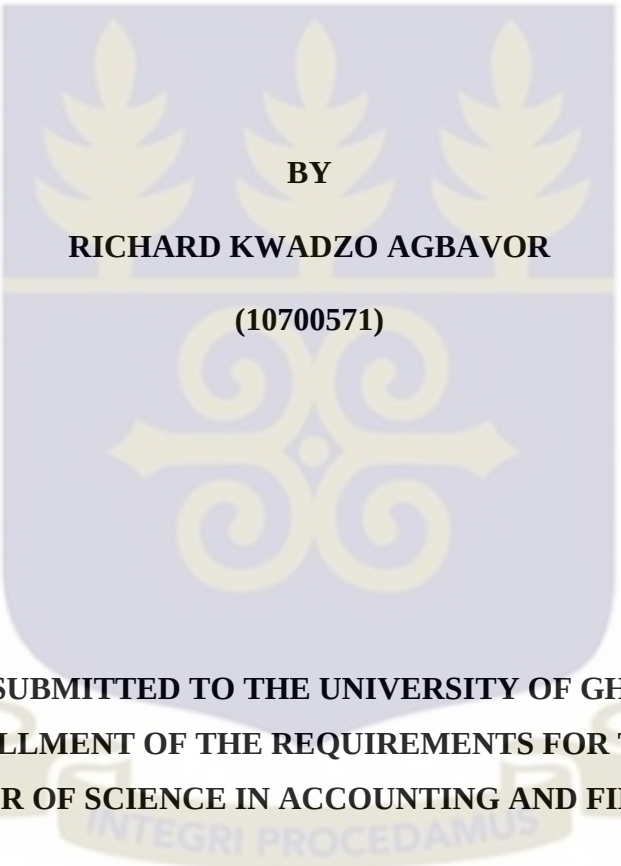


UNIVERSITY OF GHANA
(College of Humanities)

**CREDIT OFFICERS' PERSPECTIVES ON THE CAUSES OF NON-PERFORMING
LOANS: THE CASE OF COMMERCIAL BANKS IN GHANA.**



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**A LONG ESSAY SUBMITTED TO THE UNIVERSITY OF GHANA LEGON, IN
PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF
MASTER OF SCIENCE IN ACCOUNTING AND FINANCE**

AUGUST, 2019

DECLARATION

I hereby declare that this long essay is the result of my own efforts and have not partly or in its entirety been submitted to any university for a degree and that all sources of information quoted in this research have been duly acknowledge by means of complete references.

.....
RICHARD KWADZO AGBAVOR

(10700571)

.....
DATE

CERTIFICATION

I hereby certify that this thesis was supervised in accordance with the procedures laid down by
University of Ghana.

.....

DR. CLETUS AGYENIM-BOATENG

.....

DATE

DEDICATION

I dedicate this research work to my lovely wife, Happy Ami Sedzro, and my children, Nutifafa Yao Agbavor, Makafui Kwadzo Agbavor and Mawutor Kwame Agbavor.

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I am deeply grateful to God for his blessings and guidance throughout this long essay. All thanks to God for giving me life and good health to complete this work successfully.

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LIST OF ABBREVIATIONS

NPLs	-Non-Performing Loans
ROE	-Return on Equity
ROA	-Return on Asset
BOG	-Bank of Ghana
GDP	-Gross Domestic Product
CAR	-Capital Adequacy Ratio
LGD	-Loss Given Default
GMM	-General Method of Moment
RCBs	-Rural and Community Banks

ABSTRACT

The case of non-performing loans has gained increased attention in recent years because of its adverse effects on banking and non-banking financial institutions and the country's economy as a whole. Despite the various interventions implemented by the central bank to reduce this phenomenon, non-performing loans continue to grow in the books of financial institutions. The study therefore, seeks to examine credit officers' perspectives on the causes of non-performing loans in commercial banks in Ghana.

This study is an interpretative qualitative research which adopts a case study approach. The instruments used were interviews and publicly available documents. The data is analyzed using thematic analysis.

