government of Ghana (GOG) is implementing the Rural Financial Services Project (RFSP) that seeks to broaden and deepen financial intermediation in rural areas to improve access to financial services by expanded number of the rural poor.

The programme which seeks to build the capacity of RCBs, aims to strengthen the rural and Community Banks for effective intermediation through technology enhancement, human resource development and the development and testing of innovative financial instruments and products respond appropriately to the changing financial needs of the majority of Ghanaians who live in the rural areas.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND DISCUSSION

4.1 INTRODUCTION

This chapter covers the presentation and analysis of the data used in the study. It shows the findings of the study which seek to answer the research questions vis-à-vis the study objectives.

4.2 CHARACTERISTICS OF RESPONDENTS

4.2.1 Age Distribution of Respondents

The results indicated that, 14 (33.33%) of respondents were within the ages of 30 and 39 years, 12 (28.6%) of respondents were within the ages 40 and 49 years, 5 (11.9%) of respondents were also within the ages 50 and 59 years. 2 (4.8%) of the respondents were less than 30 years and 9 (21.4%) were above 60 years. The results indicated that, majority of the Bank’s loan clients were within the ages 30 and 49 years as can be seen in table 4.1

Table 4.1: Age Distribution of Respondents

Age Group	Frequency	Per Cent
Below	2	4.8
30-39	14	33.3
40-49	12	28.6
50-59	5	11.9
60 and above	9	21.4
Total	42	100

Source: Survey 2011

4.2.2 Educational Background of Respondents

The study revealed that, 24 (57.14%) of the respondents were Basic School Certificate holders, whereas 9 (21.43%) of the respondents were Secondary School Certificate holders and 9 (21.43%) of the respondents were also tertiary school holders. The study indicated that, majority of the Bank's clients are Basic school certificate holders. The results is as shown in table 4.2.

Table 4.2: Educational Background of Respondents

Level of Education	Frequency	Per Cent
Basic	24	57.14
Secondary	9	21.43
Tertiary	9	21.43
Total	42	100

Source: Survey 2011

4.3 CAUSES OF LOAN DEFAULTS

4.3.1 Factors that cause loan defaults by clients

The factors which can cause clients to default in their loan repayment were given to some Management staff to rank to enable the researcher determine which of the factors is the major cause of loan defaults in Okomfo Anokye Rural Bank Limited. As shown in table 4.3, 18 out of the 20 respondents ranked ineffective monitoring by Credit Officers as the major cause of loan defaults by clients. This was followed by delayed loan approval, then diversion of loan funds by clients, followed by lack of business management knowledge. Term of the loan and unwillingness by clients to pay loans were ranked 5th, poor credit appraisal ranked 6th, and under financing and marketing problems ranked as the 7th cause of loan defaults.

Table 4.3: Factors that cause loan defaults from the view point of Management

Causes of Loan Default	**Frequency**	**Rank**
Delayed loan approval	16	2nd
Poor credit appraisal	9	6th
Diversion of loans	14	3rd
Under financing	7	7th
Ineffective monitoring	18	1st
Poor weather conditions	4	8th
Marketing problems	7	7th
Lack of business management knowledge	13	4th
Term of the loan	10	5th
Unwillingness to repay loans	10	5th

Source: Survey 2011

On the view point of clients, as can be seen from the table 4.4, 31 out of the 42 clients interviewed ranked lack of monitoring by the Bank staff as the major cause of defaults by the clients. This was followed by late disbursement of loans, then high interest rates, short repayment period and then lack of business advisory services by the Bank staff on how clients should manage their businesses.

Table 4.4: Causes of loan defaults from the view point of clients

Causes of loan defaults	Frequency	Rank
Lack of Monitoring	31	1st
Late Disbursement of Loans	18	2nd
High Interest rates	11	3rd
Short Repayment Period	3	4th
Lack of Business Advisory Services	2	5th

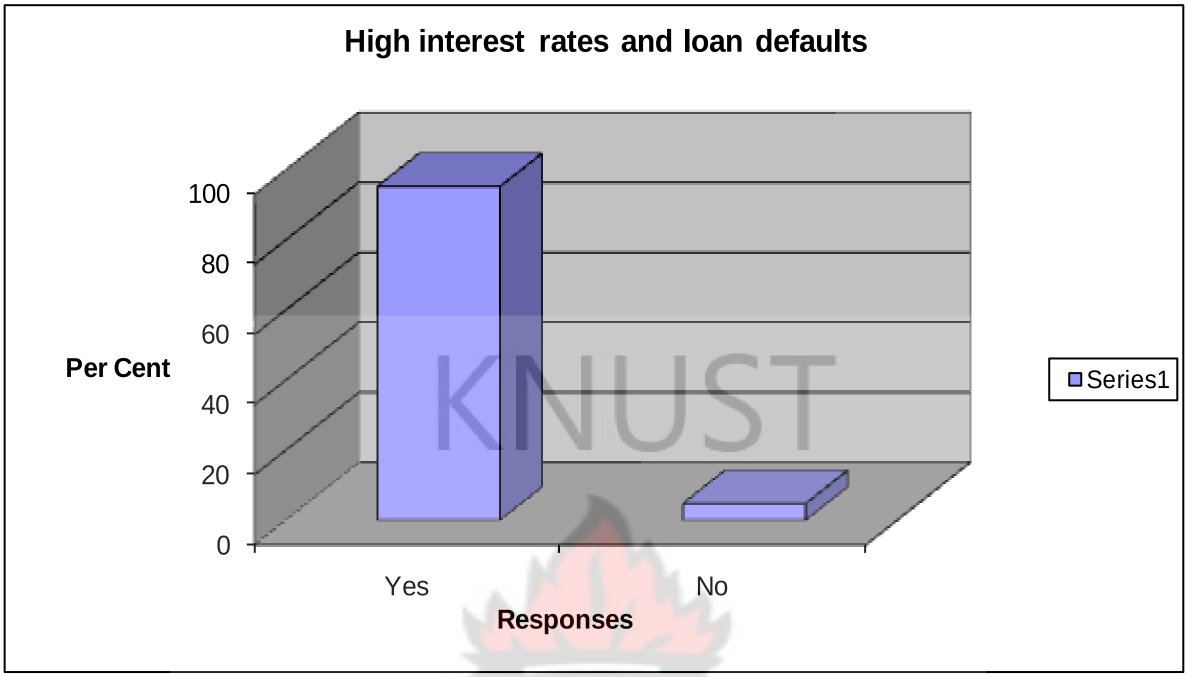
Source: Survey 2011

It is therefore categorically clear that, the high default rate recorded by the Bank is due to failure by the Bank staff to monitor effectively the loans they advance to their clients.

4.3.2 Is interest rates a contributory factor of loan default?

From the figure below, 40 (95%) out of the 42 respondents were of the view that, high interest rates can cause loan defaults whereas 2 (5%) out of the 42 respondents had a contrary view. This is shown in the figure below;

Figure 4.1 High Interest rates and loan defaults



Source: Survey 2011

However, Management is also of the view that, high interest rates cannot cause a client to default in the repayment of his/her loan since credit analysis is done to determine the cash flow of a project before loans are advanced.

