

KWAME NKRUMAH UNIVERSITY OF SCIENCE AND
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**NON-PERFORMING LOANS AND PERFORMANCE OF RURAL BANKS - A
CASE STUDY OF BOSOMTWE RURAL BANK LIMITED**

By

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DECLARATION

I hereby declare that this piece is my own work towards the Master of Business Administration and that, to the best of my knowledge, it contains no material previously published by another person or 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.

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ABSTRACT

Financial intermediation remains a major part of the traditional roles played by banks. As part of this, banks acquire money through deposits and further extend them as loans to interested customers. Granting of loans is a major activity of rural banks which contributes a greater portion of their income when repaid with interest. However, this poses serious threat to the survival of the bank when most of the loans disbursed tends to be non-performing. This study aimed at evaluating the effect of Non –Performing Loans on performance of Bosomtwe Rural Bank Limited from 2009 to 2013. Questionnaires and interview guide were used to collect data from 30 bank officials. Performance indicators used were profitability, liquidity and asset quality. The study showed that NPL ratio of the bank over the period was inconsistent though there was a steady rise from 2009 to 2011. The bank recorded the highest credit impairment loss of (GH¢218,804.82) in 2012. The major causes of NPL in the bank were loan diversion, willful default, and poor credit appraisal among others. The bank lost huge portions of its profit to NPL in each year with the highest in 2012 (19.39%). Despite the credit impairment losses the bank managed to maintain its Return on Asset ratio below the industry benchmark. However, it failed to satisfy the requirement for Return on Equity ratio for 2009 and 2010. The bank kept its asset quality below the industry maximum of 10% from 2009 to 2013. The study revealed that NPL generally affected the profitability of the bank hence pragmatic measures were proposed to minimize the incidence of loan default.

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CHAPTER ONE

GENERAL INTRODUCTION

1.0 Background of the Study

Financial Institutions, including Rural and Community Banks play a significant role in the economy by taking funds from the surplus units to the deficit units. This role is popularly referred to as financial intermediation as they take money from depositors and lends to borrowers. Traditionally, Banks buy money from the public through the deposits they take from customers and further extend them in the form of credits to interested customers. Lending and loans make up the bulk of a bank's assets and loans represent the majority of a bank's assets Njanike (2009); Saunders and Cornett, (2005). In pursuance, the bank is exposed to numerous risks including operational risk, legal risk, reputational risk, liquidity risk and credit risk. Of all these potential risks, credit risk has relative significant impact on banks overall existence. Despite the risk associated with granting of credits, Rural and Community Banks give much attention to lending activity because substantial amount of their income is earned on loans and advances in the form interest income which largely contributes to their financial performance.

Lending is not an easy task for banks because it creates a big problem which is called Non- Performing Loans (NPL) Chhimpa (2002). According to Simovic and Poznanovic, (2009), non-performing loans can affect the liquidity of banks negatively. Severe liquidity problems affect the profitability, debt servicing and lending capacity as well as the capital adequacy of the bank. All these problems, when not solved, may result in a run on a bank.

According to an annual report issued by the Efficiency and Monitoring Unit of ARB Apex Bank, Rural and Community Banks increased its asset by 31.8% from

GH¢1.1billion in 2011 to GHF¢1.5 billion in 2012 in its annual report. From this same report, the growth of Rural Banks was identified to mainly come from loans and advances, investments, cash and balances with other banks. Out of these assets, the major contributor was loans and advances since it grew by 37.5%.

Loans which no longer yield interest income are termed Non-performing (Hennie, 2003). From Alton and Hazen (2001) loans may also be classified as Non-performing when they are ninety days or more past due. A loan is non-performing when payment of interest and principal have exceeded ninety days or delayed by agreement. These classified loans (non-performing loans) remain as such until written off or payment of interest and principal are received. A well functioning financial sector helps accelerate economic growth while poorly functioning financial institutions draw back progress and worsen poverty (Barth *et al.*, 2004). It is of this reason that rural banks are expected to maintain sound credit management practices. In this regard, rural banks are expected to monitor the quality of loan portfolio, examine incidence of default and progress in recovery.

Financial institutions in developing economies like Ghana are faced with the challenge of access to information. This is technically referred to as information asymmetry; a situation in which the borrower has more information compared to the rural bank. Existence of information asymmetry makes it difficult to distinguish good borrowers from bad borrowers and eventually lead to adverse selection and sometimes moral hazards.

There are numerous factors and reasons that cause non-performing loans according to some researchers. Greenidge and Grosvenor, (2010) identified inflation rate of a country, interest rate fluctuation, monetary policy etc as some of the reasons and causes of non - performing loans. Also Rajan and Dhal, (2003) indicated that high interest rate, which

provides theoretical and practical approach in observing the economy increase the value and size of non-performing loans. High level of non - performing loans require banks to provide credit impairment loss which decrease the banks revenue as there is increase in expenditures, hence making it difficult to grow its working capital.

The total bad and doubtful debts declared by Rural and Community Banks in the year 2012 amounted to GH¢36.52 million which formed 5.6% of gross loans and advances, showing a marginal deterioration of 30 basis points over the 5.3% recorded at the end of the 3rd quarter of 2012 (Business and Financial Times, 2013). Also in the review report of Rural and Community Banks for the third quarter of 2014, One hundred and one (101) Rural and Community Banks were reported to have their Non-Performing Loans ratio in excess of the 5% benchmark indicating persistence of weak credit management practices in the banks.

All banks have various written policies that guide them in their daily lending operations as far as disbursement of loans is concerned. These policies when not assessed properly results in a risk that the borrower will not be able to make payment of loans (Feder and Just, 1980). These policies include credit appraisals, documentations, monitoring and recovery process. Generally banks with good credit risk management practice helps to identify, measure, monitor and control risk as well as to determine the capital that needs to be held against the risk of loan defaults.

The question that we tend to ask ourselves is what causes the increase in trend of non-performing loans in Rural and Community Banks? Is it that the procedure followed in granting loans is relaxed or the Rural and Community Banks lack effective strategies in recovering loans?

Exposure to credit risk continue to be the major source of problem and further affect investor's confidence in rural banking, hence the need for this research.

1.1 Statement of Problem

Business is all about taking risk as higher risk results in higher returns. The sources of income for the Rural and Community Bank includes interest on loans and advances, interest on investments, commissions and fees. Out of all these sources of income, the major contributor to total income is the interest income. Loans and advances are the major assets of the Rural and Community Banks and at the same time the threat to them as most of the loans become non-performing, hence locking up the income of the bank and adversely affecting their financial performance. Absence of good quality management of assets leads to non-performing loans which seriously damage banks financial position which further have effect on the operations of the bank (Epure and Lafuente, 2012).

Many Rural and Community Banks in Ghana are faced with the challenge of rising non-performing loan portfolio despite the existence of laid down controls and policies regarding disbursement of loans, hence an obstacle in meeting the bank's full objectives. As a result of this problem, most Rural and Community banks are on the verge of collapsing as they are rated unsatisfactorily in the annual report of ARB Apex Bank. Reducing the trend in non - performing loans is very important for both the banks performance and the economy's financial environment (McNulty *et al.*, 2001).

1.2 Objectives of Study

The general objective of the study is to examine the effect of non-performing loan portfolio on the performance of the Bosomtwe Rural Bank Limited in Ashanti region.

Specifically the study seeks to;

1. Examine the nature and trend of non-performing loans at Bosomtwe Rural Bank Limited from 2009 to 2013;
2. Identify the causes of non-performing loans;
3. Identify the effects of non-performing loans on the performance of the Bank from 2009 to 2013;
4. Examine strategies used by the bank to minimize non-performing loans

1.3 Research Questions

The following are research questions that were formulated to help find answers to the stated objectives:

1. What is the nature of non-performing loans over the five years at the Bosomtwe Rural Bank Limited?
2. What are the causes of non-performing loans at the Bank?
3. What are the effects of non-performing loans on the performance of the bank?
4. What are the strategies that are employed by the bank in minimizing non-performing loans?

1.4. Scope of Study

The study focuses on non-performing loan portfolio at Bosomtwe Rural Bank Limited. The study sought to establish the nature, causes and effects of non-performing loans on the performance of the bank as well as propose strategies that can be used in minimizing non-performing loans at the Bank. The case of the Bosomtwe Rural Bank Limited is considered in this study because it is one of the biggest rural and community banks that have branches in peri-urban and rural areas in the Ashanti Region and as such has been

contributing enormously to expand the frontiers of rural banking operations. The bank has been operating for a long time and as such can give the academic insight the study seeks to achieve. Also, the study was limited to this bank because of proximity and accessibility to information.

The research work was limited to a five year period of financial performance from 2009 to 2013 to reflect the current trend of operations. The parameters of performance for this study included profitability, liquidity and asset quality.

1.5 Significance of the Study

Rural and Community Banks were set up to mobilize funds or deposits from their catchment areas and grant credit to deserving customers within the same area. Through their intermediation, economic activities are carried out. Today most rural catchment areas have developed because of their significant contributions such as construction of schools, markets, security post etc towards the community in which they find themselves. In addition, the emergence of Rural and Community Banks has given some people the opportunities to be enrolled in school through scholarships.

Rural and Community Banks are faced with a lot of potential risks that serves as threat to their survival, thus collapsing and hindering them from carrying on more development projects for their catchment areas. Among these potential risks is credit risk which further results in non-performing loans.

This research work is aimed among other objectives to diagnose these risks so that practioners of rural banking can map strategies to curb these risks. The study would also provide further knowledge to practioners of rural banking. In addition, it will be relevant for academic work as it will add up to existing literature and also serve as a foundation

for further research for students, consultants and others who are interested in studying similar topic. Also it will serve as academic reference in finance disciplines.

1.6 Limitations of the study

The major setback of this study was time and as such a case study approach was adopted. Another problem was access to information and this necessitated the conduction of a pilot test initially, after which the Bosomtwe Rural Bank Limited gave the assurance to assist.

In addition, since Rural Banks share common characteristics and similar challenges, it is possible that some aspects of the research topic may not be discussed if they are peculiar with a particular Rural Bank. This influenced the decision to study the Bosomtwe Rural Bank Limited which is one of the biggest rural banks in Ashanti region with NPLs in excess of 5%.

The information on classification of advances (current, OLEM, sub-standard, doubtful and loss) was not forthcoming and as such the total credit impairment loss was used in this study instead of using the categorization based on number of days the loan has gone bad.

1.7 Organization of Study

The research was divided into five chapters. The first chapter encompass the background of study, problem statement, the research objectives and questions, significance and scope of the study, limitation of study and the organisation of study.

Chapter two, reviews previous works on the evolution of Rural and Community Banks, nature of non-performing loans, definitions and causes of non-performing Loans,

classification and provision of credit impairment and its implication on the financial performance of Rural Banks.

Chapter three looks at the research methodology and profile of the case study. It also outlines the research instrument and data collection procedures.

Chapter four centres on the presentation and analysis of data collected and chapter five deals with the summary, conclusions and recommendations.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter reviews current literatures that relates to the nature and causes of non-performing loans and other core aspects of the research topic under study.

2.1 Rural Banking Concepts

Rural and Community Banks with other forms of financial institutions are regulated by government entities such as the Central bank for example, in Ghana, the Bank of Ghana (BOG) and as such require license to operate. This requirement of issue of banking license varies between jurisdictions but typically include the minimum capital that is expected to be attained first before the issuance of certificate. Rural and Community Banks are units of banks that were formed in 1976 and are permitted to setup agencies at their catchment areas for the purpose of mobilizing funds. They are owned by the people within the local community but managed and controlled by Board members who may or may not be from that community. Since it is a limited liability company, shareholders who subscribe to capital of Rural Banks are limited to the nominal amount of issued share capital so subscribed. The primary goals of these banks are to mobilize savings and to extend credit to worthy customers in their areas of business, hence acting as catalyst for economic development for Ghana.