The study finds that commercial banks subject loan applicants to stringent loan requirement processes to ensure that loans are given to borrowers with low default risk who have the ability to pay regularly. The study also reveals that good credit history of the loan applicant, cash flows projections and collateral security in the form of assets or a guarantor are the main factors considered in the loan acquisition process. The study also finds that several factors ranging from business and industry challenges, economic conditions, legal amendments and new regulations, inadequate collateral security are the main causes of non-performing loans in commercial banks. The study recommends that commercial banks should ensure due diligence and effective monitoring of loans granted to loan applicants. The banks should also communicate constantly with loan applicants and adjust the payment terms if they are going through any business crises that threatens their cash flows. Again, there should be proper credit referencing bureau that allows banks to share customers' credit history among themselves.

CHAPTER ONE

INTRODUCTION

1.0 Introduction

This study examines credit officers' perspectives on the causes of non-performing loans in commercial banks in Ghana. The chapter introduces the entire study. It provides a general background of the study. It further discusses the problem statement, research objectives, research questions, the methodology used for the study and the organization of the study.

1.1 Background of the study

Commercial banks are the dominant financial institutions in most emerging economies, particularly, Ghana. Greuning and Bratanovic (2003) argue that commercial banks play a critical role to emerging economies where most borrowers have no access to capital markets. According to Khan and Senhadji (2001), well-functioning commercial banks accelerate economic growth while poorly functioning commercial banks are an impediment to economic progress and aggravate poverty. The contribution of financial institutions, particularly, commercial banks to economic growth happens through the process of taking deposit from surplus units and lending to deficit units who have business opportunities to explore but lack financial resources to do so.

The traditional role of a bank is lending and loans make up the majority of the total assets of commercial banks (Njanike, 2009). According to the research by Havrilesky and Boorman (1994), interest on loans contributes significant portion (about 85%) of all incomes generated by commercial banks. Lending is a herculean task for banks because if not assessed cautiously, it

will lead to high risk of default by borrowers leading to more non-performing loans in the books of the banks (Chhimpa, 2002). Past studies including (Bonilla, 2012 and Khemraj & Pasha, 2009) found that accumulated bad loans play a major role in bank failures. The 2008 global financial crisis and the subsequent recession in many economies has contributed to large accumulated bad loans in the books of commercial banks due to increased households' and firms' defaults, causing significant losses to the banks. Ultimately, unrecoverable amounts of loans are written off as non-performing loan (Mallick et al. 2007). Bank of Ghana classifies loan as Non Performing when it is overdue for 90 days or more.

Greenidge and Grosvenor (2010) find that the magnitude of non-performing loans is a key element in the initiation and progression of financial and banking crises. Guy (2011) agrees adding that non-performing loans have been widely used as a measure of asset quality among lending institutions and are often associated with failures and financial crises in both the developed and developing world. Reinhart and Rogoff (2010) as cited in Louzis et al (2011) point out that non-performing loans can be used to mark the onset of a banking crisis. Despite ongoing efforts to control bank lending activities, non-performing loans continue to rise which is a major concern for both international and local regulators (Boudriga et al, 2009).

The immediate consequences of non-performing loans are the reduction in profitability through disposal costs like provisions for credit losses and direct write-offs for bad debts and shrinking of loanable funds to the private sector. It is therefore imperative to investigate the causes of this phenomenon. It is against this background that this study seeks to examine credit officers' perspectives on the causes of non-performing loans in commercial banks in Ghana so that specific measures can be put in place to reduce the rate of NPLs in the books of banks.

1.2 Problem statement

Several studies including (Amuakwa-Mensah, Marbuah, & Marbuah, 2017; (Amuakwa-Mensah, 2015) Tomak, 2013; Warue, 2013; Ahmad and Bashir, 2013; Shingjerji, 2013; Warue, 2012; Bofondi and Ropele ; 2011) have identified several factors as the determinants of non-performing loans but these majority of these studies used general surveyed questions and perceptions from bank practitioners to study this phenomenon. However, to the best of my knowledge, no studies have used qualitative approach. It is therefore imperative to engage specific bank workers, particularly, credit officers whose actions and inactions have the potential of causing non-performing loans in the commercial banks.