4.3.3 Why ineffective monitoring of loans by Credit Officers

The results of the study show that, 7 (35%) of management staff interviewed attributed the inability of the Credit staff to monitor loans to difficulty in locating the clients. 5 (25%) were of the view that, inadequate logistics is the major factor which hinder Credit Officers from monitoring loans they recommend for approval. 3 (15%) of the respondents attribute lack of motivation or incentives to the Credit Officers has accounted for the inability of the Credit Officers to effectively monitor loans. 2 (10%) each attributed ineffective monitoring by

Credit officers to Directors influence on loans and poor documentation of loan facilities. Only 1 (5%) indicated that, low capacity of credit officers accounted for their inability to effectively monitor loans. This is as shown in table 4.5 below

Table 4.5 Why ineffective monitoring by Credit Officers

Why ineffective monitoring by Credit Officers	Frequency	Per Cent
Difficulty in Locating Clients	7	35
Inadequate Logistics	5	25
Lack of Motivation/Incentives	3	15
Influence by Directors	2	10
Low Capacity of Staff	1	5
Poor Documentation	2	10
Total	20	100

Source: Survey 2011

4.3.4 Factors that cause delayed loan approval

From table 4.6, respondents (Management) were asked to rank the factors which cause delay in approval and disbursement of loans to clients. Rigid approval procedures and customers inability to meet approval conditions were ranked the first factors which cause delay in approving and disbursing loans. Poor credit appraisal report by Credit Officers was ranked 2nd whereas liquidity problems were ranked the 3rd factor.

Table 4.6 Causes of delayed loan approval

Causes of Delayed Loan Approval	Frequency	Rank
Rigid approval procedures	15	1st
Customers inability to meet approval conditions	15	1st
Poor Credit Appraisal Report	12	2nd
Liquidity Problems	7	3rd

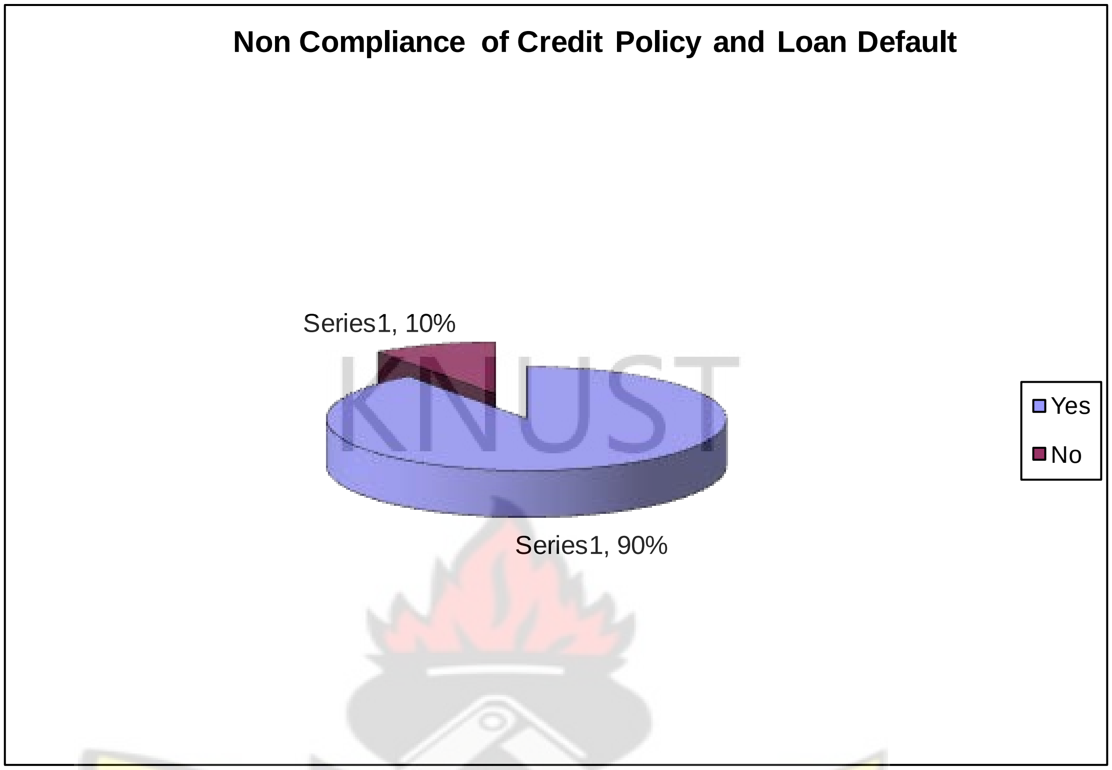
Source: Survey 2011

The researcher is of the view that, if all these factors are addressed, approval process shall be improved which shall in turn positively affect the default rate of the Bank by reducing default.

4.3.5 Non-Compliance of Credit Policy and Loan Default

Of all the Management members interviewed, 18 (90%) of the respondents answered that, non-compliance of Credit Policy of the Bank can also cause loan default whereas 2 (10%) answered on the contrary. This is illustrated in Figure 4.2 below.