All Rural and Community banks are limited liability companies and as such operate in reference with the Companies Code and some other regulations depending on the country involved for example in Ghana, the Companies Code Act 1963 (Act 179) and Banking Act 2004 (Act 673) as amended by Act 738. Rural and Community Banks contributes to the economy by mobilizing savings from the surplus units and lending it to

the deficit units, all within the radius of operation. By doing this, they ensure that resources are allocated most efficiently to productive use. Rural and Community Banks undertake mix of commercial and financial banking activities. As part of their operations or activities, they give out loans to ensure that the bank make enough income and also ensure that the small scale rural producer actually benefit from the bank credit.

Rural Banks in Ghana have come to stay as they have made it possible for people in the rural areas to get access to finance for their activities. As such it constitutes an important role in the Ghanaian Economy. Today, most rural banks have engaged themselves in developmental activities as some of the rural banks have provided computers and accessories, water, schools, security post among others in their local catchment areas. In addition to this, others have also set up funds for scholarship to help needy students in their catchment areas.

According to Bank of Ghana (BOG) Report and Accounts, (2007) the performance of rural banking system improved as five more banks moved to satisfactory category, hence bringing the total from 82 rural banks in 2006 to 87 rural banks in 2007.

2.1.1 Historical Perspective

Prior to the establishment of Rural and Community Banks, the main sources of credits to the rural community including farmers and fishermen were money lenders and traders. These individuals provided credits at very high interest rates, hence making it difficult for some people to borrow. In the quest of the Government solving this problem, it expanded the operations of Ghana Commercial Bank and Agricultural Development Bank, Ghana to rural areas, especially cocoa growing areas in order to reach farmers and fishermen who were in need for credit facilities at a lower rate. The Commercial Banks made payments to these cocoa farmers and also took deposits which were further lent it

to the urban areas. A lot of these small scale farmers did not have deposit accounts with the commercial bank as well as suitable collateral securities for commercial lending (Steel and Andah, 2003). Credit coverage as provided by the Agricultural Development Bank was inadequate since only 27% of its branches were in rural areas and credit facilities to small farmers constituted only 15% of its total portfolio (Mensah, 1993; Ranade, 1994).

In the light of this, the Government through Bank of Ghana sent a delegation to the Philippines to acquire knowledge on rural banking. Community Banks were therefore established in these rural areas with the support of the Government of Ghana through Bank of Ghana to provide the business of microfinance and other financial services to rural areas. Also this reason among others necessitated members of some communities to come together to form Rural and Community Banks. In 1980's, in an attempt to support the Government's introduction of special checks instead of cash payment to farmers, more Rural and community banks were established (Aryeetey and Nissanke, 1998).

The country as at 1984 had a total of 106 Rural and Community Banks which was mainly as a result of the introduction of Akafo Check Operations in these rural areas (Nair and Fissah, 2010). In 1998, the number of rural banks increased rapidly to 133 but decreased to 111 in 1999 with the commissioning of one new bank and the closure of 23 distressed banks.

Today, there are 135 rural and community banks in Ghana which operate in several communities (ARB Apex Bank, 2014).

2.1.2 Legal Framework

In Ghana, the financial system is sub divided into two main categories. These categories are Banking and Non-Banking Financial system. Banking Financial Institutions include

the class one (1) Banks or Commercial Banks and Rural Banks while the Non-Banking Financial Institutions include the Savings and Loans, Discount Houses, Mortgage Finance and leasing companies (BOG Annual Report, 2007).

In Ghana, all banks including Rural and Community Banks are incorporated to carry on the business of banking under the authority of an issued license by the Bank of Ghana. These banks are regulated by the Banking Act 2004 (Act 673) as amended by the Banking (Amendment) Act 2007 (Act 738). However, Rural and Community Banks were not permitted by this law to carry on the business of foreign exchange operations as their clientele is drawn from the people within their local catchment areas. Non-Banking Financial Institutions which include susu collectors and other forms of financial service providers such as money lenders are regulated by the Non-Banking Financial Institutions Act, 2008 (Act 774) and the Banking Act, 2004 (Act 673) as amended by Act 738.

The Bank of Ghana, been the regulatory body, is mandated to supervise the banks and ensure good financial practices. It also sets regulatory capital for the banks and other forms of financial institutions. All financial institutions are required to maintain a primary reserve of 8% with the Bank of Ghana and additional 5% with ARB Apex Bank for rural banks. Financial institutions that violate this regulation are sanctioned as per the Bank of Ghana Act 2002, Act 612. As part of Bank of Ghana's responsibilities, it has the authority to undertake inspections of rural and community banks at least once every year to ensure that they abide by the statutory requirements and directives.

2.1.3 Role of Apex Banks

As more rural and community banks emerged over the years, problems including weakness in management, bookkeeping, inadequate communication, weak internal control and issue of non-performing loans occurred. In 1994, the Bank of Ghana stopped

rendering technical services which included cheque clearing, specie supply, treasury management and account maintenance to rural banks.

To eradicate these problems, improve performance and facilitate exchange of information among these rural banks, managers and directors of these rural banks jointly formed the Association of Rural Banks (ARB) as the Central Bank since Bank of Ghana was not in the position to help address their problems. The ARB Apex Bank was created to provide technical, managerial and financial support services to these banks.

ARB Apex Bank is a registered public limited liability company whose mission is to “provide both banking and non-banking support services to the rural banks with the aim of improving their operational efficiency and thereby transforming them into efficient financial institutions which could effectively address the banking needs of the communities in which they operate”.

ARB Apex Bank as part of rendering technical banking services also organize training to staff, provides computer software and hardware, provides communication support and helps develop financial products among others. Today the growth of this network has resulted in the establishment of more Rural and Community Banks in other rural areas.

2.2 The Bank and its Activities

The definition of banks lies in its core functions. The oxford dictionary defines a bank as ‘an establishment for the custody of money which it pays out on a customers demand’. Banks are financial institutions that act as intermediaries between savers and borrowers and help to ensure the smooth functioning of the economy (Gobat, 2012). It is the principal source of credit for millions of households as well as business firms. Banks motivate people to save and facilitate productive use of surpluses to generate

employment and promote economic welfare. To the economist, banks are described as the intermediaries between savers and users of capital.

As part of its traditional role, banks buy money, sell money and make money. Banks buy money by taking deposits and sell money by making investments with the deposits mobilized from customers into loans and advances or credits and securities which include treasury bills, government bonds etc. Banks handles people's money for the purpose of inculcating them to save and also profit from that when it is given out in the form of credits. Banks make credit available to different kinds of people for varied purposes (Saunders and Cornett, 2003). This mechanism is known as financial intermediation, the process of channeling financial resources between deficit and surplus units.

By making profit, the bank is said to be making money. With this, the bank is seen to contribute enormously to the growth of the economy of every country as it contributes to the standard of living of individuals. Banks make money on the spread between the interest they pay on deposits and borrowed funds as well as from the interest collected from borrowers and securities. They also make money through fees, commissions and securities they trade in. Also banks play a major role to evolving economies where most of its borrowers have limited access to capital markets (Greuning and Bratanovic, 2003). In other words, it is considered as the most important enabler of financial transactions in any country's economy and is the main source of credit (Rose, 2002).

The primary source of funding debt is through Bank finance. Banks improves the information problems between investors and borrowers by monitoring borrowers to ensure that depositors' funds are properly used (Allen and Carletti, 2008). As an important determinant of sustainable growth, Banks are also the essential part of the

modern economy, not only in terms of turnover but also as the primary financier of the national economy (Driga and Dura, 2012)

2.3 Types of Loans or Facilities

Loans are forms of credit that enable individual and corporate institutions to carry on their economic or operational activities (Dedu and Enciu, 2009). Loans are forms of credit offered that is not an overdraft but repayable on demand. Loans may generally be classified as short, medium or long term depending on its nature of fixed period with a fixed or variable interest rate charged on the amount borrowed.

2.3.1 Scheduled Loans

These are loans that are granted to borrowers for specific term which demands regular payments of principal and interest. The maturity period could either be medium or long term. It is a type of loan that is characterized by fixed repayment of principal and interest at regular intervals mostly on monthly basis over the life of the facility (Asiedu-Mante, 2011).

2.3.2 Term Loan

It is a type of loan or facility with maturity of usually three to five years. For this type of loans, only the interest is paid but no payment is made against the principal until maturity when the principal becomes due. It is usually taken by borrowers for medium or long term purpose of financing, for example, purchase of property, plant and equipment (Asiedu-Mante, 2011).

2.3.3 Overdraft

Overdraft refers to a type of bank facility where the borrower is allowed by the bank to withdraw over and above the available credit balance. Customers mostly arrange for

overdraft because it is used to cover short term financing requirements. It is mostly used for the purpose of factoring, buying individual needs, cover deficit of cash due to failure in receiving goods and services on time etc. The borrower agrees with the bank on the facility at an interest rate after which the bank gives a limit beyond which the customer cannot operate.

Again, loans could be further classified into commercial, education, manufacturing, transport, funeral, and personal among others (Asiedu-Mante, 2011).

2.4 Measurement of Loan Quality

Lending is the principal core business activity of all banks as the loan portfolio is the major asset to all banks as well as the main source through which the bank make more revenue. It is the greatest source of risk to the bank's safety and soundness. Loans are seen not to be of quality when borrowers do not make due payments related to them. Over the years, in Ghana, the influx of foreign banks and the emergence of local banks over the last decade have brought significant increase in the size of non-performing assets and increased the rate of credit default by borrowers (Bank of Ghana, 2006). This industry problem with loan portfolio has actually been the main cause of bank losses and failures. To maintain sound credit practices, management need to monitor the quality loan portfolio, examine the incidence of defaults, classify and make adequate provisions and implement recovery strategies.

Measuring loan quality requires examining various sources of growth and estimating the actual with quality ratios that are mostly used in assessing loan quality. Appraising borrowers helps credit officers to assess if the borrower is in the position to utilize the loan effectively.

To have efficient credit analysis to evaluate borrowers, financial institutions use the 5Cs model of credit (Abedi, 2000; Strischek, 2006). It is considered as the fundamental of successful lending as the use of this model helps banks to increase loan performance by knowing their customers better before transacting business with them. It is considered as the cornerstone of every lending decision (Murphey, 2004). The 5Cs include character, capital, capacity, collateral and condition.

2.5 Non-Performing Loans

The definition of non-performing loans is relative as what a country, depending on its regulations, consider as non-performing loan may be different from the other. It is considered as the major cause of economic stagnation. Pearson and Greef (2006) defined loan default as the point in time for which the borrower misses at least three installments repayments within a two year period. Loan default or non-performing loans can be explained as the inability of the borrower to comply with the loan obligation when due (Balogun and Alimi, 1990). In Kenya, it was revealed that, cases on non-performing loans or defaults were common to the manufacturing sector, followed by the service industry and the agriculture industry (Nguta and Guyo, 2013).

The problem of Non-Performing Loans has gained much attention in the recent years due to the rate of its increment among rural banks. This is because it has resulted in large number of bank crises in all forms of economies globally (Brownbridge and Harvey, 1998; Basel, 1999, 2004). Loans may be non-performing when it is used in a different way other than that for which it was taken. Loans are considered bad when they no longer yield interest income for a long period of time or the total amount including principal and interest are not paid within three months (Caprio and Klingebiel, 2002).

