KWAME NRKUMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY

COLLEGE OF ART AND SOCIAL SCIENCES

KNUST SCHOOL OF BUSINESS

DETERMINANT OF LOAN DEFAULT, A CASE STUDY OF DUMPONG RURAL BANK LIMITED AND OTHER RURAL BANKS IN THE KWAHU MUNICIPALITY

A THESIS SUBMITTED TO THE DEPARTMENT ACCOUNTING AND FINANCE IN PARTIAL FULFILLMENT OF REQUIREMENT FOR THE AWARD OF MASTER OF BUSINESS ADMINISTRATION, FINANCE OPTION

BY

SAMUEL OFOSU NYARKO

AUGUST, 2016

DECLARATION

I hereby declare that this dissertation is my own work towards the fulfilment of the requirements for the award of Master of Business Administration (Finance). To the best of my knowledge, it contains no materials which have been accepted for the award of any other degree of the university, except in places where references of other people‟s work have been cited and full acknowledgements given.

Samuel Ofosu Nyarko (PG9623113) …………………….. ……………………..
Student & Index Number **Signature** **Date**

Certified by

Mr. Kwasi Poku …………………….. ……………………..

Supervisor **Signature** **Date**

Certified by

Dr. Daniel Domeher …………………….. ……………………..

Head of Department **Signature** **Date**

ABSTRACT

The main aim of this study is to examine the determinant of loan default in Dumpong rural bank and other rural banks in the Kwahu Municipality. It specifically tries to examine in detail, the laid down credit policy which regulates loan administration and to determine how loan default affects the operations of rural banks. The study employed survey and descriptive research design and uses questionnaire to collect data from five rural banks in the Kwahu Municipality namely Kwahu Rural Bank, Kwahu Praso Rural Bank, Odwen Anoma Rural Bank and Mumuadu Rural Bank. At the end of the data collection, the collected data was analyzed. Simple frequency tables, figures and percentages were used to analyze the data. The study revealed that, poor monitoring, bad weather, wrong timing of credit delivery, business failure and high interest rate makes the customers default the loan. It was further revealed that microfinance loan and agriculture loan had the highest percentage of loans default rate. The conclusion of the study is that loans default affects the profitability of rural banks and even cause a "run" on the bank. The study recommended that, rural banks should establish local credit bureaus that will provide database to which all participating financial institutions will provide the names of defaulted clients and their personal data. This will help identify defaulted clients among the banks easily. The officials of the bank must visit the customers on regular basis to know the state of their business.

DEDICATION

To the entire special people who have helped me come this far especially. My parents Mr. Sampson Nyarko and Miss Josephine Addae and my dear wife Mrs. Agnes Sefa Nyarko. To my friend Mr. Maxwell Arhin-Hayford. Thank you all and may God richly bless you.

ACKNOWLEDGEMENT

I am highly grateful to Mr. Kwasi Poku for his role in ensuring that this study meets the required standard. Despite his tight schedule, he gave me the needed guidance and support as far as this work is concerned was received.

I am deeply grateful to Prof. Joseph Magnus Frimpong (Former Dean, KNUST School of Business). I give my heartfelt appreciation and thank to all other lecturers for their various academic supports throughout my studies in the University.

I wish to also take this opportunity to express my heartfelt gratitude to all those who in diverse ways contributed to the success of this work, especially those writers whose work were cited. I say thank you and God richly bless you.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

The rural banks have come to help the socio economic of the rural people and the entire economy as a whole. In the actual sense people might not have had opportunity to invest in money, but this has become possible under the credit system created by the rural banks. The credit system put in place by the rural banks has made many customers who are every productive able to expand their businesses. Financial institution (especially rural banks) has had a vast impact on real economic movement by affecting to a large extent the supply of bank credits. As most bank credits are vital source of outsource finance in the Ghanaian economy of today. Crockett, (1996) makes an assertion that uninterrupted credit supply might bring huge transformation as far as economic activities are concerned.

In most developing countries like Ghana, rural communities are faced with poverty, low saving, inadequate credit facilities, transfer disorders and other financial services which ensure economic growth and stability. Due to these, the people are affected with poor health, low income, high unemployment and social neglect. This has affected the development of rural communities. The springing up of rural banks is a respond to a search over a long period of time for a preferable institution bargain for making credit facilities available to the rural settlers (Asiedu-Mante, 2004). The concept of rural banking is a mixed up between commercial and development banking and has been made as a unit bank so that they would be mandated to offer mobile savings and lend credit to people in the areas they are situated.

The control, ownership, management of the general operation is entrusted into the hands of the local settlers where the bank finds itself. Matter to the supervisory body of the Central Bank of Ghana, is the board of the Directors who are in-charge of the management of the affairs of the rural banks and these directors are chosen by the shareholders at annual general meeting. The corporate powers of rural banks are thus vested in the shareholders and the board of directors. Rural banks perform functions such as the acceptance of deposits and lending to their clients like the commercial banks do. Their main function is to gather together saving in the rural vicinity and give out to borrowers in these vicinity to enable them fund agriculture, small and medium scale businesses in order to raise their standard of living. Rural banks help channel surplus funds from rural saver to rural borrowers who put the money to work. In return for their funds, lenders receive the principal in addition to percentage of interest added to the principal.

The banking institutions are still expanding their services in the areas they find themselves although they are associated with high level of risk. Banks these days specifically engage the services of personnel to the fully in charge of selling the banks loans or credits by moving to one office to the other. This had made a lot of banks to be able to meet budgeted profits and had expanded their businesses and had has wave effect on the economy as a whole.

Banks had been able to advance loans to a very large category of clients both corporate businesses and private enterprises. Banks usually has various forms of accessing credit worthiness of a clients or customers before credit or loan is advanced to them. These areas of credit assessment are very crucial because proper assessment means recovery and vice versa means default. This function is done by the credit department of every bank.

Though every bank has a credit department who is in charge of appraising customers before loans are advanced to clients yet a chunk of the loan portfolio still goes bad.

The situation has been so worrying that most financial establishments have take on some unusual ways of recovering these facilities. Some banks had employed workers whose sole responsibility is to recover these loans and there are even policies and laid down procedures to follow to advance and to retrieve such loans (Fama, 1980).

Access to these facilities (loans) is seen as a way of cushioning and providing opportunities to clients. Some years ago the rural banks were thought to be the best instruments to channel financial resources to the rural areas but for what reasons they are moving their offices to the urban areas. The problem of loan default is a crucial element of the financial business of any bank. This is because it results in the creation of a certain level of cost for the organisation. This sometimes leads to the collapse of the banks because the banks are not able to recover their capital given as forms of loan to keep them in business.

1.2 Problem Statement

According to Aballey (2009), loans of banks represent the largest assets every bank can boost of and the largest source of income to every bank. In spite the large amount of income generated from loan portfolio of every bank, literature had proven large portion of loans usually are defaulted and seriously affects financial performance of these financial institutions.

Some constraints limiting the growth and development of these rural banks is their inability to administer credit facilities efficiently and effectively leading to the high loan default rate in some of these rural banks in Ghana, this is the problem of loan default or loan delinquency. The adverse effect of loan default on the operations of financial institutions is that it increases their liquidity risk, high level of non- performing assets and sustains losses. Here the empirical instigation is to aid understand whether non-payment of loan is by unpredictable behaviour or by certain aspect in a situations so that the outcome can be used by rural banks to use their credit programs for the better (Buvinic, 1997).

Therefore, careful examination of loan default is vital to establish the probable reasons for it and to unearth suitable solutions to avert a collapse of the bank. This calls for an investigation why customers refuse to pay monies that have been granted.

1.3 Research Objectives

The purpose of the thesis is to identify the determinants of loan default, in Dumpong rural bank and other rural banks in Kwahu Municipality. The specific objectives are as follows;

1. To identify the laid down credit policy of Dumpong Rural Bank and other rural banks in the Kwahu Municipality.
2. To assess the sector prone to default in Dumpong Rural Bank and other rural banks in Kwahu Municipality.
3. To examine the causes of defaults from the perspective of the management of the bank.
4. To examine problems associated with loan administration in rural banks.

1.4 Research Questions

Accomplishing the purpose of the thesis, the bellow questions will be asked.

1. Give laid down credit policy governed Dumpong Rural Bank and other rural banks in the Kwahu municipality?
2. Which loan sector is prone to default?
3. Name what causes of loan default from the management perspective?
4. State some of the problems in loan administration in rural banks?

1.5 Scope of the Work

The work is restricted to the determinants of loan default in rural banks. The study will further be limited to the Dumpong and other rural bank limited in the Kwahu district of Nkawkaw. Also the study will be limited to the credit staff and management of Dumpong rural bank and other rural banks and their credit clients. Financial constraints and time constraints made the study to be limited to five rural banks

The study was conducted in Dumpong Rural Bank and other rural banks due to nearness and data accessibility. The case areas were chosen because the researcher believed that they had the requisite knowledge about the topic selected. The primary and secondary data will be the source of information.

1.6 Justification of the Study

Research work would be of significant benefits to stakeholders of rural banking systems especially stakeholders of Dumpong Rural Bank and other rural banks. The research would help to identify the causes of loan default in the rural banks. It will also help the bank to gain more customers and make more profit if the procedures for giving out loans are adhered to.

This study will help management to put a good mechanism in place to check those lapses in giving out and retrieving of loans and also assist both management and customers in understanding the new measures put in place. Finally, the study will be of assistance to other researchers who will be interested to research on this topic.

1.7 Limitations of the Study

This research will make an additional input to the existing knowledge on the determinants of loan default in financial institutions, it has short comings. Firstly the sample could have created a limitation. The work will sample employees, management and clients of Dumpong rural bank and other rural banks. Respondents in the sampled bank might not be same employees of other banks, in terms of demographics grade, conditions of the banks, salaries, packages and incentives. If this happened, the outcome could have been influenced.

Again, the work could not take on a comprehensive survey in the entire operations of the bank. Despite all these shortcomings, it is believed that the outcome of this work would be of remarkable assistance to policy makers.

1.8 Organisation of Thesis

This work is structured into five chapters. The first chapter basically considers the introduction of the work, which covers the background of the work, problem statement, the purpose of the work, research questions, and significance of the work, limitations, delimitations and organization of the works.

The second chapter focus on the re-evaluate of related literature; it outlines the various literatures on the determinants of non-payments of loan in rural banks, while the methodology of the study is the subject of chapter three.

The fourth chapter of the study shows the presentation and analysis of the data. The fifth chapter constitute summary of findings, conclusions and recommendations of the work.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This section deals with the review of related literature on the determinants of loan defaults in rural banks and other key aspects of the issue being studied.

2.1 Banking

“Bank” is alleged to have been originated from "Banco," an Italian word, whose meaning is a bench. The Jews staying in Lombardy, who were the earlier bankers, carried out their business on benches at the market place (Goldsmith, 1860-1977). A bank may be defined as an establishment that performs one or more of the functions like accepting custody of money, lending money, extend credit, issuing currency or facilitating the transfer of funds by means of cheques, drafts, bills of exchange or other instruments of credit (Radhaswamy,1984). The broad functions of a commercial bank are borrowing (deposit) and lending (advance), agency functions like collection and payment of cheques and bills on behalf of the customers and finally general utility services like receiving valuable securities for safe custody besides underwriting of shares and debentures. According to Sharma (1974), the role of commercial banks lies in accelerating investment and growth in a developing economy. The banks are considered as the nerve centres of economies and finance of a nation and the barometer of its economic perspective. According to Mishken (1996), banks are the most appropriate institution that reduces adverse selection and moral hazards problems in the world of financial markets. This is done by banks taking collateral before lending. Government safety for depositors is the added advantage of banks. Indian banks came to be established primarily in the wake of the Swadeshi movement in 1905 and the growth of the Indian Joint Stock banks followed an altogether different pattern. With the financing of foreign trade in the hands of foreign exchange banks, owned outside India, especially in the United Kingdom the best medium for bank investment, namely trade bills were not available to others, It was difficult for the Indian banks to get into their business which was protected by established and not easily accessible advantages.