Again, despite moves by the central bank to sanitize the banking sector, the industry's asset quality remains a source of concern as Non-Performing Loans (NPLs) ratio remain as high as 18% (Bank's Sector Report, 2019). According to the Bank of Ghana report (2018), the stock of NPLs increased from GHC 7.1billion as at April 2017 to GHC8.63billion in April 2018. The continuous increase in NPLs in the books of commercial banks is a worrying situation as it has the potential of slowing economic growth. It is therefore crucial to examine credit officers' perspectives on the causes of non-performing loans in commercial banks in Ghana.

1.3 Objectives of the study

The main objective of the study is to examine credit officers' perspectives on the causes of non-performing loans in commercial banks in Ghana.

The specific objectives are:

1. To examine the loan acquisition process of commercial banks in Ghana.
2. To assess the main factors that are taken into consideration before loans are granted.
3. To identify the causes of non-performing loans in commercial banks in Ghana.

1.4 Research Questions

The following research questions are formulated to achieve research objectives;

1. What are the processes that loan applicants go through in the loan acquisition process?
2. What are the main factors taken into consideration before loans are granted?
3. What are the causes of non-performing loans in commercial banks in Ghana?

1.5 Significance of the study

The performance of loan portfolios plays a critical role in determining the financial performance and survival of commercial banks. This study, therefore, has implications for policy, practice and academic research in the accounting profession.

First, the outcome of this study will enable credit officers and bank managers to review loan acquisition and monitoring process to reduce the increasing rate of non-performing loans. It will help expose the deficiencies in the current loan acquisition process so that credit officers can pay more attention to risky areas and thereby improve its operations

Second, the study will enable major policy makers such as the Bank of Ghana to help formulate policies which will help reduce the high risk associated with non-performing loans.

Third, the study will add to the limited literature on this topic. It will also serve as a reference material for other related research works yet to be done and serve as a basis for future research

1.6 Research Methodology

The study adopted interpretative qualitative approach and it was conducted using case study method. Both Primary and Secondary sources of data were used in the research. The main instruments used were interviews and publicly available documents. Some level of observations were made to triangulate the data from the respondents. The sample for the study was taken from a population of credit officers in commercial bank companies in Ghana, particularly, GCB Bank, GT Bank and UMB Bank using purposive and convenience sampling technique. The research methodology will be discussed in details in chapter three.

1.7 Scope and Limitations of the Study

This study is limited to credit officers working in commercial banks in Accra metropolis. It is worthy to note the study did not seek to generalize the findings.

The factors that will limit the study includes time and resource constraint. This will limit the number of contact hours with respondents for further and better interactions.

Also availability of independent data to verify assertions from respondents free from personal judgement will be a problem in conducting this research. Regardless of the constraint mentioned above, the authenticity of the work will not be affected in any way.

1.8 Organization of the Study

The study is organised into five main chapters.

Chapter one consists of the introduction which deals with the background of the study. It further gives problem statement, the research objectives and research questions, significance of the study, research methodology and organization of the study.

Chapter two reviews relevant literature and the theoretical framework that guides the study. This chapter is essential as it serves as grounds for discussing empirical data and relevant theories and concepts.

Chapter three focuses on the methodology that was adopted in the conduct of the study and it includes the following: research design, data collection methods and data analysis approach.

Chapter four is mainly concerned with presentation of the results and discussion of findings.

Chapter five finally provide a summary, recommendations and conclusions.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter reviews the relevant literature regarding the topic under study. It focuses on the theoretical and empirical review as well as their contribution to this current study. The main areas include: the concept of loans, evolution of non-performing loans, theories of NPLs, determinants of NPLs, bank operations management, reducing NPLs, challenges facing commercial banks, empirical studies on the topic and Bank of Ghana report on NPLs.