Loans are considered as non-performing when not paid at scheduled periods according to the loan agreement or contract. Non -Performing Loans remain as part of banks asset until it is finally written off. Under Basel II, loan pass due after 90 days are non-performing. These non- performing loans call for high rates of provisions (Hasan and Wall, 2004).

2.6 Classification of Loans and Advances

Banks review and assign loan portfolios to categories depending on criteria such as the number of days past due for payment, characteristics and perceived risk. Since non-performing loans have impact on the future cash flows of Banks, it is necessary to make provisions. It is important to classify or make accurate aging analysis for loans as grading loans improperly could lead to distortion in a bank's Statement of financial position in addition to overstatement of capital and capital ratios (Anglomkiew *et al.*, 2009).

According to ARB Apex Review of Performance of RCB for 3rd Quarter, 2014, in Ghana, the RCBs industry NPL ratio rose from 12.0% in June 2014 to 12.63% at the end of Sept 2014 and was above the major banks industry ratio of 12.09%. This indicates that non-performing loans have come to stay and as such has become necessary to monitor the quality of loans as well as setting appropriate level of provisions which is consistent with banking regulations.

In Ghana, there is a standardized criteria for identifying non-performing loans and as such has established minimum qualifying measures used for classifying loans and advances for all banks. According to Asiedu-Mante, 2011, the following are the classifications by Bank of Ghana.

2.6.1 Current

These are loans that are less than 30 days past due. In other words their repayment periods are not yet due and are up to date on interest and principal payments. The general provision for such loans is 1%.

2.6.2 Other Loans Especially Mentioned (OLEM).

These are loans which are more than 30 days but less than 90 days past due. They constitute too much credit risk and are potentially weak. It is characterized with slow repayment of principal and interest. The prudential norm in making general provision is 10%.

2.6.3 Other Classification

There are other three categories of loan provision which are the substandard, doubtful and loss. These together are known as Non-Performing Loans. An increasing trend depicts development of hardcore portfolio arising from weaknesses in the credit management process. Substandard are more than three months overdue but less than six months. These types of loans are usually given to borrowers who are unable to meet their operating expenses due to insufficient working capital. Other evidence of such loans includes little or no repayment, interest and principal payments in arrears indicating signs of loan default. Provisioning of these loans is at 25%.

Loans classified as doubtful is also a category of loan whose possibility of loss is very high but due to certain factors that may work to strengthen the advance, its classification is considered doubtful until its exact status are determined. It shows signs of non-recovery. Doubtful loans are between 180 and 365 days overdue. Provisioning of these loans is at 50%.

In the case of loss category of loans, loans are considered as such when their recoverable advances are not justifiable. These loans are not absolutely bad since partial amounts could be recovered through intensified and exceptional efforts in future. Bankrupt companies and insolvent firms who have loans with banks are considered as loss. These loans are more than one year overdue. Provisioning of these loans is at 100%. This means that as more loans turn bad, there is the need to make higher provisions to cater for it.

2.7 Causes of Non-performing loans

Over the years, the quality of most loans across many countries remained relatively stable till the global crisis emerged in year 2007 to 2008. Some researchers have established Gross Domestic Product (GDP), exchange rate and lending rate to be factors that significantly affected loans in becoming non-performing. Loans and Advances represent the primary source of income to all banks. Due to this, the banks seek to maximize its profit or returns by giving more loans as it is more profitable compared to any other assets. In some situations, these loans get defaulted, hence non-performing making it difficult for the banks to make profit (Paterson and Wadman 2004). Since loans are important assets to banks, it is necessary to establish the factors that cause non-performing loans. It has been considered in some studies in other countries that failure of banks can be caused by non-performing loans (Brownbridge, 1998).

2.7.1 Diversion of Funds for Different Purpose

Some findings suggest that non-performing loans arise when funds borrowed are used for purposes different from what was agreed on (Richard, 2006). Added to this, Ahmad (1997) indicated that willful default together with diversion of loans and improper credit appraisal are factors of loan default. Also loan default or non-performing loans occurs

when the borrower does not comply to the terms of loan (Murray, 2011). The major factor identified to result in loans becoming non-performing included customers' failure to give vital information during the loan application process and lack of the requisite skills amongst loan officials (Santomero, 1997).

2.7.2 Asymmetry of Information

Lenders are considered mostly to have less information on borrowers because of the lack of transparency and integrity on the part of some borrowers. The concept of information asymmetry where the borrower has more information than the lender results in moral hazards and adverse selection problem making it challenging to distinguish bad borrowers from good ones (Auronen, 2013). Non-performing assets (NPLs) in banks may increase when there is the problem of adverse selection and moral hazards (Bester, 1994; Bofondi and Gobbi, 2003). Palubinskas and Stough (1999) noted that lack of dependable financial information on borrowers to help in assessing creditworthiness causes a bank failure.

2.7.3 Poor Management Procedures

A number of factors identified according to Kohanasal and Mansoori (2009) as causes of Non-Performing Loans included loan diversion, willful default by borrowers and poor management procedures. Brownbridge (1998) found out that moral hazards also contributed to bad debts or non-performing loans in banks as some banks fail to adopt prudent lending strategies and still lend to certain borrowers who are willing to pay higher rates although they are undeserving. Some findings also suggest that, the major factor that cause loans to become non-performing include diversification of funds and weak credit analysis. According to Allan and Olomi (2003) it was stated that banks are not fully resourced in terms of capacity for credit and risk management, hence

suggesting that trainings obtained may not be adequate or probably there are few staff to do effective supervision and monitoring. Mamman and Oluyemi (1994) in Nigeria, stated that, huge non-performing loans are as a result of managers and directors' lack of expertise and experience in doing credit appraisals.

However this conflicts with the findings of Waweru and Kalani, (2009) in Kenya. They established unfavorable economic environment as an important factor that caused NPLs. In the research study conducted by Berger and De Young (1995), it was found out that, the main causes of loan defaults in the industrial sector was improper selection of entrepreneurs, unrealistic terms and the schedule for loan repayments, absence of measures in following up of borrowers, natural calamities and lack of adequate collateral security.

2.7.4 Inflation

Non-performing loans are caused by inevitable factors including unexpected price changes for products such as fuel and changes in foreign exchange rates and interest rates (Gorter and Bloem, 2002). According to Berge and Boye (2007), real interest rates and unemployment were also found to be causes of non-performing loans. Added to this, Vandel (1993) confirmed interest rates charged by Banks to contribute to loan defaults by borrowers.

2.7.5 Time of Disbursement

Another factor that causes non-performing loans is the time at which loans are disbursed to borrowers. Most at times financial institutions take so long a time to disburse loans to successful applicants and such make the funds available to borrowers at the time that the funds may not be much needed. This has had so many effects on borrowers especially farmers, whose businesses are seasonal or in line with the weather conditions, hence

delaying their planting season and subsequently not making enough profit that could be used to service loans as scheduled (Sheila, 2011).

2.7.6 Repayment Period

The time given to the borrowers by lenders to make repayment of loans is usually too short therefore resulting in default in payment of amount borrowed (Sabato, 2009). That is borrowers put the money into business, at the time that lenders may also be demanding repayment of loans, hence affecting working capital as they are left with no other option than to retrieve the money to repay the loans.

2.8 Effects of Non-performing Loans

Non-Performing Loans are one of the potential problems that may lead to economic and financial instability in banks and countries at large. The higher the non-performing loans, the more the Bank make losses and this include loss of principal and interest, decreased cash flow, and increased collection or recovery cost. Giving out more loans initially may not seem problematic but with time may have series of problems on the bank when most of the loans turn out bad.

According to Karim *et al.*, (2010), Non-Performing Loans is often associated with high operational cost which affects the capital growth of banks. Confidence is an important value that banks must offer in order to get the patronage of customers and other stake holders. Non-Performing Loans reduces investors' confidence in doing business in the banking system, hence discouraging them from making reasonable investments (Somoye, 2010).

Further to this, it was also indicated that loans are necessary to improve the performance of banks. However, if non-performing loans occurs over a period of time, the resources

become locked up in sectors that are not profitable (Demirguc-Kunt and Detragiache, 1998) and this mark the beginning of bank failure (Reinhart and Rogoff, 2010). Added to this, Greenidge and Grosvenor (2010) argued that the extent of non-performing loans is a major contributor to the occurrence of financial and banking crises.

Excessive pile up of non-performing loans worsens the quality of banks' loan quality and this becomes a major cause of financial weakness. Caprio and Klingebiel (2002) stated that, in Indonesia, over sixty banks were unsuccessful in 1997 as a result of 75% of total loans been Non-performing loans.

Non-Performing Loans reduces the capital resources of banks which in turn affects their ability to grow and develop their business. Further to this, it makes it more expensive or more difficult to raise capital as non-performing loans increase the banks cost of borrowing in the whole sale market (Taylor, 1993).

As stated in the section 30 (1) (b) of the Banking Act 2004, on the restrictions on declaration of dividend, banks shall declare dividend on its shares only when adequate provisions for non-performing loans and other erosions in assets values have been made. In order words, non-performing loans affect the amount to pay as dividends to share holders, hence having a negative impact on investors earning which consequently have effect on achieving the minimum capital for operation.

2.9 Strategies for Minimizing Non-performing loans

Financial Institutions face enormous risk of non-performing loans all over the world. Due to this, it is advisable for financial institutions to come out with mechanisms that could be used to monitor behavior of borrowers. Eradication of non-performing loans seeks to help improve economic status. In Japan, different strategies were employed by Commercial Banks in an attempt to minimize the loss as a result of Non-Performing

Loans. Pursuing a lending strategy supported by appropriate credit risk was one of the strategies (Waweru and Kalani, 2009). Also in Kenya, banks desisted from focusing on security based lending and depended on customer's ability to repay loan. Interest rate was reduced and was noted to be a successful measure by the bank's management. Other strategies indicated to have helped reduced Non-Performing Loans were; proper appraisal of borrowers which was based on cash flows, forecast, feasibility studies and credit limit ratios (Waweru and Kalani, 2009).

Some researchers also indicated that bad loans can be minimized by ensuring that loans are given to borrowers who are not likely to be insolvent, in other words, borrowers with the ability to make repayment. Also credit analysis on borrowers should be undertaken to reduce credit risk and to reach a good lending decision (Kay Associates Limited (2005). The process of granting loans can begin by collecting adequate information on borrowers for the purpose of coming out with credit limits, hence having adequate appraisal can help minimize or control the loan default (Shiela, 2011). Loans cannot be given to borrowers without having effective monitoring policies in place. According to Warue (2012), financial institutions including MFIs need a monitoring system that will bring to light repayment problems clearly and quickly so that credit or loan officers could dwell much attention on loans before they become bad. A good on site credit monitoring which involves paying the borrower visits at least every quarter to ensure that the amount disbursed has been used for the intended purpose as stated in credit application letter is necessary in ensuring that non-performing loans are minimized. At the visit, credit officers are required to find out from borrowers how business is/are going and to examine records if borrowers are meeting targets (Asiedu-Mante, 2011).

In order to control the rate of non-performing loans or defaults, Anjichi (1994) indicated that bad loans could be avoided through good supervision which helps in maintaining

good loan. This can be done through visiting the premises of the borrower and checking the state of affairs together with finished goods. This was confirmed in a study conducted by Bigambah (1997). In this study, it was observed that regular monitoring help to ensure that clients maintain their business and also repay the loan.