The course that monetary management took in the pre-independence years, following the establishment of the RBI, was guided by the prevailing Government policy. With the beginning of planned economic enlargement, central banking policies and practices needed to be attained to the objectives and assumptions of successive five year plans. Banking in India falls mainly under two categories (a) Commercial banks and (b) Co-operative banks. Commercial banks are the important agencies for financing credit requirements of industry and trade, while co-operative banks have played a major role in financing agriculture. The nationalisation of scheduled commercial banks has been responsible for the development of the country (Ramachandra Rao, 1969). According to Srinivasan (1995), banks are the most the important financial intermediaries and as such they intermediate between the savers and borrowers or users of funds. Banks also act as an essential link between people who have savings and those who require money for investment in business activity. According to Radhaswamy (1984), banks in India merely acted as storehouse of community savings and lend such savings to needy investors who were acceptable to them according to certain criteria. Banks were mainly guided by the objectives of profit maximisation which in turn depended on the ability to ensure the maximisation of savings of the community flowing through banking and lending such funds to investors who would safely and efficiently use them and at the end able to repay the credit with interest. The role of banks is a very critical input in the economic development of any nation as indicated by Gerschenkron (1962) in his seminal work which shows the important role that the banking system had played during the 18th and 19th centuries in the economic development of Europe.

2.2 Rural Banking

Rural and community banks (RCBs) are unit banks whose owners are basically the rural community members who purchase shares. These banks are licensed by the central bank of Ghana, Bank of Ghana, to intermediate financially in the rural communities (Steel and Andah, 2004). The authors also indicate RCBs function as commercial banks under the Banking law of Ghana, PNDC Law 225 of 1989, except that they cannot carry out foreign exchange operations and the acceptance of valuable properties, for example, gold, for safe keeping. The Association of Rural Banks (1992) outlines the following as among the aims of RCBs:

(1) To make easy mobilisation of rural savings;

(2) To facilitate advance and provide other banking services to manufacturers in the rural areas;

(3) To take banking business to the doorstep of rural people;

(4) To be mechanism for rural development;

(5) To make contribution to the social and economic development of their catchment areas;

(6) To make profit for their shareholders.

RCBs are a network of 135 unit banks operating independently in Ghana but are regulated by the Bank of Ghana and thus are part of the regulated financial sector in Ghana. The RCBs provide most of the formal financial services for the people in the rural areas. It is estimated that they constitute about fifty per cent of all the banking outlets in Ghana (IFAD, 2002). By the end of year 2013, the RCBs together had about 595 outlets spread throughout the country. Rural banks have locations in all administrative in Ghana. RCBs are relatively small financial institutions which have average share capital of GHS 336,527, average deposits of GHS 4.3 million and average assets of GHS 3.8 million. There are 135 RCBs, out of hat 75% have assets between GHS 1.2 million and GHS 9 million, 20% have assets of less than GHS 1.2 million, and 5% have assets over GHS 12 million. Likewise, 45% of RCBs have share capital which is less than GHS 100,000 and only 5% have share capital that exceeds GHS 260,000. As a network, RCBs have accomplished an incredible level of service liberation and performance financially. Several rural banks have been nominated more than once in the Ghana Club 100, a group of 100 Ghanaian institutions given recognition on annual basis for business excellence (ARB Apex Bank Report, 2009). There are several challenges, the industry is faced. The Bank of Ghana (2004), in its assessment, rated the performance of 18 rural banks out of the 137 in their operations as nothing more than mediocrity. This assessment of the central bank was based on their capital adequacy, and it grouped five rural banks as distressed. Six of the rural banks whose performance was categorized as mediocre, another 6 rural banks whose net worth was negative and one of the sampled banks for the research were in the "casualty" category. The Apex bank for the rural banks, which was set up purposely to render services to RCBs, is not self-sufficient in financial resources and therefore lack the needed capacity to carry out its functions. The Bank of Ghana, which has a primary responsibility for providing supervision for all RCBs, is effectively controlled in discharging its supervisory duty in view of pressures from political and civil society groups, resource constraints, and limited assignment of supervisory functions and role to the

ARB-Apex Bank Ltd (ARB-Apex Bank Report, 2009).

2.3 Lending

Lending is the major function of financial intermediation in that it sense plays an important role in the business activities of banks. This same function has, on the other hand, a high level of risk. McNaughton (1992) emphasised the point that risk-taking is an integral part to banking, and banks record success when the risk they undertake is reasonably controlled and falls within their credit capability and financial reserves. The author further stated that for a bank to overcome the lending risks and to do well, bankers need to review their bureaucratic inclinations in order to become responsible to the financial needs of the economy. The bureaucratic inclinations could bring about lots of frustrations for applicants of loans for obtaining credit at the appropriate time, which may be a hindrance to achieving successful projects. Rouse (1989) said in credit delivery, a lender „lends" money and but is not an offer the lender gives away. The lender must have the future in mind and ask, whether the customer will reimburse the loan he has agreed to take at an approved date? Rouse argues that, there would at all times be some uncertainty or risk that the customer will be unable to repay, and it is in this risk assessment that the lender needs to be professionally skilful in his decision. The success of banks, in the researcher"s view, hinges on their capability to make out the demands of the public in terms of financial services, render such services efficiently at a price that is that can be seen as competitive.

Lending is perceived as an art because it entails creativity and imagination (Rouse, 1989). There can be an argument that credit management provides the rules to be followed and adhering to them religious is very essential for good credit management practices. The right decision is depended on the knowledge, skills and far-sightedness of the credit manager. This ought encompass skills and awareness in financial analysis, the performance of the sector to which the credit is going, the whole macroeconomic condition, the psychology in defining the ostensible and latent intentions of the borrower, the soil type and climate in relation of loans for agriculture purposes and the apparent impact of the credit on the performance of the loaning institution. In this state, lending processes include the disciplines of law, geography, accounting, science, culture, psychology, economics, finance and others. The circumstance renders lending activity very taxing because significant slip can lead to uninvited loss of financial resources, and consequently have negative effect on the very survival of the bank giving out the credit. In this regard, persons who have the right kind of attitude, knowledge and skills, which are free from all self-centred emotion, are required to supervise lending activities. Olashore (1988) has pointed out four important groups in lending, which include the borrower, the depositor, government and the bank. The depositor wants the highest interest possible on the money they deposit at the bank while the borrower treasures lowest rate of interest on lending. The bank seeks the highest margin between lending and borrowing interest rates, and the central government stress that lending ought to be receptive to the needs of the economic sector. In the view of these interest groups, the bank lending needs to ensure that its interest supersedes that of the others. In an economy with liberalisation and deregulation, banks determine both borrowing and lending rates of interest and the direction of credit to areas of the economy which are measured as having less risk and making more profit. For instance, with unrelenting reduction in bank rates from 43 percent in 2001 to 16 percent in October 2005, the rates of borrowing and lending by banks stayed in range of 1%-25% to 1%-10%; and 35%-56% to 25%-32% respectively. Though the agriculture sector has been the backbone of the economy of Ghana, credit by lending institutions to the sector has been low recording shares in overall credit by banks of 9.3%, 9.3% and 7.6% respectively as at end of December 2002, 2003 and 2004 (Bank of Ghana, 2004).

2.4 The concept of loan administration

Loan administration involves the various activities of a bank in ensuring that from the beginning to final payoff, there is proper documentation on loan, accurate accounting systems for loan, proper loan disbursement and collection of principal and the interest on the loan. These activities include documentation of loans at source, recording new and renewed loans to the bank's documentation system, making advance payment for the principal, invoice generation, collection and posting of payments made on loans, stating payoffs, and collateral release. Even though roles and responsibilities with respect to loan administration vary from one bank to the other, all successful banks have a defined approach to each of the task indicated above. Loan administration, as a function, is performed in financial institutions for the improvement in and control of credit policies that guarantee revenues increment and lowering of risk. It also includes increasing collections, reduction in credit cost, making more credit available to customers who are creditworthy, and developing credit terms that are competitive. Effectively managing credit risk is an important and comprehensive approach to overall management of risk. Effectively managing credit is essential to the safety and soundness of all institutions of finance. Appropriately designed systems, policies and procedures and are required to be implemented in all the institutions of finance for effective identification of measures, monitor and control risks that go with credit (Eastern Caribbean Central Bank, 2009). As a manual, credit policy is an essential framework in the everyday administration of credit. The policy contains the principles and standards of the bank as differs from bank to bank. It spells out methods for appraising, disbursing, monitoring and recovering. Sinkey, (1992) is of the belief that every bank need to have a written policy on loan. The following are some principles outlined in a credit policy document: establishment of an appropriate risk environment for credit; operating under a rigorous credit granting process; keeping an appropriate administration of credit, mechanisms for measurement and monitoring of process; and having in place adequate controls over credit risk.

The credit policy also serves as a tool for credit management as it is as a guide for credit officers. In determining who should have the responsibility to develop a bank‟s the credit policy, Summers and Webb (2005), argued that the board of directors are responsible for formulation of loan policy of a bank and to provide continuing monitoring for compliance. However it is important to note that a bank‟s board of directors may not be able to effectively influence loan policy because regulatory agencies external to financial institutions regulate and provide monitoring for the activities of financial institutions..

2.5 Meaning of loan default

Default, in finance, crops up when a debtor fails to honour his legal obligations accordance with the debt contract, for example, the debtor has failed to make a payments as scheduled, or has breached a loan condition of the debt contract. Default may come about if the debtor is either reluctant or unable to pay off their debt. This can be the case with all debt obligations including mortgages, bonds, promissory notes, and loans, , (Wikipedia, 2011). A loan default is encountered when the borrower does not pay the requirement amount or fails to abide by the loan‟s terms and conditions. (Murray, 2011) BusinessDictionary.Com offers the following definitions of default:

a. **General:** Failing to carry out something as requirement of an agreement, in the performance of a duty, or under a law.
b. **Borrowing:** Failing to honour the terms of a loan agreement. The two types of these definitions are (1) Fiscal: Failing to repay on the scheduled date. In general, if a payment is overdue by 30 days, it is in default. (2) Covenantal: Failing to honour one or more covenants of the loan agreement for example going beyond the total borrowings prescribed.
c. **Computing:** Option, attribute, or value assumed by a computer when a user has not made a choice for or supplied any. Computer's choice is based on the arrangements of the software elements or its settings
d. **Contractual:** Failure in complying with the contract terms. Contracts mostly provide for dealing with defaults with the including of the procedures or conditions for arbitration, litigation, or compensation.

e. **Legal:** Failing to do something as a requirement under legislation or as a court order, for example, failing to make appear in court to answer charges.

Wakuloba, (2003) states that loan default is being unable to make repayments for the a loan by failing to complete payments or neglecting to service the loan. Consultative Group to Assist the Poor (CGAP) 2009 is of the view that loan default occurs when a borrower is unable or does not show the willingness to repay a loan, Moreover, Pearson and Greeff (2006) considered loan default as a threshold of risk, which gives a description about the borrower"s history of repayment where he or she failed to make at three or more instalments within a twenty-four-month period. This is a representation of specific time and behaviour indicator, where there is a clear increase in the risk that the borrower in the final analysis will actually default, by stopping all repayments. This definition is in a consonance with international standards, and was essential because constant analysis necessitated a common definition. This definition is not taken wholly to mean that the borrower has completely stopped paying the loan and has thus been referred to or legal processes; or from a perspective of accounting principles that the loan had been categorised as bad or doubtful, or written-off. Loan default can be defined as the failure of a borrower to meet his or her loan obligation at the time it is due (Balogun and Alimi, 1990).

2.6 The concept of loan default

Credit (or default risk) is the possibility of a borrower not being able to repay their loans. Adams and Mehran (2004) indicate that a greater portion of bank assets fall under loans, is the major risk a bank faces risk that goes with credit, and the decisions on credits constitute a crucial function of banking. Credit risk crops up anytime a lender is shown to make a loss from a borrower, counterparty, who fails to service their debt obligation as agreed and contracted by both sides and parties (Colquitt, 2007). Loans are the largest source of credit risk for most banks, however, other sources of credit risk are located throughout the operations of a bank. With most rural banks cited in rural Ghana, the risks are greater and as result, most banks have neglected the rural areas (Webster and Fidler, 1996). A similar viewpoint is held by Anderson, (2001) who is of the view that, Agriculture, an intrinsically risky activity is cited as the primary activity of the great majority of rural households. The risks rural people face depend on the local farming systems, climatic conditions, the policy and institutional settings and infrastructure (Anderson, 2001). Erratic and rapid changes in climate, technology, rules of trade, often increase the risks that tackled with the rural folk. The most common kind of credit risk faced in trading businesses are issuer credit risk and counterparty credit risk. Therefore, it is important to do a thorough assessment of the customer‟s ability to repay before the advancement of credit to each customer.