Figure 4.2: Non Compliance of Credit Policy and Loan Default

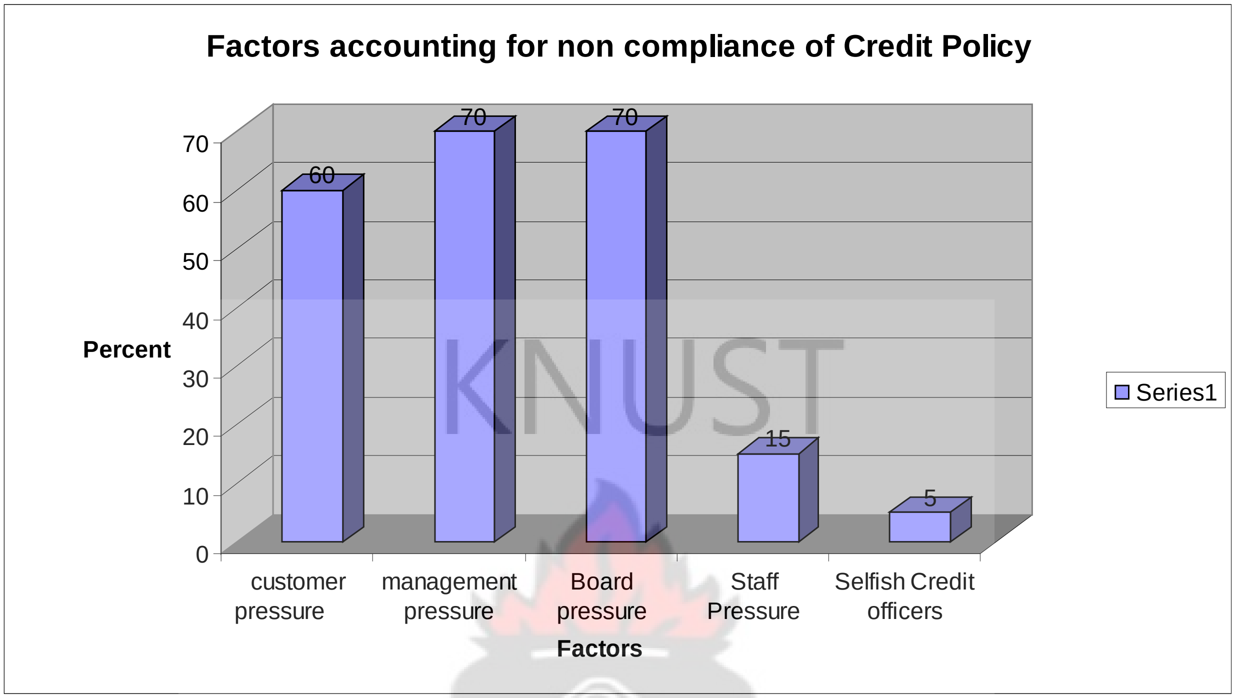


Source: Survey 2011

4.3.6 Factors accounting for non compliance of Credit Policy by Credit Officers

From figure 4.3, Management members were required by the researcher to rank factors which account for the non compliance of the Credit Policy by the Credit Officers. It can be seen from the figure that, Board and Management pressure are the major factor which account for the non compliance of the Credit Policy by the Credit Officers with a score of 70% each. Customer pressure (60%) was also the second major factor for non compliance of the Credit Policy by the Credit Officers. Staff Pressure and Selfish Credit Officers account for 15% and 5% respectively for the Non compliance of the Credit policy by the Credit Officers.

Figure 4.3 Factors accounting for non compliance of Credit Policy and Loan default



Source: Survey 2011

4.4 IMPACT OF LOAN DEFAULT ON PROFITABILITY OF OKOMFO ANOKYE RURAL BANK LIMITED

4.4.1 Analysis of the trend of loan default (Arrears rate) in the Bank

This analysis is to establish the trend of loan default rate during the period under consideration. Table 4.7 depict the trend of loan default rate of the bank over the past five years.

Table 4.7 Loan Default Rate

Year	Loan Default Rate
2005	14.25%
2006	15.56%
2007	27.38%
2008	18.52%
2009	23.50%

Source: Financial Statement, 2005-2009

Table 4.7 shows the trend of default rate of the Bank's entire loan portfolio during the five – year period under review. Non-performing loans ratio refers to the total amount of bad loans expressed as a percentage of the total loan portfolio during the period. The ratios for non-performing loans for 2005, 2006, 2007, 2008, and 2009 are 14.25%, 15.56%, 27.38%, 28.52% and 23.50% respectively. The ratios indicate that, loan defaults have been worsening. The table further revealed that, 2007 recorded the highest rate of loan default by loan clients, followed by 2009, 2008, and 2006, while 2005 recorded the lowest ratio. Personal interview with Management revealed that, in 2007, there was an increase in the loan portfolio coupled with few Credit Officers resulted in their inability to monitor the loans hence the high rate of default by loan clients. In 2008, the Bank employed 3 additional Credit Officers to assist the existing 2 Officers to handle the increasing loan portfolio, hence the decline in the default rate in 2008. The increase in the default rate in 2009 (23.50%) was as a result of failure of cocoa farmers and Bepoase Kente Weavers and Sellers Association to repay a loan facility totalling GHS233,500.00 advanced to them.

The researcher is of the view that, the low rates recorded may be attributed to lack of proper management information system which made it difficult for the Bank and other supervisors like Bank of Ghana to determine the true loan default by the loan clients. It was realized from the study that, the operations of the Bank was manual (not automated) hence very difficult to access certain information, like the default rate.

4.4.2 Analysis of the effect of loan default on interest income

Loan interest income is the major form of income to Banks and Okomfo Anokye Rural Bank is no exception. This analysis is to establish the effect of loan default on loan interest income as shown in table 4.8 below.

Table 4.8 Effect of loan default on interest income

Year	Interest Income	Charge for Bad debt	Per cent of Bad debt to loan interest income
2005	229,646.70	6,705.98	3%
2006	290,077.61	39,295.90	14%
2007	412,497.45	37,869.08	9%
2008	619,902.00	50,621.00	8%
2009	925,821.00	114,137.00	12%

Source: Financial Statement 2005-2009

The analysis shows that there was a consistent increase in the interest income generated by the Bank's loan portfolio. However, the Bank recorded 14% ratio of bad debt to interest income in 2006. This was reduced to 9% and 8% respectively in 2007 and 2008. The ratio further deteriorated in 2009 (12%). Information gathered from Management indicated that, the Bank underprovided for their bad loans, hence the Bank of Ghana through their routine inspections asked the Bank to book additional provision of GHS50,000.00 hence the increase in the provision for bad debt figure in 2009.

Table 4.9 Effect of Loan Default on Interest Income: Pearson Correlation analysis

	Charge for Bad debt	**Interest Income**
Charge for Bad debt	0.9473**	
Interest Income	0.9048*	0.9621**

* Significant at 0.05%   ** Significant at 0.01%

From table 4.9, there is a strong relationship between interest income and charge for bad debt. As seen from the table, the Pearson's Correlation Coefficient of 0.9048 at 0.05% confidence level indicates that the interest income is highly dependent on the charge for bad debt.

It can be deduced from the study that, loan defaults is having a serious negative impact on the profitability of the Bank since majority of the Bank's profit comes from interest income. This is an indication that as the loan default's figure increases, the charge for bad debt also increase and therefore the interest income reduce and vice versa.

4.4.3 Analysis of the effect of loan defaults on profitability

This analysis is to bring to the fore the effect of loan default on the profitability of the Bank. Table 4.10 shows the effect of loan loss provision on operating profit of the Bank over the last five years (i.e. 2005-2009).

Table 4.10 Effect of loan default on profitability

Year	Operating Profit before Bad Debt	Charge for Bad Debt	Operating Profit after Charge for Bad Debt	Per Cent of Bad Debt to Operating Profit
2005	66,400.40	6,705.98	59,694.42	11.2 %
2006	88,234.10	39,295.90	48,938.20	80.3 %
2007	105,465.17	37,869.08	67,596.09	56.0 %
2008	145,775.00	50,621.00	95,154.00	53.2 %
2009	211,295.00	114,137.00	97,158.00	117.5 %

Source: Financial Statement 2005-2009

The analysis indicated that, operating profit has been reduced by 11.2%, 80.3%, 56%, 53.2% and 117.5% for the years 2005, 2006, 2007, 2008 and 2009 respectively. As can be seen from the table, the percentages point to the fact that in 2005 and 2009, loan loss provision reduced the Banks operating profit of the bank by 11.2% in 2005, 80.3% in 2006, 56% in 2007, 53.2% in 2008 and 117.5% in 2009, depicting the greatest impact of bad debts as a results of loan default by clients on operating profit of the bank during the period. The year 2005, recorded the lowest percentage of bad debt to operating profit which resulted in the higher profit level during the period compared to the interest income earned.