2.10 Liquidity Management in Rural Banks

Liquidity management practices involve instituting policies and procedures to ensure that loans get to the right people, proper authorities grant the credit, the appropriate size of credit is granted and credit granted is recoverable (Asiedu-Mante, 2011). The Basel Committee on Banking Supervision (2008) also defined liquidity as the ability of a bank to fund increases in assets and meet obligations as they come due, without incurring unacceptable losses.

Having an effective liquidity risk management ensures that the bank meets its cash flow obligations. It is an important internal determinant of bank profitability among others which includes capital adequacy, credit risk, expenses management etc in addition to industry macroeconomic variables (Said and Tumin, 2011). According to Greuning and Bratanovic (2009), the price of liquidity is a function of market conditions and the market's perception of the inherent riskiness of the borrowing institution. Schmidt and Roth (1990) describe risk as the performance of activities designed to reduce the negative impact (cost) of uncertainty (risk) regarding possible losses. Added to this, Bessis (2010) indicated that, apart from risk management being a process, it also involves a set of tools and models for measuring and controlling risk.

Decker (2000) also classifies liquidity management into two forms namely funding liquidity risk and market liquidity risk. Banks create sound risk management environment by minimizing the impact of uncertainty and potential losses and direct

capital to activities that best reward. The aim of risk management is to measure risks in order to monitor and control them to help serve other important functions (Bessis 2010).

Banks or lenders in the quest of ensuring sound liquidity management practice are also required to ensure that the financial position is sound and funds lent are safe. In that, the borrower has the capacity to borrow and provide security required. In addition the borrower is expected to have the ability to meet repayment schedules when they fall due. Again, banks may invest a percentage of its resources in a short term liquid assets to provide a buffer against liquidity shocks that are likely to happen in future (Holmstrom and Tirole, 2000).

The liquidity risk of banks can be measured from the statement of financial position by dwelling more on the liquidity ratios. However, using this practice is not the solution to the liquidity problem (Poorman and Blake 2005). In measuring liquidity exposure faced by banks, peer group ratio comparisons, liquidity index and other indicators are to be measured (Saunders and Cornett, 2006). Since all banks are affected by changes in the economic climate and market conditions, monitoring of economic and market trends is the key to liquidity risk management (Basel, 2000). Failing to have a good asset quality, strong earnings and sufficient capital may cause banks to fail or fold up if it does not maintain adequate liquidity (Crowe, 2009). Contagion risk makes it possible for a bank which is registered in the minds of customers of liquidity crisis tends to have negative repercussions over the whole banking industry. Liquidity management plays an important role in survival and growth or otherwise of financial institutions, thus the need for banks to plan certain estimates, conduct effective monitoring and portfolio analysis to determine the risk involved in granting credits to borrowers.

2.11 Capital Adequacy

Customers of banks lose confidence in banks when the banks become insolvent since insolvency further leads to financial problems. The concept of capital adequacy basically relates to the inherent risks underlying banking business to maintain a stipulated unimpaired capital as support. In other words, complying with minimum capital adequacy ratios helps to promote the stability and efficiency of the banks by reducing the likelihood of banks becoming insolvent.

According to section 23 (1) of the Banking Act 2004, banks are required to maintain capital adequacy ratio of 10%. When a bank has a capital adequacy ratio of more than the minimum requirement of 10%, the bank is assumed to have a strong appetite to assume risks as compared to banks with low capital base. Any ratio below this set limit implies that, the bank is unsatisfactory and demands urgent attention for its correction.

Banks are expected to send to Bank of Ghana their capital adequacy return or BSD 5R every month at a time limit of 21 days. The returns present the capital adequacy position of rural banks as at the end of the reporting month. The risks considered in the calculation of capital adequacy ratio for rural banks include credit and operational risk. Market risk is not considered because in the case of rural banks and Community banks they do not deal in foreign exchange transactions. To calculate this ratio, both the Tier 1 and Tier 2 capital as well as the capital adjustments are considered. The formula is;

$$\text{CAR} = \frac{\text{Unimpaired / Adjusted Capital Base}}{\text{Risky Assets / Adjusted Total Assets}}$$

Capital adequacy ratio has been provided as an international standard to ensure that banks absorb a reasonable level of losses before becoming insolvent. It serves to protect depositors as in the case of winding up, customers' deposits rank in priority before capital

and also promote the stability and efficiency of the financial system. An indication of a ratio of 10% or more implies that the bank is risk averse and therefore not lending to the economy where the risk is high.

It is therefore important to have enough capital to be able to provide the services of a financial institution. Rural banks must therefore open their doors to investors for more capital injection (Business and Financial Times, 2015).

2.12 Credit Management or Administration in Rural Banks

The major source of revenue to the rural banks is through the credit or loans they give to borrowers. It is this main source of revenue that poses the highest risk to the banks due to the high default rate among borrowers. It is difficult to completely eliminate this risk though it is diversifiable. Due to this, there is the need to have sound risk management practices on the part of rural banks. This is because effective management is an important tool to the success of rural banks in the long term (Andersen and Terp, 2006). The findings from Afriyie and Akotey (2013) indicated that non-performing loans correlates positively with profitability of rural banks. They realized that despite the high loan losses, banks still earn profit though theoretically profitability should be minimized by these bad loans.

Credit administration seeks to put down some measures to reduce default or credit risk. Hence, it is necessary for banks to identify measure, monitor, control and determine adequate capital to support itself against the risk of default. Asiedu-Mante (2011) indicated that typically credit administration unit according to that rural banks perform the following functions:

2.12.1 Credit Application

This is the first step in the credit administration process where the borrowers either writes a letter or pick a standard loan application form from the bank. Information including name, address, purpose, account number, amount, source of repayment and time to contract the loan should be outlined in the form. This should be duly endorsed by the applicant. Groups and unions as well as associations should have their forms or application letters duly endorsed by members of the executive board especially the chairman and secretary authorizing them to borrow.

2.12.2 Credit Appraisal

Appraising the application of the borrower helps identify whether the applicant has the capacity to borrow or not. That is whether the individual is not a minor and in the case of group, association, society and company are within the laws of Ghana. Also, this process serves as a guide on the part of the bank to identify how long they have had business with the borrower and also finds out if the borrower can generate enough revenue to service the loan. Security for which the bank can rely on for the repayment of the loan on the event of the borrower inability to repay the loan is also considered during the appraisal stage. According to Murphy (2004), it is the cornerstone of every lending decision.

2.12.3 Credit Disbursement

Disbursement of credit to borrowers is only effected after it has been approved by the appropriate authorities. Credit approval, involving two stages; gathering relevant information and determining credit worthiness is the process of making a decision as to whether or not to extend credit (Ross *et al.*, 1999). It is followed after the offer letter which contains information such as the amount approved, repayment tenure, interest rate

and other charges among others is given to the borrower. The borrower upon receipts of this letter writes to the bank to accept the terms and conditions stated in the offer letter. Disbursement of loans could either be in bulk or in tranches.

2.12.4 Credit Monitoring

Monitoring of credit could either be off-site or on-site. It involves checking the records and regular monitoring of loan schedules and visiting borrowers work premises to ensure that the amount disbursed has been used for intended purpose. Also monitoring helps detect deviations from terms of decision.

2.12.5 Dealing with credit default

Default of loans arises when borrowers refuse or delay in the repayment of loans. When a borrower defaults, his or her guarantors are first notified after which any credit balance held as cash lien is taken to offset the loan. In some cases, the legal advisor of the bank may also issue a demand notice to initiate the takeover of the property offered as security. It is very important for banks to open credit files for each borrower. The file should contain information such as the application letter, appraisal reports, offer letters, acceptance letters, security documents, monitoring reports and demand notices. Filing these information in an organized way will ease the work of internal and external auditors.

2.13 Performance Indicators

Berger and Humphrey (1997) asserted that the whole idea of measuring bank performance is to detach banks that are performing well from those which are not performing well. Ratio analysis is an analytical tool that is used to provide insight into the performance of banks. It shows the true state of affairs of the performance of any business. It helps to determine whether a company is financially healthy and solvent,

determines the risk attached to its financial structure and to analyse the returns for its shareholders and other stakeholders. Traditionally accounting methods primarily based on the use of financial ratios have been employed for assessing bank performance (Ncube, 2009).

2.13.1 Profitability

It is the most common measure among others in assessing the performance of banks. It is the key determinant for all users of financial information. Assessing the profitability of the banks give a direction to how successful the managers have been in generating profits for the bank. Included in the profitability ratios are Return on Assets, Return on Equity, and Cost to Income ratios.

2.13.1.1 Return on Assets

This shows the ability of management to acquire deposits at a reasonable cost and invest them in profitable investments (Badreldin, 2009). It is calculated as net profit/total assets. The ratio explains how much net income is generated on per unit of assets and the higher the ratio, the better it is for the bank.

2.13.1.3 Return on Equity

This is an indication of banks growth potential and profitability. It is the percentage of return on each unit of equity invested in the bank. Return on Equity (ROE) is measured as net profit/ total equity.

2.13.1.4 Cost to Income Ratio

This ratio is used to review the operational efficiency of the bank. It can be measured as total cost /total income. It measures the income generated per cost. The lower the ratio, the better for the company and this is confirmed by Hess and Francis (2004) who

observed that there is an inverse relationship between the cost income ratio and the bank's profitability

2.14 Liquidity

Liquidity ratios, also known as solvency measures the ability of banks to meet its financial obligations when they become due. It determines the short term viability of a company. It is very essential for all financial institutions to have a certain measure of liquidity to help its every day operations. . Ratios under this category include the following;

2.14.1 Liquid assets to Total Assets

This is the percentage of short term financial obligations of the bank that could be met with its liquid assets in the sudden withdrawals of customers occur. It is measured as Liquid Assets/ Total Assets.

2.14.2 Loans and Advances to Deposit

This ratio is used to measure the ability of banks to cover withdrawals made by its customers, hence used to determine the short term viability of the bank. It is very essential for all financial institutions to have a certain measure of liquidity to help its every day operations. It is calculated as Loans and Advances/ Total Deposits. The higher the ratio, the more the bank is seen to rely on borrowed funds.

2.14.3 Net Loans to Total Assets

This is the percentage of assets that is locked up in loans. A high ratio indicates that the bank is less liquid. It is calculated as Net Loans/ Total Assets.

2.15. Asset Quality

Banks in their day to day activities are expected to make losses. However, it is important for these banks to minimize losses (Casu *et al.*, 2006). Asset Quality is measured by the ratio of a particular category of loans to the gross loans of a financial institution. The asset quality or credit quality of loans can be measured using loan loss Provision to Gross Loans and Non-Performing Loans to Gross loans, all expressed as percentages. These ratios indicate the proportion of total loan portfolio that has been set aside but not charged off.

CHAPTER THREE

METHODOLOGY AND ORGANIZATIONAL PROFILE

3.0 Introduction

This chapter present detailed idea about how the research was conducted. It explains the research design, research approach, sources of data, sampling technique adopted, sample size selected data collection methods and data analysis techniques used. In addition to the methodology is the profile of the case study which includes its history, mission, vision, and business strategy.

3.1 Research Design

The primary research objectives have been “to examine the nature of non-performing loans at Bosomtwe Rural Bank Limited; to identify the causes of non-performing loans and its effect on the performance of the bank and finally to examine strategies used in minimizing non-performing loans in this bank”.

Research design in general refers to how the study questions were answered. Cooper *et al.*, (2003) defines research design as the process of focusing on the researcher’s perspective for the purpose of a particular study. Saunders *et al.*, (2011), propose three types of research design; exploratory, explanatory and descriptive.