2.7 Loan/Credit Management

The aim of credit management is to ensure the company‟s sale and profits by keeping both credit risk and payment delinquencies within satisfactory limits. Sound credit management engross finding the correct balance in the risk or reward relationship between sales and bad-debt losses. There are a number of ways to deal with credit risk. The most common include; avoiding risk, controlling risk, transferring risk, accepting risk, (Dennis, 2008). Avoiding risk can be achieved by refusing to increase credit outlay to high-risk accounts. In most companies, however, this option is not a realistic because there are so many customers could be put in the classification of high risk. Sales will dwindle to unacceptable levels if there is refusal to sell to all these „high risk‟ customers. Risk Control involves the development of comprehensive plan to minimise credit risk in the accounts base of a company, then implementing that plan, and monitoring the credit department‟s effort to carry out the plan. Risk acceptance involves a decision to do business with customers known to be of high risk. Such institutions tend to be companies trying to make a gain in their market share, companies recording high profit margins, companies which have excess inventory, and companies which have sufficient reserves for the bad debt losses that are almost certainly go hand in hand with this policy.

2.8 Credit management and policy

The general credit management policy document for the rural banks is the Part II of the Bank of Ghana Operational Manual for Rural Banks, which was issued in 1985 and commonly referred to as the „Green Book‟, in view of its green cover (Bank of Ghana, 1985). The document states all procedures for appraising credit, process for approval of credit, borrowing limits, monitoring and rescheduling and defaults. A review of the Operational Manual for Rural Banks by the researcher revealed that it basically emphasised good credit management principles to ensure credit facilities are ultimately repaid. The study made the following observations on the manual:

a. The aspect, which stood against good loan portfolio quality, is compulsory sectorial allocation under the character of financing proposal**,** which demands a minimum of 50 per cent of lending to agricultural sector. The dependence of agriculture on the vagaries of the weather makes it risky. The rigorous implementation of this directive, leads to the demise of some rural banks;

b. Furthermore, applicants for agricultural facilities, in view of the rural poverty, could hardly honour the demand of personal stake of 50 per cent of the eligible costs. This could scare off genuine applicants, who had the potential to repay credit facilities obtained. This aspect should therefore be exercised with circumspect and varied depending on the intimate desirable knowledge of the applicants; and

c. The principle of field visits, as a monitoring devise is laudable for the bank to follow through the actual performance of credit facilities. The general effectiveness of field visits is suspect, since underlying reports are invariably non-existent. This therefore requires attention.

2.9 The Credit Granting Process

The credit process begins with the submission of an application letter by the borrower to the bank. In the application letter, the amount applied for both in words and figure, the purpose for which the loan will be used for and the duration of payment must be stated. An application form is filled and signed by the applicant. In processing the application, the credit officer has to assess the exact nature of an obligation, sources of funds for repayment, financial statements, and a forecasted cash flow covering the duration of the loan. When it is a salaried loan, banks ensure that the debt service coverage ratio or gearing ratio does not exceed 45%. According to Sinkey,

(1992) the use of the five Cs namely Character (good citizen), Capacity (cash flow), capital (Wealth), Collateral (security) and Conditions (economic, especially downside vulnerability) in the administration of credit. The process or act of quantifying these Cs so that steady decisions can be made regarding a borrowers‟ credit worthiness is termed credit analysis. From the credit analysis it will be clear if the credit can be advanced. Other lending guides are: CCCPARTS (Character, Capital, Capability, Purpose, Amount, Repayment, Terms and Security), PARSER (Person, Amount, Repayment, Security, Expediency, Remuneration and CAMPARI which is Character, Ability, Margin, Purpose, Amount, Repayment and Insurance (Journal of Chartered Institute of Bankers, 2008).

2.10 The condition for accessing loan/credit

In this environment, small businesses generally have been upbeat about credit conditions. In order to boost the chance of loan payment therefore, banks necessitate potential borrowers to discharge some fundamental requirement. Ekumah et al (2010) found in their study that a potential borrower is required to have an account. The application for credit is first examined by the credit manager, processed it and then passed on through the process for approval by the manager, the credit committee, and the board of directors depending on their respective credit approval limit. A recent study by Monge et al (2001) explored institutional arrangement and banking practices present in Costa Rica for enforcing financial contracts. He found out that banks use the value and liquidity of the collateral presented by customer as a key criterion for granting credit. Other processes that bank use in granting credit is the previous experience with borrowers. Most small business lack detailed balance sheets and other financial information, upon which lending typically rely in making underwriting decision. In practice, many banks undergo a fairly lengthy credit review process for small business loans that involve several layers of an institutions credit department hierarchy. It also entails having credit officers extended visits to the business site.

2.11 Types of Loans

Banks in Ghana lend to salaried customers, pre-financing of contracts, exports and import finance, guarantee, mortgage facilities, agricultural credit, small and Medium enterprises loan, microfinance loans. Many researchers have confirmed this for example, Kaufman, (1993) is of the view that banks can be evaluated on their credit delivery which forms the core of banking operations. Akakpo, (1994) maintains that, banks profitability depends so much on lending that their performances and success depends on how effectively they manage their lending activities. Conversely, the view of Agyeman, (1987), is divided on the issue. While recognizing the importance of bank lending, he is also of the view that it has caused polarization of the rich from the poor and concentration of economic activities in the urban areas causing rural urban migration. Webster and Fidler, (1996) hold the view that, banks in making loans tend to favour large well established firms (mostly in the urban areas) as against small and newly established ones in the rural areas because large firms offer greater financial security. The credit products offered by rural and community banks include micro-finance loans, personal loans, salary loans, transport loans, Susu loans, and overdraft facilities. Rural bank loans are used for agriculture, cottage industries, and trading.

2.12 Loans Repayment

When loans are granted, management has to ensure that borrowers repay their loans because it determine the ability to grant further credit, profitability and sustainability of depositors" funds. Because borrowers sometime do not repay loans as scheduled, Dunkman, (1996) believes that whereas financial statements determine ability to repay loans, willingness to repay loans can be determined by past records. On that note if, prior to making a loan, there is evidence that repayment is questionable, the processing is a non-starter. To criticize Dunkman, (1996), good past financial statements and past records are no guarantees for future repayment.Another area where repayment should be looked at is from group lending activities. The ideal size of a group is a subject of debate. Huppi and Feder (1990), contend that, successful lending schemes work well with homogenous groups with joint liability for default. This makes individuals in the groups responsible for the default of other members and vice. If a member of the group default, members of the group are unlikely to receive further credit. This has a tendency to encourage members in these lending groups to ensure that members of the group are people they know and are confident will repay the loan. It also makes locating borrowers easier as all members of a group are not likely to vacate the residences. Since loan non repayment is likely, several studies have come out with pre-lending measures. Holden, (1987), identified the following: to ensure that the borrower has the legal right to borrow, ability to judge the character and credit worthiness of the borrower, and finally to ascertain whether or not an amount approved is adequate for the given purpose. With profit maximization and or risk minimization on their minds, lending banks need to balance between profitability on one side and liquidity and solvency on the other side. (Agyeman, 1987) and (McNaughton, 1992).

2.13 Some of the causes of loan/credit default

According to Amidu and Hinson, (2006), larger banks have higher credit risk and there is a positive relationship between capital structure of banks to banks‟ credit. According to Sinkey,

(1992), the credit risk (or quality) of a bank‟s loan portfolio depends on two sets of factors: these are those factors that external to the bank such as macroeconomic factors, natural disasters, death etc. The others are those factors that are subject to managerial discretion. Macroeconomic indicators such as inflation, interest rate and exchange rate, natural disasters and death can have serious consequences on the credit portfolio. An increase in inflation means that the purchasing power of customer has reduced. In another words, it means that an individual cannot buy the same quantity of a product s/he hitherto bought. The exchange rate is another major exogenous factor that affects the management of credit risk. The effect of exchange rate risk is that, an anticipated exchange rate changes have on the value of the firm. This section will look at the effect of currency fluctuations on lenders‟ businesses and particularly their ability to repay loans on schedule. Currency fluctuations can have both negative and positive effects on businesses in the local economy depending on howthe changes occur. Some internal or endogenous factors also affect the riskiness or quality ofa bank‟s loan portfolio. These are improper credit appraisals, lapses in the bank‟s loan policy, the quality and integrity of the credit staff, willingness of management, and industry best practices among others.

Dunkman, 1996 attributes the causes of loan defaults to either failure of credit officers to judge repayment ability of the borrower correctly or a change in the condition of the industry or the economy as a whole. Credit appraisal is the process by which the lender assesses the credit worthiness of the borrower. It revolves around character, collateral capability and capacity. It takes into account various factors like income of the applicants, number of dependents, monthly expenditure, repayment capacity, employment history, number of years of service and other factors which affect credit rating of the borrower. Improper or poorly done credit appraisals can create big problems when it comes to loan repayment.

2.14 Credit risk

The granting of credit facilities is underpinned by the risk of being repaid when due. Williams and Heins (1985) indicated that risk identification is the process by which a business systematically and continuously identifies property, liability, and personnel exposures as soon as or before they emerge. The first step in business risk management in their view is to identify the various types of potential losses confronting the firm, and secondly, to measure these potential losses with respect to such matters as their likelihood of occurrence and their probable severity. It is therefore pertinent to assess the inherent risk of a credit facility, the existing operational management to mitigating the risk and determining the underlying actual risk. This assessment gives the idea of intended quality of the credit facility. The unlikelihood that there will be a loss arising from default at repayment of a credit facility granted is referred to as credit or default risk. The primary danger in granting credit is the chance that the borrower will not repay the loan. Rouse (1989) buttressed this by stating that a lender „lends‟ money and does not give it away and there will always be some risk that the customer will be unable to repay. This therefore calls for critical assessment of any credit request with reasonable assurance that repayment would not be of much problem. A bank further covers the uncertainty of the repayment by demanding collateral. Risk of credit has the effect risk of liquidity, which in the extreme case can make a bank end up in severe financial crisis, resulting in loss of capital, rendering the bank insolvent and could totally collapse the bank. To pinpoint and deal with risks linked with management of credit, the Basel Committee on Banking Supervision issued a publication in

September 2000, which outlined these measures:

a) Establishment of a desired credit risk environment;

b) having sound process for granting credit to guide operation ;

c) having an appropriate process for credit administering, measuring and monitoring;

d) putting in place adequate control mechanism for credit risk; and

e) a well-defined role for supervisors;

The above issues outlined by the Basel Committee on Banking Supervision (2000) are expatiated as follows:

Establishment of a desired credit risk environment

The Board of Directors must carry out the responsibility of approving and on regular basis, at least yearly, conduct review of credit risk strategy and major policies of the bank on credit risk. The strategy should be a reflection on the bank‟s level of tolerance for risk and the expectation of the bank of the level of profitability for taking various credit risks. The implementation of the approved credit risk strategy becomes the responsibility of the senior management who have to come out with policies and procedures that would be used to identify, measure, monitor and control credit risk. All of the bank‟s operations, at both the individual credit level and portfolio level, have to be addressed by the policies and procedures formulated by senior management. Banks should figure out and properly manage credit risk that inherently go with all activities and products. In introducing new products or undertaken new activities, the banks should ensure that risks thereof are adequately subjected to procedures and controls for risk management, and has received a prior approval of the board of directors or the appropriate committee that mandated to perform risk assessment and evaluation.

a. Having sound process for granting credit to guide operations

Banks must carry out their business operations within sound, clearly specified criteria for granting credit. Such criteria should clearly indicate the largest market of the bank and a detailed borrower or counter-party undertaking, as well as the use or purpose and form of the credit, and its payment source. Banks should put in place comprehensive credit limits at the individual level of borrowing and counter-parties, and groups level of borrowing and connected counter-parties that form and aggregation in comparable and reasonable manner exposures of different types , both in banking and trading book and on and off balance sheet. Banks should have a clear defined process in place giving approval to fresh credit as well as the renewal, modification, and re-financing of remaining credits. All credit extension must be carried out on an arm-length basis. Particularly, credit to interrelated companies and individuals must have authorisation on an special basis, scrutinised with special care and other necessary steps taken to check or minimise the risk of lending not done arm‟s length.

Keeping an appropriate process for credit administration, measurement and monitoring

Banks need to have a system in place for the continuing administration of their portfolios with various credit risk-bearing and a means to monitor any conditions of insufficient credits, including the determination of inadequacy of reserves and provision. Banks receive the encouragement to create and use an in-house system of rating risk in credit risk management. The system of credit rating ought to show consistency with the size nature, and complexity of a bank‟s activities. Banks need to have management information system and analytical techniques that makes it possible for management to determine or estimate the credit risks which are inherent in all activities. The management information system has to give sufficient information on the structure of the credit portfolio, as well as identifying any risk concentration. Banks are required to have in place a monitoring system for the overall structure and value of the credit portfolios and take into account possible future fluctuations in economic conditions while making an assessment of individual credits and the associated stressful conditions.