2.1 Loans

Legally, a credit facility is defined as a contractual promise between two parties where one party, the creditor agrees to provide a sum of money to a debtor, who in turn promises to return the said amount to the creditor either in one lump or in installments over a specified period of time (Hennie, 2003). The agreement may include provision of additional payment of rental charges on the funds advanced to the borrower (debtor) for the time the funds are in the hands of the debtor. The additional payments that are in the form of interest charges, processing fees, commissions, monitoring fees, among others are usually paid in addition to the principal sum lent. Indeed, these additional payments if made in accordance with the covenants of the credit facility constitute the interest income to the lender/creditor. A loan/credit facility may therefore be considered as performing if payment of both the principal and interest charges are up to date as agreed between the lender and the borrower. Per the Bank of Ghana (BoG) classification, loans are considered current if the payment of principal and interest are up to date. It goes further to stipulate that an overdraft is classified as current or performing if there are regular activities (swing) in the account

with no sign of hard core debt build-up (BoG, 2008). It can therefore be deduced that loans that are up to date in terms of principal and interest payment are described as performing loans and they constitute the healthy asset portfolio.

2.2 Credit Policy

Banking credit policy is the bank's written loan policy as determined by the Board of Directors. A loan policy formalizes lending guidelines that employees follow to conduct business. It identifies preferred loan qualities and establishes procedures for granting documentation and reviewing loans. The credit policies of banks including rural banks should address the following

- Who qualifying for credit and how much should be given.
- What type of credit is available?
- Information and documentation needed to approve new credit and renew facilities
- Target market
- Credit terms and conditions
- Credit limits
- Credit risk / how to manage credit issues
- Approval authorities, Collateral securities, Disbursement of funds, Repayment and rescheduling of credits, Credit supervision and Credit audit and reporting.

It must be noted that bank's sound credit policy would not only maintain sound credit granting standards but also ensures monitoring and control credit risk, properly evaluated new business opportunities and identifying, prevent and resolve credit problems.

2.3 Credit Processes and Monitoring

Commercial banks follow processes before granting loans to loan applicants.

The first process is credit appraisal. There are a lot of techniques used in appraisal of individual or corporate bodies. The most common techniques are the CAMPARI, and the 5c's (character, capital, collateral, condition and capacity).

The credit processes entail three (3) main functions which are listed below.

i. Business development and credit analysis:

Business development is the process of marketing bank services to existing and potential customers. With lending, it involves identifying new credit customers and soliciting their banking business as well as maintaining relationship with current customer and cross-selling non-credit services/product. Business development involves the following.

- Market research
- Advertising public relations
- Obtain formal loan request
- Interview Borrower
- Obtain final statements, Borrowing resolution and other related information.
- Evaluate management capability, collateral adequacy, industry dynamics and financial position.
- Credit officers make recommendation on accepting/rejecting loan request.

ii. Credit execution and administration

This involves the under listed

- Loan committee review proposal/recommendation
- Accept/reject decision made, terms negotiated

- Loan agreement, prepared with collateral documentation.
- Borrower signs agreement, turns over collateral, receives loans proceeds
- Perfect security interest.
- File materials in credit file.
- Process loan repayment; obtain periodic financial statements call on borrower.

iii. Credit Review.

- Review loan documentation
- Monitor compliance with loan agreement.
- Positive and negative loan covenant
- Delinquencies in loan requirement
- Discuss nature of delinquencies of other problems with borrower.
- Institute corrective action including modifying credit terms, obtaining additional capital, collateral, guarantees, etc. and call loan.

The second stage is credit Monitoring. This is an act of closely observing the unit which the bank has financial and is expecting in return interest and principal payment. The main aim of credit monitoring is to detect changes in the customer's credit worthiness so that corrective measures can be seen to minimize losses. Branch records, the annual financial reports, progress reports and the visit to company are the available tools for monitoring of loans.