Both descriptive and explanatory approaches were used in this study. In this part both qualitative and quantitative information were needed to answer the research questions mentioned. The survey approach was also adopted to help collect information which was analyzed quantitatively to generate data which was used in the analysis. Both primary and secondary data were used.

3.2 Sources of Data Collection

Both primary and secondary data were collected for this study. The type of data, sources and techniques in gathering information are as follows:

3.2.1 Primary Data

The primary source of data information was gathered through administration of questionnaire and the use of interview guide. The questionnaires were used to get unbiased opinion of respondents and the interview guide was used to obtain clarifications on unclear issues.

3.2.2 Secondary Data

The secondary data used was the published annual reports and financial statements of Bosomtwe Rural Bank Limited were used. The information covered a period of five years from 2009 to 2013. This category of data was mainly found in the print for public consumption. The data collected contained useful information needed to answer the research questions like loan portfolio of the institution, provision and charge for credit impairment loss together with profitability during the five-year period. Also other literature sources which included books, journals, articles, internet sources and other reliable secondary data sources such as the website of the bank was used. These sources were useful in the review of the literature and it served as basis for the analysis of the data collected.

3.3 Population of the Study

The population for the study included management and credit officers of Bosomtwe Rural Bank Limited. The reason for using this category of people was because most of them have rich experience in loan default by customers due to their long service to the

bank as credit officers and as such can respond better to the questionnaires and interview questions.

3.4 Sample Size

Thirty credit officers and management staff from the entire population of the employees of the bank were purposively drawn. This forms about 25% of the total employees of the bank. These were made up of credit officers at the head office, branch managers and other management staff across all the branches. These people were experts in the administration of loan. The research work avoided personal biases as selection of officials were drawn from different units of the bank. That is at the head office, one credit officer and two officials were selected as respondents. Also at the branch level, twenty seven officials including credits officers with at least two years of experience were selected for the data collection.

Stutely (2003) believed that, effective statistical study required a minimum of 30 samples hence a sample size of 30 is enough to be a representative of management and credit officers of the bank.

3.5 Sampling Technique

The study used purposive sampling technique method to select management from Bosomtwe Rural Bank Limited. In addition, because of proximity reasons, convenience sampling technique was adopted in selecting 5 out of 10 branches.

3.6 Data Collection Instruments

Sources of primary data used for the study were questionnaires and interview guide that helped obtain empirical and complete data to facilitate deeper understanding of the topic. Journals, publications, articles, books and financial statements and reports were also used

as reference materials for the study. The interview was semi-structured to allow for favorable discussion

3.7 Method of Data Analysis

Data gathered from the study was analyzed using critical analysis and examinations which helped in giving appropriate recommendations. The responses from the questionnaire were grouped into various themes in line with the research objectives and analyzed together appropriately and sequentially. For analysis purpose, the responses were coded into the Statistical Package for Social Sciences (SPSS) software. Frequencies and pearson correlation analysis were done. The statistical tools used helped conveyed the meaning of the figures captured and as such made the analysis comprehensive. The outcome of the interview was analyzed qualitatively.

3.8 Ethical Consideration

Research ethics provide researchers with a code of moral guidelines on how to conduct research in a morally acceptable way (Struwing and Stead, 2001). Almost every financial institution has strict policy on confidentiality and one can pay the ultimate price for the breach of this duty of confidentiality. A letter from the business school was initially taken and sent to the Bosomtwe Rural Bank Limited. Also an assurance was given that the information is for academic purpose and that the data will be handled professionally. Confidentiality of information collected from interviewers were preserved and ensured that their identities were not disclosed. In addition to the above, plagiarizing the works of others and republishing data as original contribution without proper acknowledgement was also avoided.

3.9 Organizational Profile

3.9.1 Brief History

Bosomtwe Rural Bank Limited was established out of response by the Bank of Ghana to the appeal of farmers and petty traders in Kuntense and its surrounding villages. In the past, farmers and traders in Kuntense and its catchment areas had to travel over long distance of about 48 kilometers to cash their Akuafo Cheques at the Ghana Commercial Bank, the nearest bank located at Bekwai. Bosomtwe Rural Bank Limited was incorporated in Ghana in November 1981 under the Ghana Companies Code 1963 (Act 179) and commenced business in 1982. The bank was authorized to carry on the business of banking under the Banking Act, 1970 (Act 339) on 9th December 1982. It was named after the only natural lake in West Africa, Lake Bosomtwe in the Bosomtwe District of the Ashanti Region.

3.9.2 Ownership and Focus

The Bank is a public limited liability company, and for that matter, relies on funds collected from individuals and corporate institutions.

Vision Statement

The bank's vision is to be a leading and efficient rural bank in its target market and provide tailored customer services.

Mission Statement

The Bank's mission is to be a reliable rural financial intermediary capable of mobilizing idle resources to support viable economic ventures in its catchment area as a way of promoting growth and development so as to meet the expectations of all stakeholders

Objectives

The objectives of the Bank include:

- To provide quality, prompt and efficient banking services to its clients
- To work profitably to ensure the payment of good returns on shareholder funds
- To promote the socio-economic development of its operational areas
- To develop the banking culture of the people in its operational areas
- To develop the banking skills of both staff and directors of the Bank
- To improve the quality of life of people in its operational area
- To be generally seen as an instrument which propel social and national economic development of Ghanaians

3.9.3 Achievement

The bank has proven to be one of the successful top ranking rural financial institutions in the Country. The bank has continued its membership with Ghana Club 100, a rating of the best 100 corporate organizations in the country. It also received the Gold Award at the 10th Ashanti Financial Services Awards organized under the auspices of Manhyia Palace in July 2013. Further to this, it has also given scholarships to the brilliant but needy students in the community where the banks are located. The security services, especially the police, have had their fair share of the support.

CHAPTER FOUR

ANALYSIS AND DISCUSSION OF FINDINGS

4.0 Introduction

This chapter covers the presentation, analysis and discussion 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. The core objective of the research is to identify the impact of non-performing loans on the performance including profitability, liquidity and asset quality of Bosomtwe Rural Bank Limited. The chapter also touches on the nature, causes and effects of non-performing loans on the performance of the bank and also identifies strategies that can be put in place to minimize its occurrence. Generally, the chapter plays an essential role in the entire research work as it relates empirical data to secondary data reviewed in previous chapters.

4.1 Analysis of the Nature of Non-performing loans

This analysis below is to establish the nature and trend of non-performing loans for Bosomtwe Rural Bank Limited for the period under consideration. The aggregate credit impairment loss has been used for the analysis instead of calculating the trend using both the categorization and number of days since that information was not released by the bank.

According to the Bank, loans are considered non-performing when loans are not repaid at the scheduled times or paid after the maturity period. That is not only are loans termed bad when not repaid before maturity but also when scheduled times of repayment are defaulted.

Figure 4.1 depict the trend of the yearly credit impairment loss of the bank over the past five years

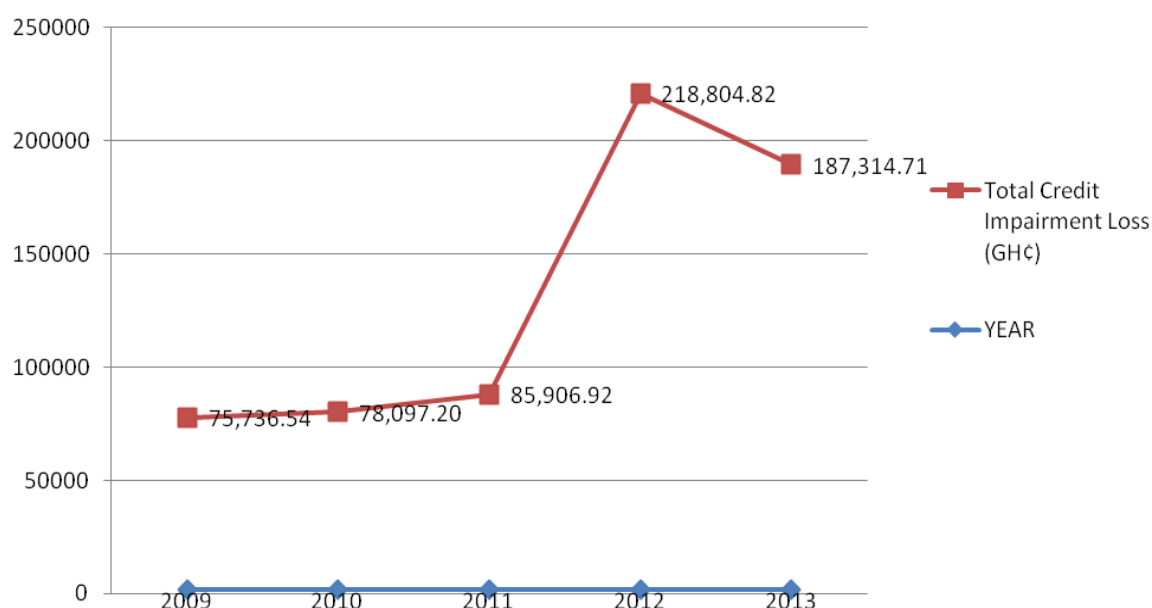


Figure 4.1 Trends in Credit Impairment Loss

Source: Annual Financial Statement (2009-2013)

Figure 4.1 shows a steady rise in credit impairment loss from 2009 to 2011. The rise from 2009 to 2010 reflects the worsened NPL ratio from 16.2% to 17.6% by the Central Bank of Ghana (Bank of Ghana report, 2010). However, there was a sharp increment in 2012 by 154.70%. This can be attributed to the fact that loans and advances increased by GH¢3,443,728.7 representing about 40% over 2011 as stated in the chairman's financial report for 2013. In 2013, credit impairment loss reduced by 26.39% despite an increase of GH¢402,237.95 (3.33%) in loans and advances. The Bank established of a loan recovery team of a staff and a credit officer, provided them with appropriate logistics and tasked them to mainly recover loans in 2013. This accounted for this observation.

4.2 Factors that cause Non – Performing Loans

This section analyzes and discusses the responses given by the respondents from the questionnaires and the conduct of the interview. Several reasons were given by the respondents in relation to the factors that cause Non – performing Loans. Majority of the responses given as the cause of non – performing loans were similar and in some cases were given by all respondents. The bank's main specific cause of bad loans identified by the interviewees and the respondents included; loans not used for the right purpose, unwillingness to make repayment of loans, lack of financial information to enable bank to its credit assessment, changes in inflation, poor monitoring of loans, untimely release of loans and poor credit appraisal.

Table 4.1 Causes of Non-Performing Loans

Factors that hinders repayment of loans	Mode	Frequency	Percentage
Loans are not used for the stated purpose	4	12	40
Unwillingness to make repayment of loan	5	19	63.3
Lack of financial information to enable bank do its credit assessment	5	22	73.3
Changes in Inflation	1	15	50
Poor monitoring of loans	5	19	63.3
Untimely release of Loans	4	20	66.7
Poor Credit appraisal	5	14	46.7
TOTAL		121	

4.2.1 Loans are not used for the stated purpose

One important reason that hinders payment of loan is when loans are not used for the stated purpose. The study revealed that out of 30 respondents, 12 respondents agreed that, loans are not used for the stated purpose. This means majority (40%) of

management and credit officers in charge of loans believed that loans that were given to customers were not used judiciously for the stated purpose. Such customers may expend the loan on social activities or may gamble on the exact business to invest the loan. This implies that, customers who are afraid of not getting the loan because the actual purpose will not guarantee getting the loan hide behind ideas to contact loans and later divert it to purposes different from reasons stated in the terms of contract. The risk of the loan ending up in the hands of such customers is termed Moral Hazard. Aballey (2009) indicated that customers use loans for different purposes other than what was agreed on in anticipation of higher returns. This confirms some findings which suggest that non-performing loans arise when funds borrowed are used for purpose different from what was agreed on (Richard, 2006).