Providing adequate control mechanisms for credit risk

The expected attributes included the following: Banks must institute system to conduct an independent, on-going assessment credit risk management process of the bank, and the outcomes of such continuous reviews should be conveyed directly to senior management and Board of Directors. It is necessary for banks to ensure that the function of credit granting is well managed and the level of credit exposure are within the confines of the limits set and are consistent with best standards and internal rules and regulations. Banks are further required to establish a system for undertaking early actions which aim at providing remedies for deteriorating credit, managing problem and related workout situations.

The role of supervisors: On the role of supervisors, the Basel Committee (2000) advised that supervisors should demand that banks institute effective system for identifying, measuring, monitoring and controlling credit risk as part of a total approach to managing risk. The Basel Committee (2000) emphasized the point that supervisors need to independently evaluate bank‟s strategies, policies, procedures and practices in relation to the granting of the credit and how the credit portfolio is managed. In addition, supervisors should take into account placing prudent limits to banks‟ exposures to individual borrowers or connected counter-parties groups. The issues brought up by the Basel Committee Publications (2000) are very relevant to credit risk management. The Board of Directors have the responsibility to approve and periodically conduct review of credit risk strategies whereas senior management are required to ensure these are effectively implemented. This issue may not be vividly pronounced in the rural banks but the other major commercial banks are alive to it. A robust process for management of credit provides the foundation for assessing how credit worthiness of beneficiaries. This helps to ascertain the of the credit whether the credit will be used for the purpose intended and also uncover any challenges, which may crop up for the enforcement of the necessary remedial action. This lessens the impact of the risk of the facility not yielding the intended returns and generating adequate flow of cash to service or pay back principal amount. Projects which have high-risk profile attachment should be given careful and constant monitoring to ensure being managed efficiently. The role of supervisors in providing good credit management practices is also a necessity. The single borrower exposure limits, insider lending (as stipulated in Part VI of the Banking Act, 2004 (Act 673)) and stringent provisioning rules are strictly enforced by the Central Bank. The Banking Act, 2004 (Act 673) ensure strict enforcement of the stringent rules and the single borrower exposure limits and insider-lending. The Central Bank has recently requested all the banks operating in Ghana to appoint risk officers to coordinate the all measures put in place to check the credit facing them. With regards to the rural banks, the Bank of Ghana has prescribed further credit limits above which such credit facilities has to be forwarded to be ratified before they are disbursed. This researcher considers the issues raised by the Basel Committee as very relevant to the management of credit risk and comments as follows:

a. The Board of Directors must give approval and conduct periodically reviews of credit risk strategies while senior management should implement such strategies as approved by the board effectively and efficiently. This would ensure that the Board of Directors exercises effective oversight over the credit management within the context of good corporate governance.

b. The institution of sound credit management ensures the use of the credit facilities for the specific purposes for which they are granted also uncover any challenges which may crop up for right action to be enforced to remedy them. Sound credit management processes mitigate the risk of the facility not realising the planned purpose and producing enough flow of cash pay off the principal amount. Projects that have high-risk profile attached to them have to be given careful and constant monitoring to guarantee efficient management.

c. The Bank of Ghana through regulations and the implementation of the Banking Act, 2004 (Act 673) ensures that banks adopt good credit management practices. The exposure limits to single borrower and internal lending (as stipulated in Part VI of the Banking Act, 2004) and stringent provisioning rules (specified in the Guide for Reporting Institutions, Bank of Ghana, 2005) are strictly enforced by the Bank of Ghana. The Bank of Ghana recently requested all banks to appoint risk officers to coordinate the all measures put in place to check the risks confronting them. With regard to rural banks, additional credit limits have been prescribed by the Bank of Ghana. Credit facilities which fall beyond the limits would have to be forwarded for ratification prior to being their disbursements.

2.15 Performance of the Rural Banks with regards to loan default

Asiedu-Mante (2002) has made an assertion that deposits which are very low and high rate of default have presented serious liquidity problems to certain rural banks, and has resulted in their losing public confidence. He gave a further indication that poor lending practices coupled with poor monitoring of credit facilities advanced to customers has led to high level of loan delinquency in a number of banks. This situation has made some rural banks unable to honour withdrawals. The situation has most often plunged some banks into distress as withdrawals could not be honoured. For instance, according to the Rural Banker, January-June 2002, in 1999 the banking licences of twenty-three distressed rural banks were withdrawn by the Bank of Ghana. The underlying factor for the twenty-three distressed rural banks was as a result of high occurrence of loan delinquency, fraudulent transactions, and poor management, which led to cash squeeze to meet withdrawals by depositors. Rose (1999), stated that in the case of most banks, loan accounts constitute fifty percent or more of all their assets and about 66 percent of their revenues. Moreover, banking risk tends to be relate mainly to loan portfolio. It is observed that when a bank finds itself in serious financial trouble, its problems usually emanates from loans that have become uncollectible as a result of poor management, illegally manipulating loans, poorly formulated and misleading lending policies, or an unexpected economic crisis. Rose‟s (1999) assertion is supported by a compilation from the returns submitted by rural to the central bank of Ghana. This indicates that the proportion of rural banks‟ loans outstanding to total assets was nearly 31.69 per cent as at end December 2004 and this increased marginally to 32.13 per cent as at end of March 2005 (Bank of Ghana, 2005). The ratio of non-performing in loans the banking industry according to the Bank of Ghana‟s compilation was 17.94 per cent as at the end of December 2003 and this reduced marginally to 16.13 per cent as at end of December 2004. The segments of non-performing loans in total loans for rural/community banks in the Greater Accra Region as at the end of December 2003 and 2004 were 23 per cent and 31 per cent in that order. The levels of the loan seen as not performing loans exceeded the Bank of

Ghana‟s prudential tolerable ratio of 15.0 per cent and this becomes an issue of concern for the banking industry, which requires institution of precautionary measures to minimise such unfavourable development. The relatively general high level of non-performing loans of rural banks in Ghana may give the reflection of the inappropriate credit management practices in vogue that need to be researched into and controlled.

2.16 Some determinant of loan default

2.16.1 Cost of borrowing (Interest Rate)

Stiglitz (1987) states that interest rates on lending would be greater if the likelihood of default is high. In this way, ventures with high risk of success attract higher interest rates. Bank of Ghana, (2005) indicates that lending to agriculture is deemed as having high risk and attracts more interest than giving loans to commerce, was about 30 per cent and 28.5 per cent respectively as at the end of December 2005. This situation however, tends to increase the risk of default, because cost of production rises if interest rates are high, and this may affect the expected demand for the affected products. This could be the reason why there is provision of subsidies to support the production of basic commodities like agricultural products in some developed countries. The cost of lending is also affected by loanable funds availability and the competing ends. In cases where Government needs to obtain substantial loans to support its business, high rates of interest are offered to prevent the private sector. This situation was encountered in the year 2000 where the rate of Treasury bill peaked at 45 per cent per annum (Bank of Ghana, 2000). The inflation level also affects interest rate. This is because a higher regime has a direct relationship with interest rates. Cox (1988) advocated this position when he pointed out that, interest rates were affected by supply and demand for funds, risk premium, factors of inflationary and amount of loan. Prior to the economic liberalisation of the in 1990, the Bank of Ghana controlled interest rates. During the period of before the liberalisation, Bank of Ghana fixed interest rates for the various sectors of the economy and the had to comply. The abolishment of this regulated economy saw the banks in Ghana fixing their own interest rates, allowing market forces to determine the micro-economic conditions. The Bank Rate of the Bank of Ghana seems to become the yardstick for the entire bank to use to determine their own interest rates. However, when there is a downward revision of the bank rate by the central bank, the other banks do not promptly respond to such revisions; it takes time for the banks to make the appropriate adjustment.

2.16.2 Borrower creditworthiness

The credit worthiness assessment is a process that gathers, processes and analyses information on the applicant of a loan. An essential part of information is obtained by credit references and credit rating. Ghana does not have established credit rating agencies to provide information on the credit standing of individuals and businesses in the system. The existence of such an agency would facilitate the credit decision process of banks. Rose (1999) indicate that the question which needs to be asked and addressed before any other is: can the customer pay back the loan or credit with a tolerable margin of error? The factors which underlie the assessment of pre-lending safeguards, in the view of Rose (1999) are as follows: capacity, collateral, character, cash, conditions and control. In a different context, Rouse (1989) referred to cues commonly used as a checklist for reviewing loan application as: "CCCPPARTS (Character, Capital, Capability, Purpose, Person, Amount, Repayment, Terms and Security); PARSER (Person, Amount, Repayment, Security, Expediency, Remuneration); CAMPARI (Character, Ability, Margin, Purpose, Amount, Repayment, Insurance/Security)". The differences the in the cues correspond to the basic principle of making as assessment for the likelihood of repayment of loan. Each of the factors outlined by Rose (ibid) are explained more in detail as follows:

Character: Past payment records of the customer; experience other lenders have had with the customer; purpose for obtaining the loan; customer‟s reputation being able to forecast personal income and business or credit rating.

Capacity: customer‟s identify and that of guarantors, customers social history, owners of legal structure, nature of activities or business operations, products and services, key customers, and suppliers for business-oriented borrower and quality of management.

Cash: the disposable income of the individual, earnings in the past, dividends, and record of sales for a business firm, adequate past and projected cash flow business; available liquid reserves, payables turnover, inventory, and accounts receivable; capital structure and leverage and control of expenditure.

Collateral: assets vulnerability to obsolescence, assets ownership, value of assets in the event of liquidation.

Conditions: current position of customer‟ in the industry and market share expected; the level of competition customer‟s products; of customer and industry sensitivity to business cycles and technological changes.

Control: requisite the banking laws and regulations pertaining to the nature and quality of loans deemed acceptable; sufficient documentation for assessors who may have a review of the loan.

Security: Securities for loans and overdrafts aim at ensuring recovery of the funds advanced to the customer in case the customer becomes reluctant or not capable of honouring his commitments. Dunkman (1996) stated justification for security is to safeguard against some uncertainties about borrowers‟ ability to repay, grounds for augmenting amount of loans beyond the current facilities, and as a last opportunity to have the loan recovered in the event of default. Agyeman (1987) is of the position that though security is needed, its use as a pre-requisite by bankers should be applied with caution becasue it is capable bringing about undesirable consequences for the bank. The author explains that, this crop up when bankable projects are financed only because of security availability. Stiglitz(1996) supported Agyeman‟s (1987) view that security has the latent consequence for skewing loans to favour owners of property. The researcher expresses the opinion that using security as the main factor in taking decisions in respect of credit advancement, viable projects lacking security backing, may be denied of credit in favour of those projects which have adequate security but not viable financially. This then serves as set back in employing financial intermediation as pivot for significantly growing and developing economically. Banks are from time to time faced with instituting legal action against institutional loan defaulters to take possession of assets used as collateral security for foreclosure. The rural communities of Ghana lack marketable properties that could be used as security and this explains why commercial banks do no find it comfortable making credit advances to the peasant farmers and owners of small-scale businesses in such communities. This necessitated the need to establish of rural banks, whose decision to extend credit does not depend rigidly on the existence of collateral security. The basis for granting credit to customers is thus the knowledge the rural banks have regarding their integrity. Akakpo (1994) also support the view that security is usually the last factor to consider in any request for loan and that security should not be the only reason for offering a loan to a customer. Any proposition for loan should independent of security. Security only provides a cushion in the event that things go wrong way. Rouse (1989) however, was the position that no credit should be offered as long as procedures for security are completely followed or at least at a stage where there could be finalisation of the security procedures without the further involvement of borrowers. This is a suggestion that the need for a customer to provide adequate security should be key in arriving at a decision on a credit. The rigidly ensuring there is complete collateral security before disbursing credits should be given some relaxation so as not to cause delay in the process of financing, which surely prevent the successful achievement of the objectives of projects. It a vital point to note that the security does not becomes the primary source of repayment. In this way, to guarantee a sustaining the relations with customers in their business activities, it is important to take into account the issue of viability of the project that is being financed. That is, there is the need to determine whether the project will generate enough cash flows to service the credit facility. Furthermore the foreclosure of property which is immovable and is pledged as security results in a long legal tussle, which could not provide prompt liquidity relief to a bank as expected. Thus, it is essential for banks to place focus much attention on the a project"s viability as a principal consideration for advancing credit to customers.