Table 4.10 also shows that, there was a sharp increase in the provision for bad debt in 2006 which resulted in the decline in profit compared to interest income earned in 2006.

The Bank recorded the highest bad debt provision of GHS114,137.00 in 2009 which significantly reduced the operating profit of the Bank by 117.5%. This implies that, if the

Bank's loan portfolio was to be quality, the Bank could have declared a huge profit in 2009. It was also gathered from Management that, the huge loan loss provision made in 2009 was due to pressure from Bank of Ghana to book additional provision of GHS50,000.00 since the Bank of Ghana saw that, the Bank has underprovided for its loans.

Table 4.11 Effects of Loan Default on profitability: Pearson Correlation analysis

	Operating Profit before Bad Debt	Charge for Bad Debt	Operating Profit after Charge for Bad Debt
Operating Profit before Bad Debt	0.9654**		
Charge for Bad Debt	0.8782	0.7231	
Operating Profit after Charge for Bad Debt	0.9621**	0.9048*	0.8890*

* Significant at 0.05%   ** Significant at 0.01%

From table 4.11, Operating profit before and after bad debt provision are highly depend on loan default since the significant figures of the Pearson's Correlation co-efficient are 0.8782 and 0.9048 respectively. These imply that, to get more profit, the Bank must recover most of its overdue loans.

The significance of this analysis is to bring to the fore the factors that result in high bad debt provision which is as a result of failure by clients to pay back the credit facilities advanced to them which impact negatively on the bank's profit.

4.4.4 Relationship between the rate of default and its effect on the Bank's operations

Table 4.12 Loan default and its effect on the Bank's operations

Default Rate	Affected operations of the bank	Has not affected the operations of the bank	Total	Percent
High	6	2	8	40
Moderate	11	0	11	55
Low	0	1	1	5
Total	17	3	20	100

Source: Survey 2011

8 (40%) of the respondents (Management) indicated that, the loan default rate of the Bank is high, 11 (55%) indicated that the default rate is moderate, whereas only 1 (5%) of the respondents indicated that the default rate is low. From the table, 17 respondents out of the 20 interviewed saw that, the loan default rate has affected the bank's operations whereas 3 out of the 20 respondents indicated that, the default rate has not affected the Bank's operations.

Analysis of the effect of Overdue loans on Income and Profit

This analysis is to bring to the fore how overdue loans affect income and profit. From the table, there has been a consistent increase in the overdue loans from 2005 to 2009, i.e. GHS32,692.73, GHS126,910.40, GHS173,764.41, GHS185,927.61 and GHS308,321.14 respectively. It can be seen from table 4.13 that, as the overdue loans increases, the Bank has to make higher provisions for bad and doubtful debt, thereby reducing the profit made by the Bank.

Table 4.13 Analysis of the effect of overdue loans on income and profit

Year	Income	Charge for Bad Debt	Profit	Overdue Loans
2005	229,646.70	6,705.98	59,694.42	32,692.73
2006	290,077.61	39,295.90	48,938.20	126,910.40
2007	412,497.45	37,869.08	67,596.09	173,764.41
2008	619,902.00	50,621.00	95,154.00	185,927.61
2009	925,821.00	114,137.00	97,158.00	308,321.14

Financial Statements (2005-2009)

Table 4.14 Effect of Overdue Loans on Income and Profit: Pearson Correlation analysis

	Income	Profit	Overdue Loans
Income	0.9052*		
Profit	0.9410*	0.7603	
Overdue Loans	0.9621**	0.8890*	0.9648**

* Significant at 0.05%   ** Significant at 0.01%

From table 4.14, Income and profit are highly dependent on overdue loans since the significant figure of the Pearson's Correlation co-efficient are 0.9621 and 0.8890 respectively. This implies that, to get more income and hence profit, the Bank must recover most of its overdue loans.

4.5 WAYS OF REDUCING LOAN DEFAULT IN OKOMFO ANOKYE RURAL BANK LIMITED

4.5.1 How bad loans are recovered

Recovering bad loans from clients was another question and the majority of the management interviewed responded in the way presented below. 11 (55%) responded through calling on guarantors who guaranteed the facility to come and settle the debt, 6 (30%) through court action, 2 (10%) through seizure of client's company assets pledged as collateral and 1 (5%) responded sale of collateral provided by clients.

Table 4.15 How bad loans are recovered

Ways of recovering bad debts	Frequency	Percentage
Court Action	6	30
Seizure of Company Assets pledged as security	2	10
Call on Guarantors	11	55
Sale of Collateral provided by clients	1	5
Total	20	100

Source: Survey 2011

The above statistics indicates that, most of the bad loans are recovered through the calling in of guarantors to pay the facility which has been unpaid by the principal debtor. This has therefore made it difficult for loan applicants to have guarantors to guarantee their loans these days since most of them are afraid of the client's default and the liability on them.

4.5.2 Ways of Reducing loan default by clients

The table below analyzes ways of reducing loan defaults from the view point of customers. In table 4.12, customers were made to rank ways of reducing loan default in the Bank. As indicated in the table, customers are of the view that, to reduce loan default, the Bank staff should effectively monitor the loan they advance to its customers since it was ranked the 1st with a frequency of 31. Timely disbursement of loans was ranked the 2nd, in reducing loan default with a frequency of 18 and reduction in interest rates was ranked the 3rd with a frequency of 11. Extension of the repayment period of loans, Optimal amount of loans disbursed to clients and poor credit appraisal by Credit Officers were each ranked the 4th way of reducing loan default. Business Advisory Services was ranked the 5th factor in reducing loan defaults.

Table 4.16 Ways of reducing loan defaults from the view point of clients

Ways of Reducing Loan Default	Frequency	Rank
Monitoring	31	1st
Timely Disbursement of Loan	18	2nd
Reduction in Interest rates	11	3rd
Extension of Loan Repayment Period	3	4th
Optimal amount of Loans Should be disbursed	3	4th
Proper Appraisal by Credit Officer	3	4th
Business Advisory Services	2	5th

Source: Survey 2011

4.5.3 Improving loan recovery

Management's responses on how loan recovery can be improved are analyzed in table 4.16. 9 (45%) responded effective monitoring by the Credit Officers, 5 (25%) responded proper and simplified credit appraisal report preparation, 4 (20%) responded timely disbursement of loans. Finally, 1 (5%) responded motivation of credit staff and 1 (5%) also responded provision of logistics to the Credit Department for the monitoring of loans.