4.2.2 Unwillingness to make repayment of loans

From Table 4.1 and appendix I it was clear that unwillingness on the part of the customer to make repayment of loans is a major factor that contributes non-performance of loans as 63.3% and 23.3% of the respondents strongly agreed and agreed respectively. Only one of the respondents (3.3%) disagreed to this. According to the respondents some of the borrowers willfully default loans for no apparent reason though they are in the position to repay the loan. This confirms the findings of Ahmad (1997) which revealed that, the lack of willingness to pay among other factors causes loan default. However, this was inconsistent with the findings of Arko (2012) where customers were the respondents. This means that as officials perceive customers as just unwilling to make repayment, customers disagree.

4.2.3 Lack of financial information to enable bank do its credit assessment

Twenty two (22) of the respondents representing 73.3% strongly agreed that absence of financial information on the part of the borrower leads to occurrence of loan default as this does not enable the bank do proper credit assessment. According to Palubinskas and Stough (1999) inadequate financial information on borrowers to help in assessing creditworthiness causes bank failure. This corroborates the findings of this study. This may be as a result of the informal sector that dominates the economy and as such does not engage the services of accounts clerks. Hence customers' lack of proper book keeping skills which include records on daily sales, daily expenses and other forms of transactions which the bank relies on to make good credit assessment.

4.2.4 Changes in Inflation

Gorter and Bloem (2002) revealed that, change in fuel prices and foreign exchange rates inevitably affect borrowers' ability to make repayment of loans. However, majority of the respondents (50%) strongly disagreed that change in inflation causes non-performing loans. Only 7 (23.4%) were in support that it influences customers' ability to make repayment as shown in appendix I.

4.2.5 Poor monitoring of loans

This study emphasized that poor monitoring is a major cause of non-performing loans in the bank as 63.3% of the respondents strongly agreed and 20% agreed as indicated in appendix I. This is consistent with the findings of Arko (2012) in which the lack of effective monitoring was ranked as 1st among other causes of NPLs. The respondents added that there is the need for constant monitoring to ensure that borrowers comply with the terms and conditions as stated. Nonetheless, credit officers are unable to undertake on-site visits to the borrower and also the problem of ineffective monitoring

could be attributed to inadequate resources such as under-staffing and logistics which are all needed to make effective monitoring of each customer. One of the respondents hinted that, some credit officers may just ignore some customers when they feel that project site is not accessible.

4.2.6 Untimely release of Loans

Wrong timing for the release of the requested loan as a cause of non-performing loans was agreed by 66.7% of the respondents. This outcome is also shared by Sheila (2011) and Aballey (2009) which showed that, untimely release of loans tend to be unfavorable especially customers whose business are seasonal or time bound may not find much use for the loan at the wrong time. The reason that accounts for this delay is mostly due to the bureaucratic approval procedure that the bank has to follow before disbursing the loan.

4.2.7. Poor Credit appraisal

Ninety percent (46.70%) of the respondents were of the view that poor credit appraisal techniques on the part of the credit officers before the release of loans accounts for NPLs as shown in appendix I. This corroborates the report by Ahmad (19997) which indicated that improper credit appraisal among other factors as causes of non-performing loans. The cause for the poor appraisal as indicated by some respondents was due to the non-disclosure of important information on the part of the borrower during the application process. Since this is inevitable, there is always the risk of the loan getting into unsafe hands (adverse selection). As indicated by santomero (1997), poor credit appraisal may also be as a result of lack of proper skills among some loan officials.

4.3 Analysis of the Effects of Non –Performing Loans on the Performance of the Bank

4.3.1 Non-performing loans and Profitability

The analysis is to assess the impact of credit impairment loss on the profitability of the bank. Table 4.2 below shows the effects of credit impairment loss on operating profit and returns to the bank over the five year period considered.

Table 4.2 Effect of NPL on performance of bank

YEAR	OPERATING PROFIT BEFORE CREDIT IMPAIRMENT LOSS	CHARGE FOR CREDIT IMPAIRMENT LOSS	OPERATING PROFIT AFTER IMPAIRMENT LOSS	RATIO Of CREDIT IMPARMENT LOSS TO OPERATING PROFIT	RETURN ON ASSETS	RETURN ON EQUITY
	GH¢	GH¢	GH¢	%	%	%
2009	651,971.91	75,736.54	576,235.37	11.62	4.24	32.25
2010	702,465.72	78,097.20	624,368.52	11.12	3.53	30.27
2011	831,344.40	85,906.92	745,437.48	10.33	3.21	28.02
2012	1,128,179.29	218,804.82	909,374.47	19.39	2.51	25.96
2013	1,344,111.65	187,317.71	1,156,793.94	13.94	3.82	27.80
TOTAL	4,658,072.97	645,863.19	4,012,209.78	66.40		

From the table, operating profit reduced by 11.62%, 11.12%, 10.33%, 19.39% and 13.34% for 2009, 2010, 2011, 2012 and 2013 respectively. From 2009 to 2010, the ratio of credit impairment loss to operating profit decreased marginally and further decreased significantly in 2011 which was the least impact of bad loans on the bank for the stated period.

The ratios further point to the fact that bad debts reduced operating profit of the bank by 19.39% in 2012 which was the greatest impact of bad debts within the period under consideration. This was as a result of the high provisions caused by massive non-performing loans.

However, the year 2013, recorded a significant decrease in the ratio of credit impairment loss to operating profit. This was attributed to an intensive loan recovery team that was setup in the year.

During the period, the total operating profit of GH¢ 4,658,072.97 was reduced by bad debt figure of GH¢ 645,863.19 representing 66.40%. On the whole, there was an overall negative impact of bad loans on the operating profit of the bank. The high credit impairment loss emanated from high loan losses recorded in the period.

Table 4.3 Effect of credit impairment loss on profit: Pearson correlation analysis

Correlations			
		Impairment loss	Profit
Impairment loss	Pearson Correlation	1	.832*
	Sig. (2-tailed)		.080
	N	5	5
Operating profit after impairment loss	Pearson Correlation	.832*	1
	Sig. (2-tailed)	.080	
	N	5	5

*significant at 95% confidence interval

Form Table 4.3, operating profit after impairment loss is highly dependent on loan default since the Pearson correlation coefficient of 0.832 is significant. This implies that, to get more profit the bank must put forward strategies to recover most of its overdue loans as there is an inverse relationship between bank's profitability and NPLs (Achou, 2007).

Again, return on assets and return on equity are important indicators of profitability in the banking sector (Godlewski, 2004). From Table 4.2, the Return on Asset Ratio (ROA)

for 2009, 2010, 2011 and 2012 are 4.24%, 3.53%, 3.21% and 2.92% respectively. This showed a continuous decline from 2009 to 2012 implying that huge sums of the bank's loans and advances were non-performing. In an attempt to increase its efficiency in generating profit with its available asset, the bank instituted loan recovery teams in 2013, hence accounting for the increase in ROA ratio to 3.28%. That notwithstanding, in the period under discussion, the bank failed to meet the industry benchmark of a minimum ROA ratio of 5%.

In addition, the bank's profitability performance was determined using the Return on Equity (ROE). This represents the rate of return generated by the owners' Equity. In other words, the effectiveness of management in utilization of funds contributed by shareholders. Similar to the Return on Assets, from Table 4.2, the ROE decreased consistently from 2009 to 2012 (32.25 in 2009, 30.27 in 2010, 28.02 in 2011, 25.96 in 2012). Apart from the first two years of the period under consideration (2009 and 2010), the bank failed to meet the industry minimum benchmark of 30%.

4.3.2 Non-Performing Loans and Liquidity

As a determinant of the bank's performance, its liquidity was measured. This research employed loan to deposit ratio which indicates the ability of banks to resist deposit withdrawals. In other words, it is used to determine the short term viability of a bank. Lower loans to deposits ratio means a reduction in the risk that banks may not have sufficient cash to meet unexpected deposit demands or new loan demand. The table below shows the annual liquidity (loan to deposits ratio) of Bosomtwe Rural Bank Limited from 2009 to 2013.

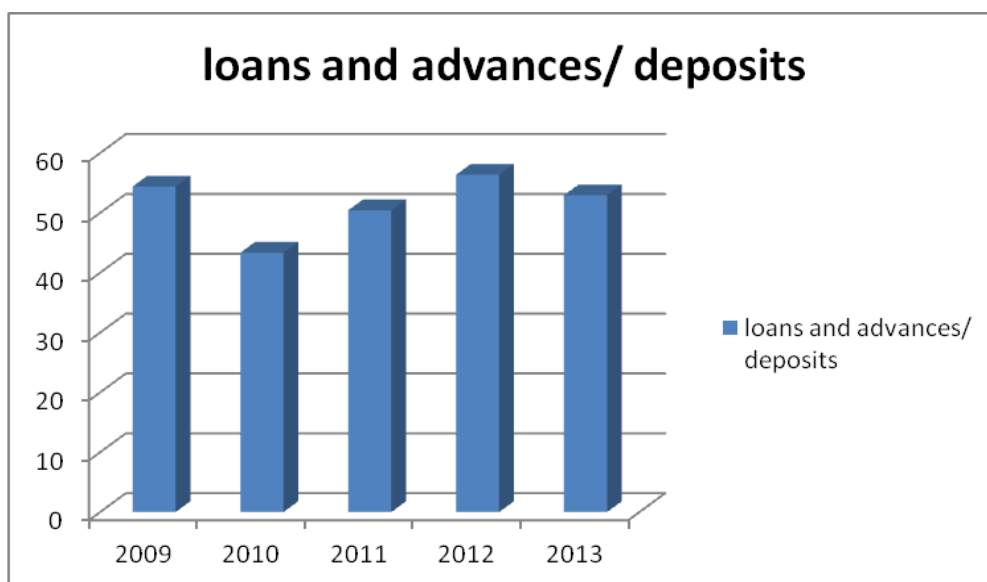


Figure 4.2 Annual Loans to Deposits ratio

Source: Annual Financial Statement (2009-2013)

From fig 4.2 showed that, the bank's performance within the period of consideration, in terms of liquidity, was satisfactory since the loans and advances to total deposits ratios were below the industry benchmark of maximum of 57%. That is 54.3% for 2009, 43.4% for 2010, 50.42% for 2011, 56.36% for 2012 and 52.93% for 2013.

On the other hand, if the liquidity performance of Bosomtwe Rural Bank Limited is compared against that of the standards of the best performing banks (minimum of 50% loans to deposit ratio), then it can be inferred that, the bank only performed satisfactorily in 2010.

Table 4.4 Annual Reserves

YEAR	PRIMARY RESERVE (%)	SECONDARY RESERVE (%)
2009	15.97	52.27
2010	17.37	57.40
2011	18.33	48.24
2012	12.91	40.81
2013	12.65	47.45

Source: Annual Financial Statement (2009-2013)

As part of the evaluating the bank's performance, this study also sought to examine the level of primary and secondary reserves of the bank which is a mandatory requirement by the Bank of Ghana. These reserves include cash and bank balances and investments in government securities which the bank holds against its liabilities (Asiedu-Mante, 2011). From Table 4.4, the mandatory primary reserve requirement by Bank of Ghana (13%) was met by the bank in the first three years of consideration. This implies that, despite the huge loans and advances and the possible occurrences of non-performing loans, the bank had enough cash to cover unexpected withdrawal. That notwithstanding, in 2012 and 2013, Bosomtwe Rural Bank Limited had primary reserves marginally below the requirement of the Bank of Ghana.