2.16.3 Monitoring

Credit facilities monitoring is a crucial function in ensuring project success for repayment to be made. Huppi and Feder (1990) made a revelation that effectively providing monitoring for credit facility results in higher recovery of loans by identifying possible risks (for example, loan diversions) and providing reminders to borrowers about their obligations to the bank that has given them credit . Credit facilities monitoring have been typically concentrated on make sure there is repayment when there are indications of defaults for payment of interest or principal by instalment. The researcher considers such practice as failing to achieve desired loan repayments because the facility might have deteriorated already. The researcher is of the position that loan monitoring should be comprehensive by closely observing what happens right from the moment the facility disbursed through ascertaining the funds deployment regarding the intended project, making following-ups and progress reviews, identifying deficiencies for possible guidance through discussions and field visits, ensuring timely repayment of proceeds from the project and providing advice on additional expansion or project re-direction. Monitoring „armed-chair‟ approach inevitably becomes a reason for failure to repay credit facilities. There should be effective monitoring instituted by a lending bank and keep management informed about the state of affairs regarding each project for which credit facility has been provided.

2.17 Loans Classification and provisioning

The outstanding credit facilities provided by banks are grouped quality assessment and determination of the loan loss provision level required. The classification of advances and loans by the rural banks has it basis on the guidelines the Bank of Ghana has issued . The classifications are in five categories, which are determined by the extent of default duration and other accompanying circumstances (i.e. a but beneficiary is deceased though facility not due to be repaid and with no provision for collateral). The current conditions for classification and required provisions loan loss are as shown in Table 1.

Table 2.1 Classification of Loans and Provisioning Rate for Banks

Category/Characteristics	Percentage of Required Provision
Current: Repayments on course or overdue up to 30 days.	1%
Other loans especially mentioned (OLEM): Repayment overdue from 30 – 90 days.	10%
Substandard: Repayment overdue from 90 – 180 days with insufficient cash flow and working capital.	25%
Doubtful: Repayment overdue from 180 – 360 days and in addition to facility not well secured and existing conditions make repayment questionable.	50%
Loss: Repayment overdue over 360 days and conditions pose no hope for repayment.	100.%

Source: Bank of Ghana's Guide for Reporting Institutions, 2005

The rate of provision is applicable to the total balance on the "Current" category. In the case of the other four categories, it corresponds to the balances net of prescribed realisable pledged collateral (ie cash, lien on deposits, treasury bills,). Bad and Doubtful Debts provisions are made in anticipation of credit facilities not being repaid when they are due. The Bank of Ghana guidelines as shown in Table 2.1 above, are the basis for making the provisions. The mechanism for provisioning is a yardstick regarding the strength of the bank‟s credit management practice. There is an inverse relation between the provisioning figure and its sustainable increasing trend on one hand and the credit management. Thus, there is high subjectivity in mechanism of provisioning particularly if the overdue period does not form the main benchmark. This, therefore, should be handled with much circumspection and cooperation between the central bank and the other banks. The consequence of misapplying the principle are distortions in both the profitability profile and quality of a bank‟s loan asset. The general provision of 1% on the balances of the classification „Current‟ without recourse to netting off allowable collateral in reference to the other classifications makes the application of the principle inconsistent.

CHAPTER THREE

METHODOLOGY AND THE ORGANISATIONAL PROFILE

3.0 Introduction

The chapter three presents and examines the methodology employed for the study. Thus the research design (quantitative and qualitative), research strategy (cross-sectional survey), population of the study, sample size and sampling techniques are discussed in this chapter. The data sources, techniques for the data collection and data analysis instruments as well as ethical consideration have also been examined. The primary and secondary data were used for the study.

3.1 Research Design

The research design deployed for this study was a cross sectional descriptive survey. The researcher further employed a mix method strategy. The reason was that the mix method strategy serves as a complement to each other. It also corroborates and off-sets the weakness of each other. With the survey strategy, researchers use questionnaires to gather data in order to answer question for a research problem. Neuman (2000) also points out that survey strategy involves asking a lot of people the same questions and examining their responses. The rationale behind using this strategy was to give a cross section of the loans officers and other managers the opportunity to clearly state their views, perceptions and feelings in order to evaluate the impact of non-performing loans on the rural bank performance whiles inferences would be made at the end of the study to cover the all bank from which the sample was drawn.

3.2 Population

Population refers to a group of people or objects which form the subject of study. In simple meaning, it consists of all the individuals or objects whose features are being studied (Saunders et al, 2007). In other words, population is the entire number of people or elements available for a study. The population for this study comprised of management and staff of selected Rural Banks in Kwahu Municipality. Target population comprised of loan officers and managers of the selected rural banks.

3.3 Sample Size and Sampling Procedure

A sample refers to any portion of a universe or population that is representation of that population. For the purpose of this study a purposive sampling technique was used to select the five (5) rural banks. Whiles convenient sampling technique is used to obtain a sample of 30 respondents for the study. Five respondents each are selected from Dumpong Rural Bank,

Kwahu Rural Bank, Odwen Anoma Rural Bank, Mumuadu Rural Bank and Kwahu Praso Rural Bank. This is due to time, finance and information scarcity.

3.4 Sources of Data

The data needed for a study can be collected either as secondary data or as primary data. Hussey et al., (1997) explain primary data will be collected at source whereas secondary data will be gotten from an already existed data. In this thesis, both secondary and primary data were utilized.

3.4.1 Primary Data

Primary data is a type of data that is collected at first hand. For this study the instrument used in collecting the primary data is questionnaires.

3.4.2 Secondary Data

Secondary data is a king of data collected for other purposes, and it is based on already existing data. Secondary data for this thesis are from literature like magazines, journals, books, articles, internet, and databases. The bank‟s policy documents and operational manual and were also not left out for some information. Other books from on-line and libraries formed the considerable portion of the literature review

3.5 Data Collection Instrument

In considering the topic, it was comprehend that questionnaires would be the main and the most suitable instrument to use. Questionnaires are relatively inexpensive less time-consuming way to gather data from a large number of respondents. The wording of the questionnaires to the target group was given a serious thought. The reason was to make sure the respondents provided objective responses to the questions in the questionnaire. The questions were in the form of forced choice-format or open ended and closed. With the open ended questions, the respondents gave their own answers; there was room for them to express their own opinions. For the closedended format, respondents had no choice than to choose between several given options.

3.6 Data Analysis

Data analysis is deals with the examination, categorization, and tabulation of sources of evidence to address the research questions and the objectives of the study. Before analysing the data, the data was cleaned up to remove possible errors to ensure accuracy and consistency. The analysis was done in two forms namely, statistical (quantitative) and non-statistical (qualitative). The researcher evaluated, summarized, and interpreted data quantitative using descriptive statistical techniques such as frequency tables. Microsoft Excel was used to generate the charts using the data collected. The scores for all questions were also summed up and the average score used. Data were reviewed after the collection of the completed questionnaires. The data from the interview were compiled. The qualitative analysis approaches of data engrossed data decreasing and tabulation. The secondary relevant data from published and unpublished works were also reviewed.

3.7 Limitations of the Study

The major restriction in the course of the study was time. In some cases a lot of time was spent waiting for the right person to get the right information while at other times it was just not possible to see such people because of their busy schedules. Also, some respondents failed to provide answers to the questionnaire which constituted 15% of the total targeted group. Financially, the research would have been much better if the needed financial resources were there when needed. Even though the researcher budgeted to spend certain amount of money on this study, but estimates were far below the actual due to the current nature of the economy. There was no body qualified as research assistant to help administer the questionnaire to the targeted group. There was also a challenge in retrieving the questionnaires administered.

3.8 Profiles of Selected Rural Banks In Kwahu Municipality

3.8.1 Dumpong Rural Bank Ltd

Dumpong Rural Bank Ltd established under the companies code as a limited liability company on the December 21st ,1987 at Kwahu Oframase, a towon in the Kwahu South District of the Eastern Region. The bank commenced operations on the 16th of February, 1988. Its initial stated capital was GHS350.60, with the Bank of Ghana contributing GHS50.00 in non- voting redeemable preference shares to support the bank. Following a fall in economic activities at Kwahu Oframase in addition to the bad nature of the road network in the area; the bank relocated its head office to Asakraka-Kwahu in 1992. The bank suffered a severe crisis, characterised by low liquidity arising from huge unpaid debts owed by a large number of loan defaulters. In 2003, the Bank of Ghana moved to rescue the bank by appointing an interim management committee

(IMC) and a new supervising manager to oversee the operations of the bank. The ARB Apex Bank also recapitalised the bank with an amount of GHS450, 000.00. As a result of these changes, in 2006 another new supervising manager was appointed through ARB Bank to oversee the operations of the bank, coupled with innovative ideas by the supervising manager and his able management team, micro finance products, thus individual and group micro finance products were introduced which further transformed the bank from a loss making organization to a profit making organization in the year 2007. The bank presently operates with four branches which are located at KwahuTafo in the Kwahu East District, Akoasi in the Birim North District, Nkawkaw in the Kwahu West Municipality and Asakraka in the Kwahu South District. Residents in the bank‟s catchment areas are the main shareholders of the bank. The bank has a sevenmember board of directors and has one supervising manager, three senior staff and five department heads. The bank‟s number of staff stands at 89.

***3.8.1.1* Mission Statement**

Its mission is to provide first-class banking and micro- finance services to improve the standards of living of the people in its catchment area and the whole of the Eastern Region.

3.8.1.2 Vision

The vision of Dumpong Rural Bank Limited is to position itself as the leader in rural banking and be a leading micro finance bank in the Eastern Region by 2015.

3.8.1.3 Core Values

The core values of the bank are: dedication and commitment; customer satisfaction; honesty, quality and prompt service; innovative products; productive and qualified human resource; and community development.

3.8.2 Mumuadu Rural Bank Ltd

The establishment of the Mumuadu Rural Bank Ltd occurred on the 26th of November, 1982, under the Companies Code 1963 (Act 179), The head office of the bank is at Osino. It is a financial institution with a workforce of about 96. It is a renowned rural bank in the Eastern Region, and has seven branches in Osino, Begoro, Kyebi, Koforidua, Suhum, Nkawkaw and New Abirem.

3.8.2.1 Mission Statement

The mission of Mumuadu Rural Bank Ltd is to promote and finance sustainable micro activities.

The bank aims at maximizing profit, earnings per share and market price per share (i.e. Shareholders worth). Also to become a well-managed Rural Bank in Ghana through a wellmotivated workforce; offer tailor-measured products and provide more customer friendly services to its clientele better than its competitors in the banking sector.

3.8.2.2 Vision

The bank has its vision to be first of the best rural banks in Ghana by 2015.

3.8.3 Kwahu Rural Bank Ltd

This bank was established in February, 1980 with its head office at PepeaseKwahu. It has branches in BepongKwahu, TafoKwahu, Nkawkaw, Koforidua, New Abirem, Market squareNkawkaw and Mpraeso. The bank as the name suggest belongs to the people of Kwahu and has staff strength of over 100 people. The bank had been ranked in club 100 before.

3.8.3.1 Mission Statement

To provide effective and efficient financial services by mobilizing funds to fortify the bank‟s capital base; ensure efficient banking services to all of its clients, and high returns to shareholders, other stakeholders, through strong networking with motivated and well-trained staff.

3.8.3.2 Vision

Their aim is to be the leader in rural bank in micro financing in Ghana by the year 2015.

3.8.4 Kwahu Praso Rural Bank Ltd

The bank was established in October, 1982 under the companies code 1963 (ACT 179). The head office of the bank is at Kwahu Praso. The bank has branches at the following places:

Nkawkaw, Obo, KwahuTafo, Koforidua and Kwahu Nkwatia with two mobilization centers at Pra River and Sumenakese. The bank has a staff force of 76. The shareholders of the bank are mainly residents in the catchment areas of the bank. The bank has a board made up of ten directors and managed by a senior manager, four senior staff and five heads of departments

3.8.4.1 Mission Statement

To provide effective and efficient financial services by mobilizing of funds to fortify the bank‟s capital base; ensure efficient banking services to all clients, and good returns to shareholders, other stakeholders, through strong networking with motivated and well-trained staff.

3.8.4.2 Vision

To be ranked among the best financial institutions, capable of providing excellent financial services and ensuring high standard of living of the people in its environs by the year 2016.

3.8.5 OdwenAnoma Rural Bank Ltd

The bank was founded as a limited liability company under the Companies Code on the 21st December 1987 in Kwahu Abetifi in the Kwahu east district of the Eastern Region and commenced business on the 16th of February 1988. The bank currently as four branches located at Koforidua, Abetifi, Kwahu-Mpraeso in the Kwahu south district, and Nkawkaw in the Kwahu west district. Residents in the bank‟s catchment areas are the main shareholders of the bank. The bank has a workforce of about 86.