Table 4.17 Improving Loan Recovery

Ways of Improving Loan Recovery	Frequency	Percent
Motivation of Staff	1	5
Effective Monitoring	9	45
Proper and Simplified Credit Appraisal Report	5	25
Timely Disbursement	4	20
Logistics provision	1	5

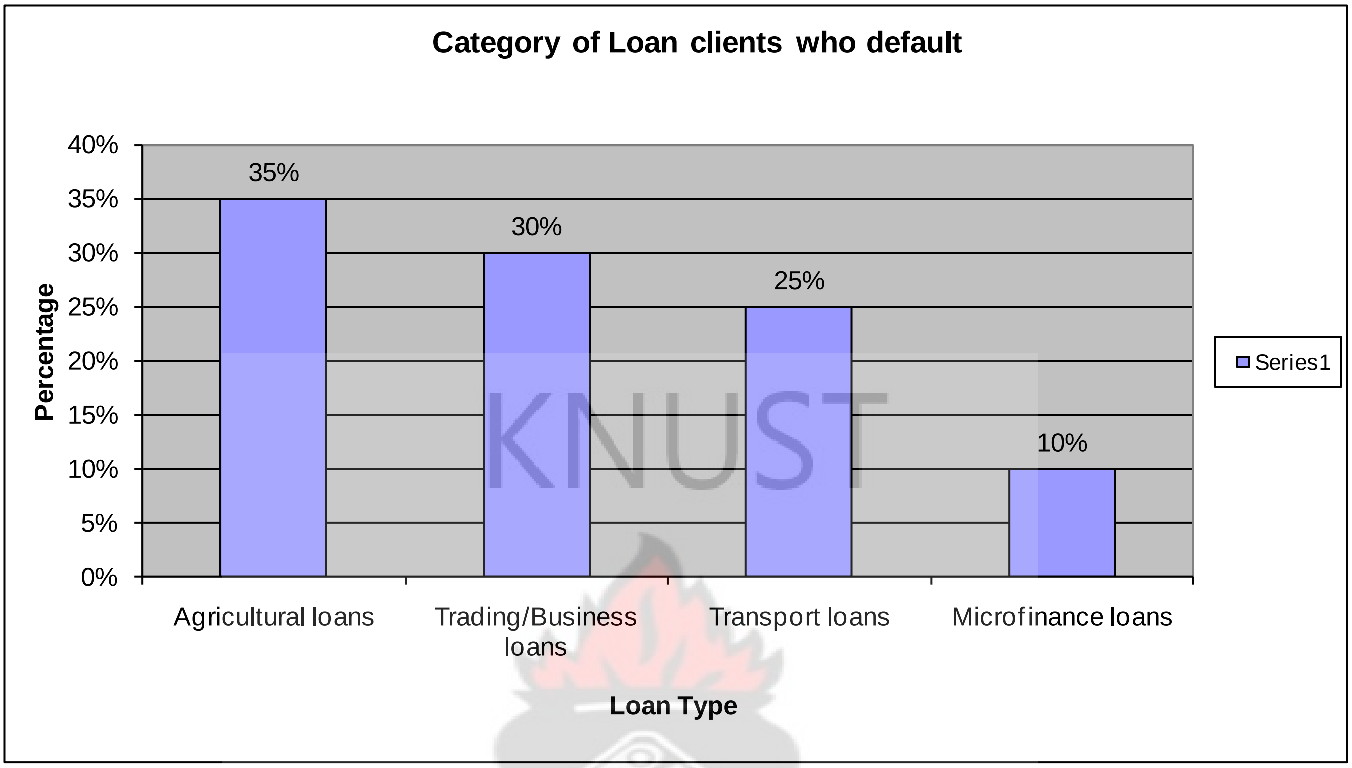
Source: Survey 2011

4.6 CATEGORY OF LOAN CLIENTS WHO DEFAULT

The Bank has several loan products: Overdrafts, Salary loans, Transport Loans, Cottage Industry loans, Trading/Business loans, Microfinance loans, School/Church Development loans, Agricultural loans, Susu loans, Funeral loans, etc.

Of all the various types of loans, 7 (35%) of the respondents responded that Agricultural loans have the highest default rate. This was followed by Trading/Business loans, 6 (30%), then 5 (25%) Transport loans and finally Microfinance loans 2 (10%) as illustrated in figure 4.4.

Figure 4.4: Category of loan clients who default



Source: Survey 2011

The above data presentation and analysis provide the study findings in relation to the research questions. The next chapter covers the summary of findings, conclusions and recommendations

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter entails a recap of the research findings and the methods used in obtaining the data for the study. It further provides conclusions and recommendations relating to the study objectives. This is very essential as it gives the implications of the findings and the possible measures that could help reduce the problem of loan default being experienced by the Bank.

5.2 Summary of Findings

The subject of this study was a descriptive one to find out the causes and effect of loan defaults on the profitability of Okomfo Anokye Rural Bank Limited.

The findings of the study revealed several factors causes loan default and hence bad loans. Ineffective monitoring of loans and delayed loan approval were emphasized by all respondents as major causes of the loan default in Okomfo Anokye Rural Bank Limited. It was seen from the study that, ineffective monitoring of loans by Credit Officers is attributed to difficulty in locating loan clients and lack of logistics.

The findings show that the bank recorded huge amount of non-performing loans, especially in 2007 and 2009 as shown by 17.38% and 13.50% of total loans respectively, during the period. The non-performing loans ratios for the past five years, however, indicated an increasing trend from 2005 – 2007, declined in 2008 and started increasing in 2009. This means that management of the bank has to improve upon its loan monitoring and recovery activities to bring down bad loans to the barest minimum.

The study further revealed that, operating profit has been reduced by 11.2%, 80.3%, 56.0%, 53.2% and 117.5% for 2005, 2006, 2007, 2008 and 2009 respectively. The findings show that 2009 recorded the highest while 2005 recorded the least. The overall reduction of operating profit by 63.64% is very high signifying that bad debts charges consumed a chunk of the bank's operating profit during the period. Bad debt therefore impacted negatively on the financial health of the bank over the past five years under consideration.

The study also revealed that, loan defaults can be reduced drastically through effective monitoring of loan, timely disbursement of loans, reduction in interest rates and extension of the loan repayment period for clients.

It is also worth noting that among the sectors of the bank's lending activities, the agricultural and Trading/Business sectors recorded the highest incidence of loan defaults.

5.3 Conclusion

The findings as briefly summarized above give rise to some conclusions that could be drawn from the analysis.

It is evident from the findings that the bank's loan portfolio contained huge amounts of non-performing loans since little attention is given to the monitoring and recovery of loans by Credit Officers and Agency Managers of the Bank.

In view of the reduction of a chunk of the loan interest income and operating profit, it can be concluded that loan defaults affect the financial performance of the Bank through the following: increased provision for bad and doubtful debts, creates liquidity problems which can lead to a run on the Bank, increases expenses in the form of human hours used in chasing loan defaulters and stationery used in writing demand letters and reminders.

Looking at the factors that account for loan defaults and as such bad loans as established by the research findings, it can also be concluded that Agriculture and Trading/Business sectors credit is heavily exposed to credit risk than other sectors. Management therefore needs to put in place practical measures to mitigate the risk in these sectors so as to improve the quality of the overall loan portfolio of the bank.