Similarly, from 2009 to 2013, the bank exceeded the minimum mandatory requirement by the Bank of Ghana (30%). Conversely, though the bank met its secondary reserve requirement, its reserve ratios are seemingly on the high side which is indicative of poor intermediation.

4.3.3 Non-Performing Loans and Asset Quality

In Banks, the best leading indicator of financial performance is the extent of loan loss in its loan portfolio. According to Dermirguc-Kunt *et al.* (2000), Asset quality is an important performance indicator since it is a key predictor of bank insolvency. It is a measure of the Bank's ability to ensure that loans together with their principals are collected. The loan loss provision to gross loan ratio as a measure of asset quality is an indicator of how the bank is protected against future losses.

Table 4.5 Annual Gross Non Performing Loan Ratios

YEAR	LOAN LOSS PROVISION TO GROSS LOANS (%)
2009	6.16
2010	6.79
2011	5.68
2012	5.87
2013	7.18

Source: Annual Financial Statement (2009-2013)

Table 4.5 revealed that, the bank kept its ratio of loan loss provision to gross loans below the industry maximum of 10% for the period. This suggests that, the bank made moderate financial expenses hence a higher profitability in the stated years. The lower loan loss provision to gross loans implies that the bank could lower the spread between the interest it pays on its deposits and the interest it charges on its loans hence providing more benefits for its customers. It can also be inferred from the table that, the ratio was worst for 2013 (7.18%) indicating a relatively higher financial expenses or lower profitability compared to the previous years. The year 2011 had the best credit quality

with a loan loss provision to gross loan ratio of 5.68% implying that, the bank lost income on only a smaller proportion of their loan portfolio.

4.4 Strategies Used in Minimizing Non-Performance in Bososmtwe Rural Bank Limited

The study also sought to examine the strategies that the Bosomtwe Rural Bank Limited use to minimize the incidence of loan defaults through the interview conducted. All the seven interviewees who were credit officers stated that, credit bureau is used as a reference in assisting them to determine delinquent borrowers. Details of the loan applicant is keyed into the system to enable them assess his/her loan profile. By so doing the bank is able to determine if the applicant has any commitment with other banks.

In addition, majority of the interviewees indicated loan appraisal as a way of minimizing non-performing loans in their bank. According to them, they adhere to the principles of KYC (Know-your-customer) as part of the appraisal process. For companies, the bank request proof that it is fully registered. Corporate institutions and individuals who manage their own businesses are also required to provide financials such as cash-flow statements, daily sales and expenses etc.

The study also revealed that, from 2013, the bank instituted a special recovery and monitoring unit. Management ensures that these units are fully resourced in terms of staff and logistics and task them to specifically monitor all categories of loans (performing and non-performing). They also initiate the recovery processes by serving defaulters with remind notices. This strategy accounted for the decrease in loan default in the bank for the year 2013 as shown on fig 4.1.

Loan pricing is also one of the strategies employed by the bank to prevent loan default as mentioned by the credit officers. Since high interest rates more often than not puts

borrowers in a position not to make repayment, the bank charges appropriate rate in order not to over burden the borrower with high interest rates.

The credit officers interviewed further pointed out that, the credit officers and credit committee on the Board meet on quarterly basis to review and assess the quality of loans disbursed. By so doing, they are able to come up with better strategies that best fit for each category of loan default.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the findings and method used in obtaining the data for the study. It further gives conclusion of the study and as well offers recommendations in line with the research objectives. This is very important as it gives the implications of the findings as well as the possible strategies that could help reduce the problem of loan defaults at Bosomtwe Rural Bank Limited.

5.2 Summary of Findings

The findings show that, Bosomtwe Rural Bank Limited refers to loans that are not repaid at scheduled times or paid after the maturity period as non-performing. The bank does not only term loans that are not repaid before maturity as bad but also when scheduled times of repayment are defaulted.

The analysis further revealed a steady rise in credit impairment loss from 2009 to 2011. However, in 2012 the credit impairment loss increased astronomically by 154.70% which was attributed to fact that more loans and advances increased by GH¢ 3,443,728.7 over 2011. The bank recorded a reduction of 26.39% in non-performing loans in the year 2013 due to good loan recovery strategies that was implemented in that year.

From the analysis, several factors accounted for the occurrence of bad loans in the Bosomtwe Rural Bank Limited. Most of the respondents stated that the major causes of non-performing loans were unwillingness on the part of the borrower to make repayment, lack of financial information for the bank to do its credit assessment, poor monitoring of loans and poor credit appraisal. Other factors included diversion of loans

and untimely release of loans by the bank. Though changes inflation leads to non-performing loans according to Gorter and Bloem (2002), the analysis showed otherwise for the Bosomtwe Rural Bank Limited as 50% of the respondents strongly disagreed.

The analysis further revealed that non-performing loans reduced the bank's operating profit by 11.62% in 2009, 11.12% in 2010, 10.33% in 2011, 19.39% in 2012 and 13.34% in 2013. This showed that the bank had the biggest impact of non-performing loans in 2012 (19.39%) due to additional provisions required of the bank by the Bank of Ghana. In 2010, bad loans had the least impact on the bank's profitability among the five (5) year period.

From the analysis, the bank's return on Asset was also was affected by non-performing loans. The Return on Asset Ratios (ROA) declined continuously from 2009 to 2012 implying that huge portion of the bank's loan portfolio was bad in those years. Though there was an improvement in 2013 (3.82%), on the whole, the bank failed to meet the minimum industry benchmark of 5%. A similar trend was observed for the effects of bad loans on Return on Equity (ROE). The bank only met the minimum ROE requirement of 30% in 2009 (32.25%) and 2010 (30.27%).

The analysis showed that the liquidity position of Bosomtwe Rural Bank Limited for the 5 year period was encouraging as the bank did not exceed the maximum industry benchmark of 57%. This position was emphasized by the bank's ability to meet the industry requirements for primary and secondary reserves. On this basis, the banks liquidity performance could be rated satisfactory.

For the period under consideration, the bank kept its asset quality (loan loss provision to gross loans ratio) below the industry maximum of 10% suggesting a moderate financial expenses and a higher profitability in those years. That notwithstanding, among the

years, the bank maintained the best asset quality in 2011(5.68%) and the worst in 2013 (7.18%).

In the quest to minimize loan default and improve loan recovery in the bank, several strategies such as the use of credit bureau, credit appraisal, loan pricing and the use of special loan recovery teams among others are employed by the officials as revealed in the study.

5.3 Conclusion

The study gave 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 as shown by non-performing loan ratios during the period. The decline in 2013 however reflects management efforts at improving the bank's loan portfolio.

The factors that enormously contributed to loan default included diversion of loans, poor credit appraisal, and lack of financial information on the part of the customers and untimely release of loans among many others.

Reduction in operating profit of the bank was largely due to non-performing loans despite its tremendous effort in maintaining a sound asset quality and liquidity. Considering the effect of non-performing loans on the performance as shown by the research findings, it can also be concluded though there was an improvement in 2013, there is no doubt that Non-performing loans still poses a challenge to the survival of the banking industry.

5.4 Proposed Recommendations for Minimizing Non-Performing Loans at Bosomtwe Rural Bank Limited

As an indicator of performance, the NPLs ratio reflected the instability of the bank. This reveals that the situation about the bad loan portfolio of the bank during the period under review was somehow devastating as it eroded the huge financial gains the bank made over the years. It is very essential for the bank management to adopt practical and realistic measures to minimize the problem of bad loans in the bank. Some of these measures as suggested by respondents who were interviewed are elaborated below;

- **Proper credit appraisal**

The study revealed that poor credit appraisal by some credit officers eventually lead to the occurrence of non-performing loans. Credit appraisal process deals with taking a decision as to whether to disburse loan to the applicant. A wrong decision means giving out loans to customers who are not capable of making repayment thus eventually leading to bad loans. Accumulation of non-performing loans can lead to the insolvency of banks hence the need for proper credit appraisal by the bank.

The bank is advised to adopt a loan evaluation framework as a guide when appraising loans. This should include; evaluating the character (history, integrity and background) of the applicant, margin of profit, capability (technical competence, business and legal ability) of the applicant, stated purpose of the loan, adequacy of the amount of loan required, repayment conditions and also the collateral security offered. Such a framework can help credit officers make proper appraisals before loans are disbursed.

As part of the appraisal process, credit officers are advised to pay more attention to the strength of applicants' cash-flow rather than profit in determining the applicants' ability

to make loan repayment. It is also prudent that they do not lend to applicants who are highly connected to management or the Board since this can reduce the risk of default.

- **Effective monitoring**

Effective monitoring of the loan facilities is one of the practical ways of minimizing loan default. Since lending is an activity that carries risk (moral hazard), it is necessary that the bank institutes appropriate follow-up action that can minimize the incidence of non-performing loans. It is recommended that the bank initiates effective monitoring from the time of disbursement till the final repayment of the loan. Monitoring enables credit officers confirm information provided by the customer on their income and expenditure as well as detect the adverse trends and potential problem loans as early as possible.

An effective way of monitoring is assured when management provides credit officers adequate logistics such as vehicles. The bank is also advised to employ additional credit officers so as to limit credit officers to a specific geographical region which enable them visit clients more often and also reduce time and money wasted on travelling. Credit officers should also provide and keep detailed reports after each visit for future reference. Occasionally, credit officers should request for management and audited accounts to be fully aware of the up-to-date situation of the borrower to determine his/her credit worthiness

- **Provision of Good enforceable securities**

For banks, the primary security for a loan is the borrowers personal will to repay. However, it is impractical to determine the willingness of a customer to make repayment therefore loans given out against primary security of the borrower is an unsecured loan. There is therefore the need for credit officers to request for additional security from the borrower that can be enforced legally.

As a better insulation against default, credit officers should request for additional securities such as shares, fixed deposits and property that may serve as a deterrent to customers who intend to default willfully. It is recommended that credit officers ensure that such securities serve as good collaterals and are legally enforceable. That is, there should be proper documentation of the securities so as to enable the bank seek legal backing when the need for such an action arises. For instance, securities in the form of lands are supposed to be scrutinize to ensure that all necessary documentations are properly registered with the Ministry of Lands

Securing credit facilities in this way helps reduce willful loan default which eventually helps improve the banks' loan portfolio.

There is therefore the need for stringent security requirement policy that can be implemented in cases of loan default to recover some of the losses so as the minimize the effect of NPLs on profitability

- **Training and Financial advisory services for customers**

Another strategy for reducing non-performing loans is to offer financial and advisory services to loan applicants before and after disbursement of loans. The bank is strongly advised to educate its potential borrowers on the need to keep proper records of their daily transactions and other financial information. They are also encouraged to advise them on business dynamics that is the kind of business the customer may invest the loan in order to generate higher returns in line with the trend of the economy.

- **Appreciation**

In as much as defaulters are served remind and demand notices, customers who make payment within scheduled times should also be appreciated. It is recommended the bank unexpectedly visit such valued customers and make presentations of awards or give

appreciation messages. This would not only encourage such customers to continue such desirable business attitudes but also serve as a motivational tool for other borrowers.

- **Training for Credit Officers**

It is recommended that management periodically organizes refresher training programs for credit officers. Training programs should include modules that would equip them with the skills and techniques for eliminating enough risk during the credit granting process. Such training would enable credit officers undertake better assessment of loan portfolios, detect early signs of default and provide pragmatic measures to prevent any deterioration of the loan portfolio.