The third stage is loan repayment: Any bank's ability to offer more loans is determined by the possibility of repayment of loans. This means that the more loans are repaid the more the banks become solvent hence its ability to grant more loans to others who may also apply. For the required profitability, banks must be careful in its management of loans. The possibility of adverse selection

of customers is a very common outcome of many loans given. This is as a result of the fact that customer's records are used to determine the ability to service the loan; some customers have the tendency of hiding real position at hand. Bruck (1997) opines that, loan administration goes beyond just approval of loans. The repayment of loans by customers would be made possible through its control and supervision. Personal loans granted to salaried workers, records a higher percentage of repayments. For instance, the credit given to agricultural farmers should be clearly monitored to ensure that decision of loan acquisition and the purchasing of other assets at the expense of servicing the loan on maturity is avoided.

The possibility of loan repayment on group lending is due to the fact that joint and several liability clauses are put in place to serve as a respite for the lenders. This gives the mandate for serious action to be taken against the group even to the extent of selling their personal assets to recover the loan.

2.4 Credit Risk

According to the Basel committee on banking supervision (2001) credit risk is simply defined as the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms. In afterwards, credit risk is the possibility of losing the outstanding loan partially or totally, to conduct events or partial risk.

The Basel Committee proposes two methods for calculating the capital requirements for credit risk. The 1st one which measures the risk in standardized manner and the 2nd one subject to the explicit approval of the bank's supervision and allows banks to use the internal rating based (IRB) Kay (2002) also defined credit risk as distribution of financial losses due to unexpected changes in the credit quality of counterparty in financial agreement. He highlighted that the probability of

default is estimated by specifying a model of investor uncertainty; a model of the available information and its evolution overtime, and a model definition of the default event.

2.4.1 Components of Credit Risk in Banks.

There are three major components of credits risk in Banks. This include the following

- i. Transaction Risk. This risk looks at changes or availability in credit and earnings resulting from having to underwrite individual loan transaction.
- ii. Intrinsic Risk: This type of risk is inherent in certain lines of business and loans to certain industries.
- iii. Concentration Risk: This risk aggregate transaction and intrinsic risk within the portfolio and may result from loans to one borrower or one industry.

Credit represents an amount of money that will be paid at some future date, in return for benefits received earlier, such as goods and services now for payment in future. Bank lending involves a bank providing a loan in return for the promise of interest and principal repayment in future.

2.4.2 Measurement of Credit Risk in Banks

Credit risk management is very important in the banking industry. Banks can usually project the average level of credit losses it can reasonably experience. The parameters that are usually used to measure credit risk are referred to;

- i) **Expected Losses (EL):** This is perceived as cost of business undertaking by financial institutions
- ii) **Unexpected Losses (UL):** These are losses above the expected level when banks anticipate their occurrence, though the timing and severity cannot be reliably known with hindsight.

Unexpected losses might be absorbed by the interest rate charged on credit exposure although the market will not support adequate prices to cover all unexpected losses.

iii) Loss Given Default (LGD): The amount of money which the bank can lose when the borrower defaults on a loan.

Thus, when losses occur, capital is needed to cover the risk of such losses. It is interesting to note that banks have the incentives to minimize capital they hold since reducing the capital releases more funds available which can be invested in profitable ventures. However, the lesser the bank's capital, the greater the likelihood that it will not be able to meet its own debt obligation as they fall due. That is losses in a given year will not be covered by profit available plus capital and therefore the bank becomes bankrupt or insolent. This means that banks must carefully balance the risks and rewards of having enough capital available. Thus, a bank must be able to determine how much capital it should hold.

2.5 Credit Recovery

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

It must be noted that Banks advances such as loans and overdrafts have disbursement date and maturity or expiry date. Upon disbursement of credit facilities customers are given schedule of repayment which deprives the key component including disbursement date, expiry date, and monthly repayment amount if applicable guides the credit officer to effectively monitor and recover non-performing loans.

Credit recovery process involves the following

- Send a reminder letter, one month before due date.
- First demand notice on due date.
- Second demand notice, one after first demand notice.
- Third and final demand notice, one month after second demand notices.
- Refer to recovery unit if available finally between 90 and 180 days upon expiry should be reported to the legal unit.