5.4 Recommendations

The foregoing findings of the study reveal a worrisome situation about loan defaults and its effects on the entire loan portfolio of the bank during the period under review as a result of loan defaults by clients. A careful review of the analysis of loan default shows that bad debt provision eroded the huge financial gains the bank has made over the years especially in 2009. Indeed, it shows that the problem has affected the financial performance of the bank during the period. In view of the important role the bank plays in the economic development of Ghana, it is very essential for all stakeholders, especially management to adopt practical and proactive measures to minimize the problem of loan default in the bank. The following recommendations are therefore made with the hope that they will minimize the causes of loan defaults by clients.

It was revealed from the study that, the credit appraisal report written by the Credit Officers was so voluminous; hence, most of the Credit Officers spend much of their time in the office preparing appraisal reports making it difficult for them to go out to monitor the loans they have already granted to clients. The credit appraisal format must be simplified so that, credit officers will spend little time in its preparation to enable them have enough time for recovery and monitoring of loans. This will also prevent the delay in approval of loans.

It is recommended that management should organise regular training programmes for credit staff and Agency Managers in areas like credit management, risk management and financial analysis. This would sharpen the knowledge and skills of credit officers so as to improve on the quality of credit appraisal, prevent delayed loan approvals, enable credit officers appreciate the need to comply with credit policy and further enhance monitoring of credit. It is also believed that through training programmes, credit staff would be able to conduct effective analysis of loan portfolio structure of their branches and give much attention to loans with warning signals.

Besides, another important way of minimizing loan defaults is through regular and effective monitoring and supervision of loan facilities granted to clients. This would prevent diversion of funds into business ventures other than the agreed purposes, help credit officers assist customers who are facing some business management problems such as improper records keeping, and overtrading that affect their business operations.

Furthermore, to ensure effective monitoring of loans, management should ensure that credit offices at all branches, are adequately resourced in terms of staff, vehicles and other logistics, to support monitoring activities. Again management needs to show commitment through the provision of these resources at all branches. Management should also ensure regular supervision of Agency Managers and Credit Officers at the branches through the bank's internal credit auditing systems. It is worth emphasizing that effective monitoring of loan facilities through field visits and reviewing of customers accounts on regular basis, enables the lender assesses borrowers' current financial conditions, ensure the adequacy of collaterals, ensure that loans are in compliance with the terms and conditions of the facility, and identify potential problem loans for action to be taken.

In view of the fact that banks and other lenders cannot tell from the looks of people's faces whether they are good borrowers or bad borrowers, it is recommended that loans granted to customers should be well secured in terms of adequacy of the collateral provided and also ensure that proper legal documentation is put in place. This would reduce the losses arising from problem loans and minimise the effects of such loans in the form of bad debt provisions, on the financial performance of the bank.

In addition, Credit Officers and Agency Managers should report the performance of 50 largest exposures at all the Branches/Agencies to head office every week to enable management take a remedial action to address those clients who intend to create problems for the Bank, since default by these clients has a serious impact on the loan loss provision made by the Bank, hence profitability.

The bank should also use credit reference agencies in line with the Credit Reporting Act, 2007 (Act 726) for the purpose of determining the creditworthiness of borrowers as a means of minimizing bad loans. It is known that, these Credit bureaus keep information on people for the purpose of assessing their creditworthiness in the granting of credit to them. This would enable the bank identify good customers and thus minimize loan default. The management of the bank should therefore ensure that all credit officers and loan approving authorities utilize the services of these institutions when conducting credit appraisals before loans are granted.

The bank should establish a product research and development department to study the performance of all the Bank's products so that those which are not doing well can be repackaged to make them marketable on the market.

The Bank should introduce proper and effective management information system to enable it generates timely and accurate information on both clients and staff to monitor the operations of the Agency Managers and Credit Officers at the Branches. The internal audit unit must also be strengthened to be proactive and to check whether the right procedures are followed before disbursement of loans and to ensure effective monitoring by credit officers and managers.

Clients who have outstanding loans but operate profitable businesses can be refinanced to increase their cash flow generation capacity to be able to repay the outstanding loan balance. The outstanding loan balance should also be rescheduled to match the new cash flow from the business. This will bring back the facility to current and also reduce the high provision for bad and doubtful debts made on non performing loans.

The Bank should also resource the Recovery Department to enable them carry out their functions very well to recover the overdue loans. The Department should also be involved in the monitoring of loans from the day the loans are granted.

In conclusion, the Bank should minimize the granting of Agricultural, Trading/Business sectors loan and shifts its attention to Salary, Susu, Overdrafts and School/Church Development loans which has minimal default rates.

REFERENCES

Aballey, F.B. (2009). *Bad loans portfolio: The Case of Agricultural Development Bank*, Unpublished Dissertation.

Agyemang, K.O. (2010). *Causes of Loan Defaults: A case study of Opportunity International Savings and Loans Company Limited*, Unpublished Dissertation.

Ahmad, S.A. (1997). *Natural Hazards and Hazard Management in the Greater Caribbean and Latin America*, Publication No. 3

Akinwumi, J.A. and Ajayi, A. O. (1990). *The Role of Loan Repayment Capacity in Small Scale Farmers Credit Administration*. Quarterly Journal of Credit Administration, 15(2)

Anaman, K. (2006). *Central Bank Abolishes Secondary Reserves*, Business and Financial Times, July 19, 2006. Issue No. 828

Annual Reports and Financial Statements (2005-2009), Okomfo Anokye Rural Bank Limited.

Awoyemi and Quartey (2002): *Research Methods in Education*, Accra, KNA B Limited

Balogun, E.D. and Alimi, A. (1988). *Loan Delinquency Among Small Farmers in Developing Countries: A Case Study of the Small-Farmer Credit Programme in Lagos State of Nigeria*, CBN Economic and Financial Review, 26(3).

Bank of Ghana Act 2002, Act 612, Ghana Publishing Corporation, Accra

Berger, A. N. and DeYoung, R. (1995), *Problem Loans and Cost Efficiency in Commercial Banks*, Centre for Financial Institutions Working Papers, Wharton School Centre for Financial Institutions, University of Pennsylvania.

Biney, M. (2006). *The Practice of Lending*, A Paper presented at the National Banking College, Accra, Ghana.

Blanden, M. (1996). *The Real World Series*, The Banker, Vol. 146

Bruck, N. (1997). *Development Banking Concept and Theory*. Journal of the Ghana Institute of Bankers 4(1)

BusinessDictionary.Com, (2011), *Definition of Default*, [http://www.businessdictionary.com/definition/default.html], (accessed 4th April, 2011)

Bwonya-Wakuloba, R.A. (2007). "*Causes of Default in Government Micro Credit Programmes; A case study of Uasin Gishu District Trade Development Joint Loan Board Scheme*, Kenya.

Colgate, M. (1997). *Personal Bankers and Relationship Marketing*, Journal of Financial Services and Marketing, Vol. 12.