3.8.5.1 Mission Statement

To be a rural bank of choice in the country through a well-motivated staff and efficient management with innovative customized products to gain greater market share.

3.8.5.2 Vision

To be the leader in rural bank in the Ghana, with community development in its catchment area by the end of the year 2016.

CHAPTER FOUR

DATA INTERPRETATION AND ANALYSIS

4.0 Introduction

The chapter four deals with the analysis of the results of the primary and secondary data of field survey to investigate into the determinants of loan default in rural banks at other rural banks in Kwahu municipality (Dumpong Rural Bank, Kwahu Rural Bank, OdwenAnoma Rural Bank, Mumuadu Rural Bank and KwahuPraso Rural Bank) with particular indication to the responses gotten as well as variables identified from literature. The results of the study were presented in the forms of tables. Prior to analysis of the data, the questionnaires were cleaned up of errors to ensure consistency, uniformity, accuracy and completeness. The results of the survey were processed with Microsoft Excel (spread sheet), charts, frequency distribution tables and percentage were used where appropriate to illustrate findings, analyse the close-ended questions more clearly and relation with the objectives of the study.

4.1 Background Information

Table 4.1 Respondents Current Position In The Banking Industry

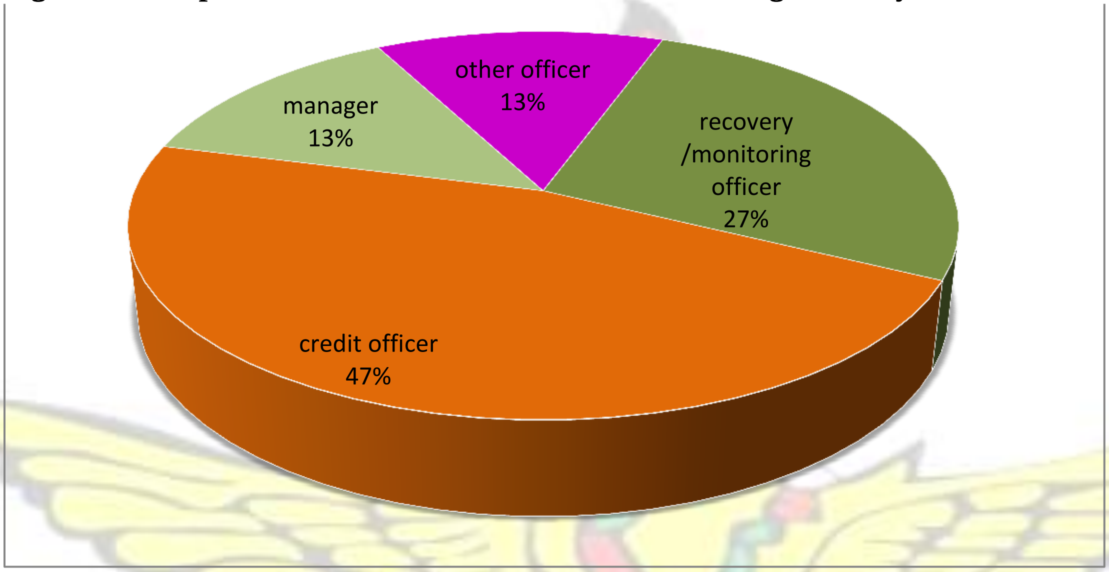
Variables	Frequency	Percent	Cumulative Percent
Recovery/monitoring officer	8	26.7	26.7
Credit officer	14	46.7	73.4
Manager	4	13.3	86.7
Other officer	4	13.3	100.0
Total	30	100.0	

Source: Field Survey, 2015

The Table 4.1 reveals the current position workers in the selected rural banks (Kwahu Municipality). Workers who are recovery/monitoring officers are 26.7%, 46.7% of them are credit officers. Workers who are manager are 13.3% and workers who are holding other positions are 13.3%. The results shows that majority of the workers are credit officers. The figure

4.1 gives a pictorial view of the results in the table 4.1.

Figure 4.1 Respondents Current Position In The Banking Industry



Source: Field Survey, 2015

Table 4.2 Respondents Experience In The Banking Industry

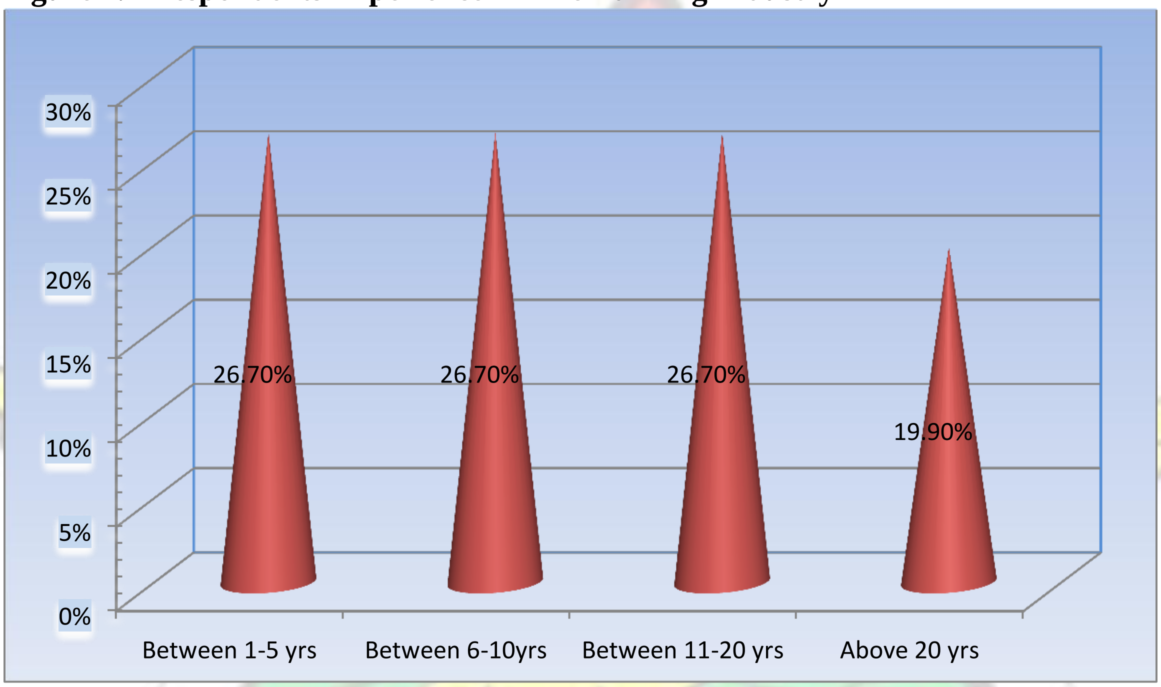
Variables	Frequency	Percent	Cumulative Percent
1 - 5years	8	26.7	26.7
6 - 10 years	8	26.7	53.4
11 - 20 years	8	26.7	80.1
Above 20 years	6	19.90	100.0
Total	30	100.0	

Source: Field Survey, 2015

The Table 4.2 identifies the banking experience of the worker in the banking industry. Workers with 1-5 years banking experience are 26.7%, workers with 6-10 years banking experience are

26.7% and workers with 11-20 years banking experience are 26.7%. Finally, 19.90% of the workers are having more than 20 years banking experience. This implies that majority of the workers in the Selected Rural Banks in the Kwahu municipality are having below 20 years working experience. The figure 4.2 further enhances the results in the table 4.2.

Figure 4.2 Respondents Experience In The Banking Industry



Source: Field Survey, 2015

Table 4.3 Determinant Of Loan Defaults Are Obvious

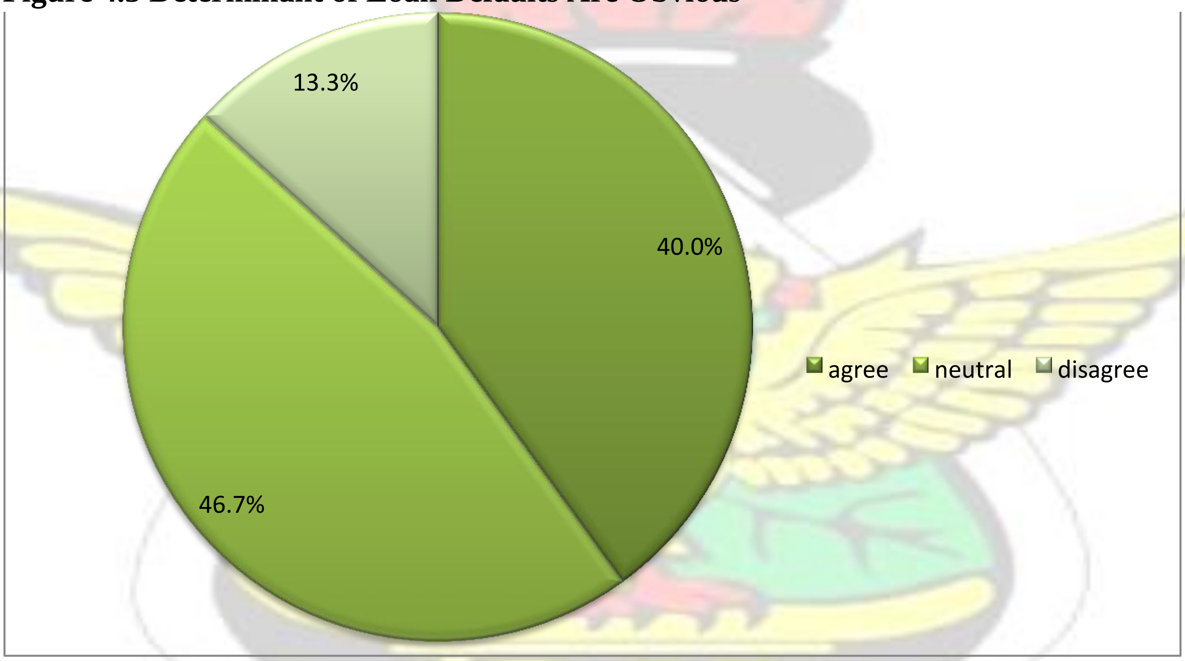
Variables	Frequency	Percent	Cumulative Percent
Agree	12	40.0	40.0
Neutral	14	46.7	86.7
Disagree	4	13.3	100.0
Total	30	100.0	

Source: Field Survey, 2015

The Table 4.3 declares that 46.7% of the workers did not specify whether obviously there are determinant of loan default. Workers who agreed that there are determinants of loan default in the Selected Rural banks in Kwahu municipality are 40.0% and 13.3% of them also disagreed.

The study implies that obviously there are determinant of loan defaults in the Selected Rural Banks in the Kwahu Municipality. A picture of the results in the table 4.3 is in the figure 4.3below.