Credit officers should be trained on the need to prevent unnecessary delays in loan approvals, as well as appreciate the need to comply with credit policy and monitoring of credit. Through training programs, credit officers are trained on the need to demonstrate professionalism and integrity in their duty and as such put the interest of the bank ahead of theirs.

- **Use of Credit bureaus**

In the credit granting process, it is most often difficult in assessing the credit worthiness of a customer. Credit bureau has an indirect impact on the liquidity of the banking sector by reducing the credit risk which can lead to liquidity risk.

It is recommended that, in line with the Credit Reporting Act, 2007 (Act 726), the Bank resort to the use credit reference agencies for the purpose of determining the creditworthiness of borrowers. This is a system of credit reporting which provides timely, accurate, and up-to-date information on the debt profile and repayment history of borrowers. This would enable the bank identify customers who are credit worthy hence preventing possible future loan default. To ensure the effectiveness of this

recommendation, Management is advised to frequently update the credit bureau agency with information on all loans disbursed. Management also has a role to play in ensuring that, credit officers make use of these references during credit appraisal before disbursing loans.

5.5 Recommendations for future studies

A major limitation in this study was time constraint which led to the use of case study approach and a combination of secondary and primary data. In future, more than one bank could be studied on the same topic or other related aspects of the topic. Also, a future study might research into the bad loan problem in different sectors of the bank to identify the sector with the greatest influence on the bank's loan portfolio.

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APPENDIX I

Frequencies

[DataSet1] C:\Users\GLORIA\Desktop\SPSS 2015.sav

Statistics

		Loans are not used for the stated purpose	Unwillingness to make repayment of loan	Changes in Inflation	Poor monitoring of loans	Poor Credit appraisal	Untimely release of Loans	Lack of financial information to enable bank do its credit assessment
N	Valid	30	30	30	30	30	30	30
	Missing	0	0	0	0	0	0	0
Mean		3.93	4.47	2.17	4.33	4.37	3.83	4.50
Mode		4	5	1	5	5	4	5
Std. Deviation		1.048	.819	1.392	1.093	.669	.648	1.075

Frequency Table

Loans are not used for the stated purpose

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly disagree	1	3.3	3.3	3.3
	Disagree	2	6.7	6.7	10.0
	Neutral	5	16.7	16.7	26.7
	Agree	12	40.0	40.0	66.7
	Strongly agree	10	33.3	33.3	100.0
	Total	30	100.0	100.0	

Unwillingness to make repayment of loan

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Disagree	1	3.3	3.3	3.3
	Neutral	3	10.0	10.0	13.3
	Agree	7	23.3	23.3	36.7
	Strongly agree	19	63.3	63.3	100.0
	Total	30	100.0	100.0	

Changes in Inflation

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	15	50.0	50.0	50.0
	Disagree	4	13.3	13.3	63.3
	Neutral	4	13.3	13.3	76.7
	Agree	5	16.7	16.7	93.3
	Strongly Disagree	2	6.7	6.7	100.0
	Total	30	100.0	100.0	

Poor monitoring of loans

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	1	3.3	3.3	3.3
	Disagree	2	6.7	6.7	10.0
	Neutral	2	6.7	6.7	16.7
	Agree	6	20.0	20.0	36.7
	Strongly Agree	19	63.3	63.3	100.0
	Total	30	100.0	100.0	

Poor Credit appraisal

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Neutral	3	10.0	10.0	10.0
	Agree	13	43.3	43.3	53.3
	Strongly Agree	14	46.7	46.7	100.0
	Total	30	100.0	100.0	

Untimely release of Loans

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Disagree	1	3.3	3.3	3.3
	Neutral	6	20.0	20.0	23.3
	Agree	20	66.7	66.7	90.0
	Strongly Agree	3	10.0	10.0	100.0
	Total	30	100.0	100.0	

Lack of financial information to enable bank do its credit assessment

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Stongly Disagree	2	6.7	6.7	6.7
	Neutral	1	3.3	3.3	10.0
	Agree	5	16.7	16.7	26.7
	Strongly agree	22	73.3	73.3	100.0
	Total	30	100.0	100.0	

APPENDIX II

STATEMENT OF PROFIT AND LOSS AND OTHER COMPREHENSIVE INCOME

	2009 GH¢	2010 GH¢	2011 GH¢	2012 GH¢	2013 GH¢
Interest Income	1,558,227.10	2,555,152.05	3,123,120.65	4,456,521.82	5,591,733.31
Interest Expenses	(321,516.71)	(332,334.72)	(286,832.48)	(293,657.41)	(554,099.76)
Net Interest Income	1,867,819.22	2,222,817.33	2,836,288.17	4,162,864.41	5,037,633.55
Fees and Commissions	251,050.63	324,612.23	345,620.71	517,075.13	409,489.39
Other Operating Incomes	53,754.00	68,726.42	96,692.18	184,462.83	377,808.64
Total Income	2,172,623.85	2,616,155.98	3,278,601.06	4,864,402.37	5,824,931.58
Operating Expenses	(1,520,651.94)	(1,913,690.26)	(2,447,256.66)	(3,736,223.08)	(4,480,819.93)
Operating Profit before Credit Impairment Loss	651,971.91	702,465.72	831,344.40	1,128,179.29	1,344,111.65
Credit Impairment Loss	(75,736.54)	(78,097.20)	(85,906.92)	(218,804.82)	(187,314.71)
Profit before Taxation	576,235.37	624,368.52	745,437.48	909,374.47	1,156,796.94
Taxation	(55,435.97)	(58,233.02)	(71,889.17)	(125,367.08)	(132,254.26)
Net Profit for the Year	520,799.40	566,135.50	673,548.31	784,007.39	1,024,542.68
Other Comprehensive Income					
Changes in Fair Value Investments	-	24,590.00	14,814.12	-	-
Total Comprehensive Income for the Year	520,799.40	590,725.50	688,362.43	784,007.39	1,024,542.68

STATEMENT OF FINANCIAL POSITION

	2009 GH¢	2010 GH¢	2011 GH¢	2012 GH¢	2013 GH¢
ASSETS					
Cash and Bank Balance	1,558,227.10	2,390,194.48	3,142,832.63	2,769,127.39	2,984,092.92
Short Term Investments	5,102,000.00	7,926,590.00	8,300,000.00	8,752,787.50	11,196,785.01
Loan and Advances to Customers	4,977,914.75	5,559,382.02	8,152,468.13	11,377,392.01	11,592,315.25
Other Assets	383,976.63	573,168.75	1,073,977.62	2,398,161.14	3,702,221.50
Total Current Assets	12,022,118.48	16,449,335.25	20,669,278.38	25,297,468.04	29,475,414.68
Investment in Equity	-	-	41,404.12	41,404.12	41,404.12
Property, Plant and Equipment	248,761.73	293,908.02	736,303.78	1,511,362.76	1,757,225.46
Total Non-Current Assets	248,761.73	293,908.02	777,707.90	1,552,766.88	1,798,629.58
TOTAL ASSETS	12,270,880.21	16,743,243.27	21,446,986.28	26,850,234.92	31,274,044.26

LIABILITIES

Customers' Savings and Deposits	9,756,121.30	13,761,946.29	17,141,437.10	21,447,917.35	23,596,607.85
Creditors and Accruals	362,206.74	362,180.90	1,053,348.61	1,483,563.04	1,042,375.79
Taxation	15,808.94	8,233.00	30,389.17	25,752.83	89,601.96
Borrowings	22,189.58	17,217.78	20,244.40	2,821.00	1,514,444.00
Total Liabilities	10,156,326.56	14,149,577.97	18,245,419.28	22,960,054.22	26,243,029.60

SHAREHOLDERS' FUNDS

Stated Capital	401,792.75	412,540.27	440,410.77	537,815.77	641,594.35
Statutory Reserve Fund	465,919.54	536,686.48	620,880.02	718,880.95	846,948.78
Capital Surplus	-	24,590.00	39,404.12	39,404.12	39,404.12
Retained Earnings	-	-	2,016,162.87	2,482,668.23	3,044,427.70
Pension Fund	13,559.80	61,179.53	57,208.70	65,178.67	153,823.95
Development Fund	20,000.00	20,000.00	27,500.52	28,809.56	20,563.16
Capital Grant	-	-	-	17,423.40	284,252.60
Income surplus	1,213,281.56	1,538,669.02	-	-	-
Total Shareholders' Fund	2,114,553.65	2,593,665.30	3,201,567.00	3,890,180.70	5,031,014.66

TOTAL LIABILITIES AND SHAREHOLDERS' FUND

12,270,880.21	16,743,243.27	21,446,986.28	26,850,234.92	31,274,044.26
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APPENDIX III

TERM	DEFINITION	INDUSTRY BENCHMARK (%)
Return on Asset (ROA)	$\frac{\text{Operating Profit}}{\text{Total Assets}} \times 100$	Minimum 5
Return on Equity	$\frac{\text{Operating Profit}}{\text{Equity}} \times 100$	Minimum 30
Advances/ Total Deposit	$\frac{\text{Total Loans/OD}}{\text{Total Deposit}} \times 100$	Maximum 57
Loan Loss Provison/ Gross Loans	$\frac{\text{Total Credit Impairment Loss}}{\text{Gross Advances}} \times 100$	Maximum 10

APPENDIX IV

QUESTIONNAIRES

This questionnaire seeks to collect data on non – performing loans and performance of Bosomtwe Rural Bank Limited in Ashanti region. The data collected will be used for academic purpose only and confidentiality is assured. Please answer the question by ticking the appropriate boxes or providing your answers where necessary. Thank you

TO BE COMPLETED BY OFFICIALS OF BOSOMTWE RURAL BANK

LIMITED

1. How long have you been working with the bank?

Under 2 years [] 2-4 years [] 5-7 years [] 8 years and above []

2. What percentage of your loan portfolio is nonperforming?

Less than 20% [] 20-50% [] above 50% []

Please indicate your level of agreement or disagreement to the following statements.

Please use the scale below

1 = Strongly disagree 2 = Disagree 3 = Neutral 4 = Agree 5 = Strongly agree

	Factors that hinders payment of loans	1	2	3	4	5
1	Loans are not used for the right purpose					
2	Repayment period is short					
3	The loan is not put into business at the right time.					
4	Noncompliance of the terms of loans					
5	Unwillingness to make repayment of loan					
6	Poor personal information given by borrowers					
7	Lack of financial information to enable bank do its credit assessment					
8	Unfavourable terms and conditions of loan					
9	Natural disasters affect loan repayment					
10	changes in inflation rates affect loan repayment					
11	Implications of changes in interest rates affect loan repayment					
12	Poor monitoring of loans					
13	Untimely release of Loans					
14	Lack of understanding of terms and conditions					
15	Poor credit appraisal					

If other, please specify

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.....
.....

**INTERVIEW GUIDE FOR CREDIT OFFICERS OF BOSOMTWE RURAL
BANK LIMITED**

This guide seeks to collect data on non – performing loans and performance of Bosomtwe Rural Bank in Ashanti region. The data collected will be used for academic purpose only and confidentiality is assured. Please answer the question by ticking the appropriate boxes or providing your answers where necessary. Thank you

What is the nature of non-performing loans?

.....

.....

.....

What are the causes of non-performing loans in your Bank?

.....

.....

.....

How do non – performing loans affect the performance of the bank?

.....

.....

.....

What are the Strategies used by the bank in recovering non – performing loans?

.....

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