Consultative Group to Assist the Poor/World Bank (2009), "Delinquency Management and Interest Rate Setting for Microfinance Institutions" [http://www.cgap.org], (accessed 13th January, 2011).

Day, A. (1997), *Just Bank it, just brand it*, The Ghanaian Banker, Vol. 147

Dwumah, T. (2006). *Central Bank abolishes secondary reserve*, Business & Financial Times, 2006.

Farlex Financial Dictionary, (2009), "*Loan Loss Provision*": [http://financial-dictionary.thefreedictionary.com/Loan+Loss+Provision], (accessed 28th December, 2010)

Gilles, M. (1996). "*Employment Protection, Product Market Competition and Growth*", [http://ideas.repec.org/p/iza/izadps/dp554.html] (accessed 12th February, 2011).

Gorter, N. & Bloem M. (2002). "*The macroeconomic statistical treatment of Non Performing Loans*, Publication of the Organization for Economic corporation & Development". [http://www.dbj.go.jp/english/IC/active/hot/adfiap/pdf/nagarajan.pdf], (accessed 19th November, 2010).

Hoque M.Z. (2004). "*Impact of Interest Rates on Loan Defaults: Experience from a Developing Country*". [www.info-researchmeeting.com/Sample%20Paper.doc], (accessed 21st January, 2011)

Hornby, A.S. (2001), *Oxford Advanced Learners Dictionary*, Special Price Edition, Oxford University Press.

Incoom S. E. (1998). *The monetary & financial systems*. Accra: Ghana Institute of bankers.

Investorwords.Com, (2011). "*Definition of Credit Analysis*", [http://www.investorwords.com/1195/credit_analysis.html], (accessed 21st January, 2011)

Kohansal, M.R. and Mansoori, H. (2009). *Factors Affecting on Loan Repayment Performance of Farmers in Khorasan-Razavi Province of Iran*, Conference on International Research on Food Security, Natural Resource Management and Rural Development, University of Hamburg.

Kone, K. H. (2006), *Problem loans Management Practices, Ecobank Ghana Limited as a case study*, Unpublished Dissertation.

Koontz, L. D. (2001), "*Loan Monitoring System: SBA Needs to Evaluate Use of Software*" [http://www.gao.gov/new.items/d02188.pdf], (accessed 10th March, 2011)

Kwakwa, P.O. (2009). *Causes of Non-Performing Loans at Bosomtwe Rural Bank Limited in Ghana*, Unpublished Dissertation.

Laurin, A. Majnoni, G. Ferencz, G. Maimbo, S. M., Shankar, R. and Wane F. T. K (2002): *Bank Loan Classification and Provisioning Practices in Selected Developed and Emerging Countries, A Survey of Current Practices in Countries represented on the Basel Core Principles Liaison Group*, World Bank Finance Forum.

McKinnon, R.I. (1973). *Money and Capital in Economic Development*, Washington D.C. The Brookings Institution

Merritt, E. (2009), *Mortgage Default: Causes and Cures*, Mortgage Loan Compliance, The Forensic Loan Audit Company.

Murray, J. (2011). *Default on a loan*, United States Business Law and Taxes Guide

Myjoyonline.Com, (2011). "*Loan default rate surges*", [http://news.myjoyonline.com/business/201102/61645.asp] (accessed 27th March, 2011)

National Credit Act (2005). Act No. 34 of 2005, Republic of South Africa, Volume 489 No. 28619

Nishimura, K., Kazuhito I., and Yukiko O., (2001). "*The Disposal of Non-Performing Loans and Its Potential Influence*". [http://www5.cao.go.jp/keizai3/2001/0628furyousaiken-e.pdf], (accessed 13th December, 2010)

Nyarko, E. (2005). *Financial challenges facing urban SMEs under Financial Sector Liberalization in Ghana*, Journal of Small Business Management, Vol. 15.

Okomfo Anokye Rural Bank Limited, (2007): *Five Year Strategic Plan Document*, Vityll Press, Kumasi

Okomfo Anokye Rural Bank Limited, (2009). *Credit Policy*. Yaci Publications Limited, Kumasi

Okorie, A. (1986). *Major Determinants of Agricultural Loan Repayments, Savings and Development*, X(1)

Okpugie, G. (2009). *High Microfinance Interest Rates Cause Loan Defaults in Nigeria*, The Guardian, Nigeria.

Olomola, A.S. (2001). *The nature and determinants of rural loan repayment performance in Nigeria: The case of FADU's micro-credit programme*. NISER monograph series NO 3, (NISER), Ibadan.

Pearson, R. and Greef, M. (2006). *Causes of Default among Housing Micro Loan Clients, FinMark Trust Rural Housing Loan Fund*, National Housing Finance Corporation and Development Bank of Southern Africa, South Africa

Ribeiro, M. (2006). *The Credit Prudential Framework for Banks*. Paper presented at the National Banking College, Accra, Ghana.

Rittenberg, L. (1991). *Investment spending and interest rate policy*: The case of Financial liberalisation in Turkey', Journal of Development Studies, Vol. 27.

Roe, A.R. (1982). *High interest rates: a new conventional wisdom for development policy; Some conclusions from Sri Lankan experience,* World Development, 10(3).

Rouse, C. N. (1989). *Bankers lending techniques,* London: Chartered Institute of Bankers Publication

Shaw, E.S. (1973). *Financial deepening in economic development*, New York. Oxford University Press

Sounders, M., Philip, L., Andrian, T. (2007). *Research Methods for Business Students*. Pearson Educational Complex, Pitman Publishing Limited

Sowa, N. K. (1996*). Inflation, interest rates and banking*. The Ghanaian banker, (4) 1,

The Banking Act of 2004

Vandel, K., (1993). *A perspective on Mortgage Default Research*. Journal of the American Real Estate and Urban Economics. Vol 23 (4)

Volkwein, J. F. and Cabrera, F. A. (1998). *Who Defaults on Student Loans? The Effects of Race, Class, and Gender on Borrower Behaviour, in Condemning Students to Debt:* College Loans and Public Policy. ed. Richard Fossey and Mark Bateman.

Wikipedia.Com, (2011). "*Definition of Default*",
[http://en.wikipedia.org/wiki/Default_%28finance%29], (accessed 23rd March, 2011)

APPENDIX 1

QUESTIONNAIRE FOR MANAGEMENT

The following questionnaire is meant to collect data for academic purposes only. All responses shall be treated strictly confidential. Your response to this questionnaire would be highly appreciated.

1. What is your position in the bank?

   ....
.

2. How long have you been with the bank?

   ....

3. What types of credit facilities are normally applied for in your bank?

   a. Overdraft

   b. Salary Loan

   c. Commercial Loan

   d. Susu Loan

   e. Funeral Loan

   f. Others, Specify………………………………………..

4. What is the application procedure for your Loans? ....

   ……………………………………………………………………………………………....

   ……………………………………………………………………………………………

5. What documents are normally requested for before the facility is processed?

Please state your comments...

....

.