Figure 4.3 Determinant of Loan Defaults Are Obvious



Source: Field Survey, 2015

4.2: Determinance of Non Performing Loans

Table 4.4 Identification of the laid down credit policy of your bank

Variables	Frequency	Percentage (%)
Target group	15	50.0
Approval Authority	30	100.0
Credit Methodology	30	100.0
Credit limit	25	83.3

Lending principles	30	100.0
Terms of loan repayments	30	100.0
Any others	0	0.0
Total	**30**	**100.0**

Source: Author‟s field survey, 2015

The Table 4.4 declares that 100% of the workers did specify that their bank have credit policy which specifies approval authority, credit methodology, lending principles and terms of loan repayment. Workers of 25 specified that their bank does not have limit when it comes to granting of loans provided the loan applicant operates well and can repay (ability in CAMPARI). 15 workers representing 50% were of the view that their banks have target group in which loans can be advanced to. The study implies that obviously there are laid down credit policy for all the selected Rural Banks in the Kwahu Municipality

4.2.2 Sector prone to loan default of Respondents

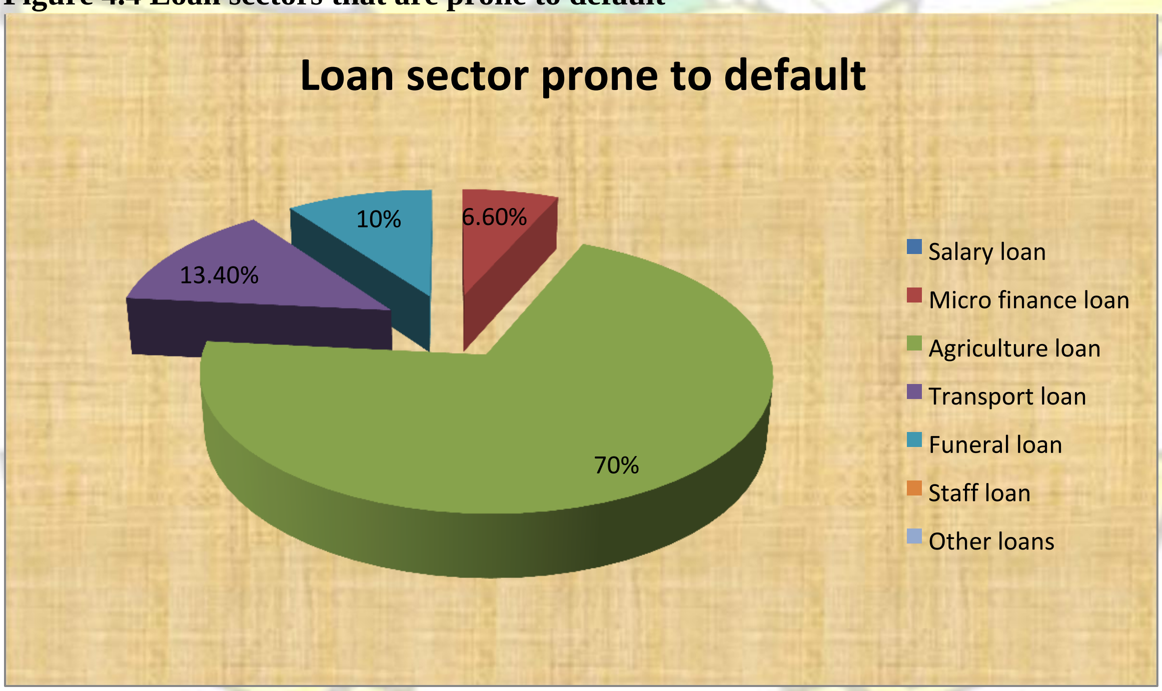
From table 4.4, it shows the percentage breakdown of respondents‟ sector of credit that is prone to loan default of the selected RCBs in Kwahu municipality. Majority which constitute 21 of the workers claimed that agriculture loan has the highest loan default rate which represents 70 percent of respondents. This inferred that the agriculture loan is very risky in rural banks. Four (4) of them were of the view that transportation was next prone to loan default in their bank of the selected RCBs constituted 13.4 percent, whiles 3 of workers mentioned that funeral loan is also prone to loan default (10 percent). Two (2) workers attested that micro finance loan have 6.6 percent prone to loan default in the selected rural banks in Kwahu municipality. Surprisely, none of the workers mentioned that salary loan, staff loan and other loans are prone to loan default in selected RCBs in Kwahu municipality.

Table 4.5 sector of credit that is prone to default

Product	Frequency	Percentage (%)
Salary loan	0	0.0
Micro Finance Loan	2	6.6
Agriculture loan	21	70.0
Transport loan	4	13.4
Funeral Loan	3	10.0
Staff Loan	0	0.0
Other Loans	0	0.0
Total	**30**	**100.0**

Source: Author"s field survey, 2015

Figure 4.4 Loan sectors that are prone to default



4.2.3: Loan default Factors

Table 4.6 Factors that cause occurrence of default of loans

ITEMS	RANK
Poor monitoring / Follow up	1.7333
Poor risk assessment	1.6000
High interest rate	1.5000
Wrong timing for the facility granted	1.4000
Others, please specify	1.4000
Lenient credit term	1.3000
Credit culture/ Orientation	1.3000
Rapid loan growth by banks	1.0667
Size of the Bank	1.0000
N	50

Source: Field Survey, 2015

The Table 4.6 examines the loan default factors of selected Rural Banks in the Kwahu Municipality. Poor monitoring/follows (X=1.73), Poor risk assessment(X=1.60), High interest rate (X=1.50), Wrong timing for the facility granted(X=1.40), others (X=1.400), Lenient credit term(X=1.30), credit culture/orientation (X=1.30), Rapid loan growth by banks (1.06%), Size of the Bank(X=1.00).

The finding indicates that all the aforementioned are factors of loan default factors of selected Rural Banks in Kwahu municipality. It was found that poor monitoring/follow up is the major factor of the selected Rural banks in the Kwahu municipality. The remaining factors are also issues bordering the non-performance of the bank.

4.2.4 : Credit Monitoring And The Occurrence Of loan default

Table 4.7 Descriptive Statistics on Credit Monitoring and the Occurrence Of loan default

Variables	Mean	Std. Deviation
Poorly assessed and advanced loan may perform well if properly monitored	4.2667	.58329
Strict monitoring ensures loan performance	4.0667	.25371
Loan follow up is directly related to occurrence of nonperforming loans	3.7667	.67891
Banks with higher budget for loan monitoring have lower nonperforming loans	3.5667	1.00630
Valid (N)	30	

Source: Field Survey, 2015

With the help of Likert scale 1-5 (where a mean of 5 indicated strongly agree, 4 agreed, 3 neutral, 2 disagree and 1 indicated strongly disagree), the study tasked the respondents to rate their agreement or disagreement with the factors listed in the table.

The Table 4.7 explores the credit monitoring and the occurrence of loan default of Selected Rural Banks in the Kwahu municipality. The variables are stated below; banks with higher budget for loan monitoring have lower loan default (X=3.56, STD=1.00), poorly assessed and advanced loan may perform well if properly monitored (X=4.26, STD=.58), strict monitoring ensures loan performance (X=4.06, STD=.25) and loan follow up is directly related to occurrence of nonperforming loans (X=3.76, STD=.67).

This implies that half of the workers came into agreement that strict monitoring ensures loan performance and poorly assessed and advanced loan may perform well if properly monitored as factors to credit monitoring and the occurrence of loan default of Selected Rural Banks in Kwahu. Again, the other half of the workers also of the opinion that loan follow up is directly related to occurrence of nonperforming loans and banks with higher budget for loan monitoring have lower loans going bad or default as their supporting factors for credit monitoring and the occurrence of loan defaults of selected rural banks in Kwahu Municipality.

4.2.5: Collateral And The Occurrence Of loan default

Table 4.8 Descriptive Statistics on Collateral and the Occurrence Of loan default

Variables	Mean	Std. Deviation
Most of the time no collateralized loans are defaulted	4.1667	0.37905
Collateralizing loans helps to protect loan default	4.0667	1.14269
Collateralized loan perform well	4.0333	0.80872
N =30		

Source: Field Survey, 2015

With the help of Likert scale 1-5 (where a mean of 5 indicated strongly agree, 4 agreed, 3 neutral, 2 disagree and 1 indicated strongly disagree), the study tasked the respondents to rate their agreement or disagreement with the factors enumerated in the table.

The Table 4.8 discloses the collateral and the occurrence of loan defaults of selected rural banks in the Kwahu municipality. Most of the time no collateralized loans are defaulted (X=4.16, STD=.37) Collateralizing loans helps to protect loan default (X=4.06, STD=1.14) and collateralized loan perform well (X=4.03, STD=.80).

Surprisingly, all the workers are with one accord that most of the time no collateralized loans are defaulted, collateralized loan perform well and collateralizing loans helps to protect loan default are their reasons for collateral and the occurrence of NPL of Selected Rural Banks the Kwahu Municipality. When such collateral are demanded by the rural banks before facilities are advanced to the customers, they are always of the belief that if they default, their properties will be confiscated by the banks.

4.2.6: Borrower's Orientation and the Occurrence of NPL

Table 4.9 Descriptive Statistics On Borrower's Orientation And The Occurrence Of Loan Default

Variables	Mean	Std. Deviation
Loan price affect loan performance	4.6000	1.03724
There is a relationship between loan default and borrower's culture	4.2667	.58329
Charging big interest rate leads to loan default	4.1000	.54772
Borrower's orientation / culture is related to loan performance	4.0667	.25371
Lenient / lax credit term cause loan default	4.0667	1.14269
Society's cultural development leads to good loans performance	4.0333	.92786
Default in some areas is ascribed to the culture of the borrower's	4.0333	.61495
Borrowers default because they don't understand credit terms well	3.6667	1.09334
Loans with interest rate tends to turn to default	3.3000	1.11880
N	30	

Source: Field Survey, 2015

With the help of Likert scale 1-5 (where a mean of 5 indicated strongly agree, 4 agreed, 3 neutral, 2 disagree and 1 indicated strongly disagree), the study tasked the respondents to rate their agreement or disagreement with the factors enumerated in the table.

The Table 4.9, measures the borrower‟s orientation and the occurrence of default of Selected Rural Banks in the Kwahu municipality. The following variables are; borrowers default because they do not understand credit terms well (X=3.66, STD=1.11), loan price affect loan performance (X=4.60, STD=1.03), there is a relationship between loan default and borrower's culture (X=4.26, STD=.58), loans with higher interest rate tends to default (X=3.30, STD=1.11), charging big interest rate leads to loan default (X=4.10, STD=.54), borrower's orientation / culture is related to loan performance (X=4.06, STD=.25), default in some areas is ascribed to the culture of the borrower's (X=4.03, STD=.92) and lenient / lax credit term cause loan default (X=4.06, STD=1.14).

The study shows that loan price affect loan performance, charging big interest rate leads to loan default, default in some areas is ascribed to the culture of the borrower's and there is a relationship between loan default and borrower's culture are some of the factors why majority of the workers came into strongly agreement with borrower‟s orientation and the occurrence of loan defaults of Selected Rural Banks in the Kwahu municipality

However, loans with high interest rate tends to turn to default and borrowers default because they do not understand credit terms well are also factors which few of the workers mentioned as the reasons borrower‟s orientation and the occurrence of loan default of selected rural banks in the Kwahu municipality.

4.2.7: Credit Size And The Occurrence Of Default

Table 4.10: Descriptive Statistic Credit Size And The Occurrence Of Default

Variables	Mean	Std. Deviation
With growth in bank size comes growth on default	4.2000	1.18613
Banks who credit growth is rapid experience huge default level	3.9667	.88992
Having large number of borrowers cause loan default	3.9000	1.47040
Loans default rate is directly related to bank's size	3.7000	1.36836
Aggressive lending leads to large default	3.4667	1.47936
Compromised integrity in lending leads to loan default	3.4333	1.16511
N	30	

Source: Field Survey, 2015

With the help of Likert scale 1-5 (where a mean of 5 indicated strongly agree, 4 agreed, 3 neutral, 2 disagree and 1 indicated strongly disagree), the study tasked the respondents to rate their agreement or disagreement with the factors enumerated in the table.

The Table 4.10 discloses the credit size and the occurrence of loan default of Selected Rural Banks in the Kwahu municipality. The following are the factors stated; banks who credit growth is rapid experience huge default level (X=3.9, STD=.88), with growth in Bank size comes growth on default (X=4.20, STD=1.18), compromised integrityin lending leads to loan default (X=3.43, STD=1.16), aggressive lending leads to large loan default (X=3.46, STD=1.47), having large number of borrowers cause loan default (X=3.90, STD=1.47), and loans default rate is directly related to Bank's size (X=3.70, STD=1.36). This indicates that few of the workers strongly agreed that growth in bank size comes growth on non-performing loans are the reasons for credit size and occurrence of loan default.

Subsequently, majority of the workers also mentioned some factors as the reasons for credit size and the occurrence of defaults among the selected rural banks in the Kwahu municipality. Notably are; loans default rate is directly related to bank's size, having large number of borrowers cause loan default, compromised integrity in lending leads to loan default, banks who credit growth is rapid experience huge default level and aggressive lending leads to large NPL volume / ratio.

CHAPTER FIVE

FINDINGS CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

The chapter five presents major findings regarding the investigating into the determinants of loan defaults in Selected Rural Banks Kwahu municipality namely Dumpong Rural Bank, Kwahu Rural Bank, Odwen Anoma Rural Bank, Mumuadu Rural Bank and KwahuPraso Rural Bank. From the data interpreted from the preceding chapter, a conclusion inferred from the major findings and recommendations are made for further studies

5.1 Summary of Findings

5.1.1Background Information

The study found that majority of the workers with 46.7% were credit officers whilst, 13.3% of them were managers and other officers, 26.7% were recovering/ monitoring officers. Only 19.90% of the workers were having above 20 years banking experience. However, 26.7% of the workers were having 1-5 years, 6-10 years and 11-20 years of experience when it comes to bank credit processes. Surprisingly, majority which was 46.7% of the workers were neutral on the determinants of loan default are obvious.