6. What is normally the duration of your Loan facility?

i. 6 – 12 months ii. 12 - 24 months iii. 24 months and above

7. How is the loan default rate in your bank?

High ☐ Moderate ☐ Low ☐ (tick as applicable).

8. Has the default rate affected your bank's operations?

Yes ☐ No ☐

Please give reasons for your answer

....

....

....

....

9. In your opinion, which of the following are the factors which cause loan defaults in financial institutions?

i delayed loan approval [ ] vi poor weather conditions [ ]

ii poor credit appraisal [ ] vii marketing problems [ ]

iii diversion of loans [ ] viii lack of business management knowledge [ ]

iv under financing [ ] ix term of the loan [ ]

v ineffective monitoring [ ] x unwillingness to repay loans [ ]

Others, please specify……………………………………………………………….

……………………………………………………………………………………….

10. What are the problems faced in your loan recovery?

....

....

11. Do you think non-compliance with credit policy of the Bank accounts for bad loans?

(a) Yes (b) No

12. If yes above, which of the following account for that?

(a) customer pressure [ ]

(b) management pressure [ ]

(c) Board pressure [ ]

(c) all the above [ ]

(d) others, please specify………………………..

13. How would you rank the following factors as causes of bad loans using a scale of 1 to 5 with 5 being the highest and 1 the lowest?

i delayed loan approval [ ]

ii poor credit appraisal [ ]

iii diversion of loans [ ]

iv under financing [ ]

v ineffective monitoring by credit officers [ ]

vi poor weather conditions [ ]

vii marketing problems

viii lack of business management knowledge [ ] vix non-compliance with credit policy [ ]

x term of the loan [ ]

xi unwillingness to repay loans by clients [ ]

14. Which of the following factors hinder effective monitoring of loans by Credit Officers?

(a) lack of logistics

(b) under staffing

(c) ineffective supervision by management

(d) poor road to project site

(e) inadequate motivation

(f) poor attitude of staff

(g) all the above

15. What are the causes of delayed loan approval?

(a) rigid approval procedures

(b) customers inability to meet approval requirements

(c) liquidity problems

(d) poor credit appraisal

16. Which of the following reasons do you think account for loan diversion by customers?

(a) lack of proper monitoring

(b) anticipation of high gains in other business ventures

(c) ignorance of terms and conditions attached

(d) differences in interest rate applied on loans in different sectors

(e) inadequate financing

(f) late disbursement of loans

17. What account for the problem of under financing of projects?

(a) poor credit appraisal

(b) inadequate collateral

(c) liquidity problems

(d) low account turnover

18. Which of the following loan types record the highest default rate?

i. Agricultural loans

ii. Trading/Business loans

iii. Transport loans

iv Microfinance loans

v Susu loans

vi Salary loans

19. What are the attitudes of your clients towards loan repayment?

a. Better

b. Good

c. Poor

d. Worse

20. How do you recover bad loans from your clients?

i. Through court action

ii. Seizure of collateral and company assets

iii. Call on guarantors

iv. Sale of collateral provided by clients

21. In your opinion, what are the effects of loan defaults on your Bank's profitability?

1………………………………………………………………………………………….

2…………………………………………………………………………………………..

3…………………………………………………………………………………………..

4………………………………………………………………………………………………

5………………………………………………………………………………………………

22. What measures should management put in place to reduce loan defaults?

a) ………………………………………………………………………………………………

b) ……………………………………………………………………………………….....….

c) …………………………………………………………………………………..………….

d) ………..………………………………………………………………..……………….

APPENDIX 2

QUESTIONNAIRE FOR CLIENTS

The following questionnaire is meant to collect data for academic purposes only. All responses shall be treated strictly confidential. Your response to this questionnaire would be highly appreciated.

1. Kindly provide your age in years…………………………..
2. What is your Marital status: Single [ ] Married [ ] Divorced [ ] Widow [ ]

   Other, specify……………….
3. What is your educational background? Basic [ ] Secondary [ ] Tertiary [ ]
4. What is the size of your Family? Less than 5 [ ], Between 5 – 10 [ ] Over 10 [ ]
5. What type of business are you engaged in? Trading [ ], Agriculture [ ]

   Transportation [ ] Cottage Industry [ ], Others, Specify………………………..
6. How many times have you benefited from loan facilities from the Bank

   Once [ ] Twice [ ] Trice [ ] Others [ ] Others, Specify………………………
7. What was the size of your last loan? Less than GHS500 [ ] Between GHS500.00 – GHS2,000.00 [ ] Between GHS2,001.00 – GHS5,000.00 [ ] Between GHS5,001.00 – GHS10,000.00 [ ] GHS10,001.00 – GHS20,000.00 [ ], Over GHS20,000.00
8. Did the Bank give you the amount requested? Yes [ ] No [ ]
9. If no, why were you denied?

   ………………………………………………………………………………………

   ……………………………………………………………………………………….
10. Were you able to repay it as scheduled? Yes [ ] No [ ]

11. If No, what accounted for the default (State as many causes as you can)

………………………………..…………………………………………………

……………………………………………………………………………………

……………………………………………………………………………………

……………………………………………………………………………………

……………………………………………………………………………………

12. What do you think can be done to improve the situation? State your

comments………………………………………………………………………..

……………………………………………………………………………………

……………………………………………………………………………………

……………………………………………………………………………………

13. How is the Banks loan processing like (State your comments)

……………………………………………………………………………………

……………………………………………………………………………………

……………………………………………………………………………………

14. Do you like the Bank's loan processing procedures? Yes [ ] No [ ]

15. If no, what improvement would you like to see in the loan processing of the Bank?

……………………………………………………………………………………

……………………………………………………………………………………

……………………………………………………………………………………

……………………………………………………………………………………

16. What did the Bank ask you to provide before the loan was advanced?

………………………………………………………………………………………

………………………………………………………………………………………

………………………………………………………………………………………

17. What was the interest rate charged by the Bank for the loan you have defaulted? Less than 30% [ ], Between 31 – 40% [ ], Over 40% [ ]
18. Do you think high interest rates can cause loan defaults? Yes [ ] No [ ]
19. In your opinion, what do you think the Bank should do to reduce loan defaults

………………………………………………………………………………………

………………………………………………………………………………………

………………………………………………………………………………………

20. How would describe the services you have been receiving from OARB Credit Officers
    a. Best
    b. Better
    c. Good
    d. Poor
    e. Worse
    f. Worst
21. Select 5 things you don't like about OARB loans
    i. High interest rates
    ii. High processing fees
    iii. Delay in the disbursement of loans
    iv. Terms of repayment very short
    v. Kick backs/bribes to Credit Officers

vi. Loan size too small

vii. Rude behaviour of Credit Officers and related staff towards clients

viii. Provision of cash security and landed property to guarantee loans

22. Based on your answer to Question 21, state at last 3 things you want OARB to improve on its loans delivery

a. …………………………………………………………………………………………

b. ………………………………………………………………………………………….

c. …………………………………………………………………………………………..

d. ………………………………………………………………………………………….

.