5.1.2 Non-performing loans

The finding indicated that the poor monitoring/ follow up is the major factor of non-performing loan factors of Selected Rural Banks in Kwahu municipality. The remaining factors like; poor risk assessment, high interest rates, wrong timing for the facility granted, lenient credit team, rapid loan growth by banks, size of the bank, and credit culture/orientation are also minor factors bordering the non-performance of the bank selected in Kwahu municipality.

5.1.3 The laid down credit policy of your bank

The study revealed that majority of the workers was of the view that they have laid down credit policy that they follow when it comes to credit administration. All the workers attested that their credit policy talked about approval authority, credit methodology, lending principles and terms of loan repayments. Surprisingly, 15 workers said their credit policy was silent on the target group and 25 workers also said same that there is no celling for their credit limit to client.

5.1.4 Credit monitoring and the occurrence of loan default

The study explored that half of the workers mentioned strict monitoring ensures loan performance and poorly assessed and advanced loan may perform well if properly monitored as factors to credit monitoring and the occurrence of default of selected rural banks in the Kwahu municipality.

Again, the other half of the workers also pointed that loan monitoring and follow-up is directly related to occurrence of loan defaults and banks with huge budget for loan monitoring have less loan default as their supporting factors for credit monitoring and the occurrence of loan default in the selected rural banks in the Kwahu municipality.

5.1.5 Collateral and the occurrence of loan default

Surprisingly, all the workers were with one accord that most of the time no collateralized loans are defaulted, collateralized loan perform well and collateralizing loans helps to protect loan default, are their reasons for collateral and the occurrence of non-performing loan of the selected rural banks in the Kwahu municipality.

5.1.6 Borrower's orientation and the occurrence of default

The study showed that loan price affect loan performance, charging high interest rate leads to loan default, default in some rural banks is attributed to the culture of the borrower's and there is a relationship between loan default and borrower's culture, are some of the factors why majority of the workers came into support with borrower‟s orientation and the occurrence of default of Selected Rural Banks in the Kwahu municipality. However, loans with interest rate tends to turn to non-performing loan and borrowers default because they do not understand credit terms well are also factors which few of the workers mentioned as the reasons for borrower‟s orientation and the occurrence of default of Selected Rural Banks in the Kwahu municipality.

5.1.7 Credit size and the occurrence of loan default

This declared that few of the workers had the perception that growth in bank size comes growth on non-performing loan are the reasons for credit size and occurrence of default of Selected rural banks in the Kwahu municipality.

Subsequently, majority of the workers also mentioned some factors as the reasons for credit size and the occurrence of NPL of Selected rural banks in the Kwahu municipality. Notably are; loans default rate is directly related to Bank's size, having large number of borrowers cause loan default, compromised integrity in lending leads to loan default and banks who credit growth is rapid experience huge default level.

5.2 Conclusion

In conclusion, loan default arise as a result of high interest rate of banks, large number of borrowers, poor monitoring/follow up of loans given to customers or clients, the leniency of credit officers and managers, poor risk assessment, and rapidity in growth of loan by banks and poor credit culture/orientation among others.

Again, proper monitoring and follow up and the use of collateral before the issuance of credit or loans will ensure the prevention of loan default.

Also agriculture loans are very risky and when granting it must be insured

5.3 Recommendation

The following are some of the recommendations for ensuring that loans granted clients do not default:

Firstly, effective monitoring and follow ups on borrowers to ascertain the progress of loan given in order to avert the instance of loans going bad.

Again, banks must adequately train staff in charge of credit in loan matters to enhance their credit issuance skills and also give orientation to prospective borrowers on strategic sectors to channel the loan so that its repayment will be fruitful.

Also, interest or charges on loans must be reduced by banks in order to facilitate repayment by borrowers.

It is recommended that banks must have research department to carry out effective risk assessment in order to give the requisite advice on the issuance of loans to borrowers

It is recommended that banks must initiate or if already in place strengthen their credit or loan policy in order to outline rigorous requirements that have to be met by borrowers before the issuance of loans.

Lastly, banks need to institute a collateral regime where loans to borrowers would be collateralized in order to have alternative repayment scheme.

5.4 Suggestions for Further Studies

This study concentrated on the determinant of loan default in selected RCBs in Kwahu municipality, it is therefore suggested that it should be extended to cover the entire RCBs industry in Eastern Region and not only Kwahu municipality. It is therefore recommended that further studies in relation to determinant of loan default in RCBs at Kwahu Municipality should be compared with outcome of the same RCBs in whole Eastern Region.

REFERENCES

Agyedu, G.O., Donkor, F, &Obeng, S. (2010). *Teach Yourself Research Methods*, University press, KNUST, Kumasi, Ghana.

Agyeman, K. (1987). “Short Term Lending Policies”, *Journal of the Ghana Institute of Bankers*, 2(1), 31-33.

Akakpo, R. (1994). “Benefits of Appropriate Lending Techniques”, *The Ghanaian Banker*, 2*(1), 35-36.*

Andah.D&Steel.W.F. (2000), Regulation of Financial Institutions.

Asiedu-Mante, E. (2004). Rural Banking In Ghana, Achievement and Prospects. Paper presented at the 3rd Annual Conference of Micro-finance in Arusha, Tanzania.

Asiedu-Mante, E. (2002). “Silver Jubilee Celebration of the Rural Banking in Ghana”, *The Rural Banker*, January – June, 2002.

Bank of Ghana Operational Manual for Rural Banks, 1985.

Bank of Ghana, Consolidated Returns of Rural Banks: 2003, 2004, 2005‟.

Basel Committee on Banking Supervision, “Principles for the Management of Credit Risk”, September 2000.

Bell, C., Srinivasin, T.N., &Udry, C. (1997.) Rationing, spillover and interlinking in credit markets: thecase of rural Punjab. Oxford Econ.Pap., 4 (49), 557–585.

CARE (2000*),* Microfinance Risk Management Hand Book. CARE International.

Consultative Group to Assist the Poor (CGAP, 2001) report

Cox, D. (1988).*Success in Elements of Banking.*London: John Murray Ltd.

Dunkman, W. E. (1996). *Money, Credit and Banking.*New York: Random House.

Danzil, W & Antony, H, (2007), Corporate Finance Principles and Practice (Consultative Group to Assist the Poor,(CGAP).http://www.cgap.org/html/poccasional_papers01.html

Government of Ghana, Banking Act, 2004 (Act 673), Accra: Ghana Publishing Corporation.

Huppi, M &Feder, G. (1990). "The Role of Groups and Credit Cooperatives in Rural Lending", *The World Bank Research Observer*, 5 (2), 187-202.

John Kay Associates Limited(2005), In-House Training in Accounting for non-accountants for credit officers.

Pandey I. M (2004) *Financial Management*.MacGrawHill. New Delhi.

Rose, P. S. (1999). *Commercial Bank Management.*Boston: Irwin/McGraw-Hill.

Rouse, C. N. (1989). *Bankers' Learning Techniques.*London: CIB Publications.

Sharma & Nepal (1997), Sustainability of Micro Finance Institution from small farmers perspective.

Stiglitz, J. E. (1987). "Some Theoretical Aspects of Agricultural Policies", World *Bank Research Observer*, 2 (1), 31-33.

Stiglitz, J. E. (1996). "Some Lessons from the East Asian Miracle", *World Bank Research Observer*, 2(2), 151-175.

Weston, J.F & Brigham E.F. (1982).*Essentials of Managerial Finance.*Person Publishers. New Yolk,

Williams, C. A. Jr. &Heins, R. M. (1985).*Risk Management and Insurance*. New York: McGraw-Hill.

APPENDIX A

QUESTIONNAIRES

This questionnaire is intended to solicit for information that will enable the researcher to investigate into factors that determine non-performing loans at Selected Rural Banks in Kwahu Municipal. The exercise is for academic purpose only in partial fulfilment for the degree of Masters of business administration with option in finance. Remember that your responses are confidential and solely for academic purposes.

SECTION ONE – BACKGROUND INFORMATION

1. Your current position in the Banking industry,in the boxes below, please tick **[√]**

Credit Officer	[ ]
Recovery/ monitoring officer	[ ]
Manager	[ ]
Marketing Officer	[ ]
Other	[ ]please specify ______________________

2. Indicate your experience in bank credit processes: please tick **[√]**1-5 [ ] 6-10 [ ]11-20 [ ] 21-30[ ] 30 and Above [ ]

Determinants of nonperforming loans or determinantsof default are obvious.In the boxes below, please tick **[√]**

Agree[ ]Neutral[ ]Disagree[ ]

SECTION TWO – DETERMINANTS OF NON PERFORMING LOANS

3. What are the laid down credits policy of your bank in terms of. Kindly write what is entail in your credit policy manual of your bank

Target Group…………………………………………………………………………

Approval Authority………………………………………………………………... Credit methodology………………………………………………………………..

Credit Limit…………………………………………………………………………

Lending principles……………………………………………………………….. Terms of loan repayments…………………………………………………………..

Any other……………………………………………………………………………

4. What sector of credit is prone to loan default in your bank. In the boxes below, please tick **[√]**

Salary loan [ ]

Commercial loan [ ]

Micro Finance Loan [ ]

Agriculture loan [ ]

Transport Loan [ ]

Staff Loan [ ]

Funeral Loan [ ]

Other Loans [ ] Specify…………………………………………..

5. Please rank the factors that cause occurrence of default of loans in your Bank**.** Using the scale below, please **circle** the response that best reflect your view

Strongly	Disagree	Disagree	Neutral	Agree	Strongly Agree
1	2	3	4	5	

Rapid loan growth by banks	1	2	3	4	5
High interest rate	1	2	3	4	5
Lenient credit terms	1	2	3	4	5
Credit culture/ Orientation	1	2	3	4	5
Size of the bank	1	2	3	4	5
Poor monitoring	1	2	3	4	5
Wrong timing for the facility granted	1	2	3	4	5
Poor risk assessment	1	2	3	4	5
Other, please specify	1	2	3	4	5

6. Please indicate your degree of agreement or disagreement to the statements pertaining to credit monitoring and the occurrence of default**.** Please use the following 5 point Likert scale to answer the questions where 1. Strongly Agree

2. Agree 3. Neutral 4. Disagree 5. Strongly Disagree

Strict monitoring ensures loan performance	(1)	(2)	(3)	(4)	(5)
Poorly assessed and advanced loans may perform well if properly monitored	(1)	(2)	(3)	(4)	(5)
Loan follow up is directly related to occurrence of nonperforming loans	(1)	(2)	(3)	(4)	(5)
Banks with higher budget for loan monitoring have lower non-performing loans	(1)	(2)	(3)	(4)	(5)

7. Please indicate your degree of agreement or disagreement to the statements pertaining to Collateral and the occurrence of default**.**

Please use the following 5 point Likert scale to answer the questions where 1. Strongly Agree 2. Agree 3. Neutral 4. Disagree 5. Strongly Disagree

Collateralized loans perform well	(1) (2) (3) (4) (5)
Collateralizing loans help protect loan default	(1) (2) (3) (4) (5)
Most of the time non collateralized loans are defaulted	(1) (2) (3) (4) (5)

8. Answer the questions in the following by ticking**[√]** in your opinion the correct answer: by indicating your degree of your knowledge to the statements pertaining to borrower‟s orientation and the occurrence of loan default

#	**Determinants**	**Very-well Known**	**Fairly Known**	**Known**	**Unknown**
1	Borrower‟s orientation/culture is related to loan performance				
2	Society‟s cultural development leads to good loan performance				
3	There is a relationship between loan default and borrower‟s culture				
4	Default in some area is ascribed to the culture of the borrowers				
5	Loans with big interest rate tend to turn to NPL or default				
5	Charging big interest rate leads to loan default				
6	Loan price affects loan performance				
7	Lenient / lax credit term cause loan default				
8	Borrowers default because they do not understand credit terms well				
9					

9. Answer the questions in the following by ticking**[√]** in your opinion the correct answer: by indicating your degree of your knowledge to the statements pertaining to borrower‟s Credit size and the occurrence of loan default

#	Determinants	Very-well Known	Fairly Known	Known	Unknown
1	Aggressive lending leads to large default				
2	Banks whose credit growth is rapid experience huge default level				
3	With growth in banks size comes growth on default				
4	Compromised integrity in lending leads to loan default				
5	Having large number of borrowers causes loan default				
5	Loans default rate is directly related to banks‟ size				
6	Having small number of borrowers causes loan default				

10. What are some of the challenges you encounter in credit management in your bank

____

____

____

____

____

____

____

____

11. State any contributions you think are the determinant of loan default in your bank apart from the above stated?

1. ____
2. ____
3. ____

Thank you for participating in this study.