2.6 Non Performing Loans (NPLs)

The term Non-Performing Loans is used interchangeably with bad loans and impaired loans as identified in Fofack (2005). Berger and De young (1997) also describes these types of loans as “problem loans” In broad context, loans that are outstanding in both interest and principal for a period of time contrary to terms and conditions spelt out in the loan agreement are considered as non-performing loans. Available literature gives varied descriptions of non-performing loans. Some researchers observe that whilst certain countries use quantitative criteria, e.g the number of days the credit facility is overdue, others rely on qualitative criteria such as information about the customer’s financial status and management judgement about future payments (Bloem and Gorter,2001).

Alton and Hazen (2001) described non-performing loans as loans that are ninety days or more past due or no longer accruing interest. Caprio and Klingebiel (1990) cited in Fofack (2005), consider non-performing loans as loans which for a relatively long period of time do not generate income, that is both the principal and interest on these loans remain unpaid for at least 90 days. A non-performing loan may also refer to one that is not earning income and full payment of principal and

interest is no longer anticipated, principal or interest is 90 days or more or the maturity date has passed and payment in full has not been made.

2.7 Theoretical reviews on Non-Performing Loans

Several theories have been propounded to explain the causes of non-performing loans. These theories highlight the factors that contribute to the causes of non-performing loans in financial institutions. These include: transaction cost theory, stakeholder theory, asymmetry theory and agency theory. They will be discussed in the subsequent sub-sections.

2.7.1 Transaction Cost Theory

Transaction cost theory contradicts the assumption of complete markets. It is based on convexities in transaction technologies. Here, the financial intermediaries act as coalitions of individual lenders or scale or scope in the transaction technology.

Transaction cost theory has proven an essential framework for decision on the vertical boundaries of the firm. Transaction costs are the cost associated to the division of work. Williamson (2000), indicated that transaction occurs when a good or service is transferred across a technology separable interfaces. Variables that describe a transaction are among others, the specificity, the uncertainty, and the frequency of the transaction, whether an asset or a service is only or much more valuable in the context of a specific transaction. In the following human capital specificity, the asset specificity and the site specificity are taken into account (Reddy, 2002).

2.7.2 Stakeholder theory

Stakeholders' theory, developed originally by Freeman (1984) as a managerial instrument, has since evolved into a theory of the firm with high explanatory potential. Stakeholder theory focuses explicitly on equilibrium of stakeholder's interests as the main determinant of corporate policy.

The most promising contribution to risk management is the extension of implicit contracts theory from employment to other contracts, including sales and financing (Cornell and Shapiro, 1987). To certain industries, particularly high-tech and services, consumer trust in the company being able to continue offering its services in the future can substantially contribute to company value. However, the value of these implicit claims is highly sensitive to expected costs of financial distress and bankruptcy. Since corporate risk management practices lead to a decrease in these expected costs, company value rises (Klimczak, 2005). Therefore, stakeholder theory provides a new insight into possible rationale for risk management. However, it has not yet been tested directly. Investigations of financial distress hypothesis provide only indirect evidence (Judge, 2006).

2.7.3 Asymmetry Theory

The theory of asymmetric information tells us that it may be difficult to distinguish good from bad borrowers (Auronen, 2003 and Richard, 2011), which may result into adverse selection and moral hazards problems. The theory explains that in the market, the party that possesses more information on a specific item to be transacted is in a position to negotiate optimal terms for the transaction than the other party (Auronen, 2003).

The party that knows less about the same specific item to be transacted is therefore in a position of making either right or wrong decision concerning the transaction. Adverse selection and moral hazards have led to significant accumulation of Non-Performing loans in banks (Bester, 1994).

2.7.4 Agency Theory

According to the Agency theory, the principal agency problem can be reduced by better monitoring such as establishing more appropriate incentives for managers. In the field of corporate risk

management agency issue have been shown to influence managerial attitudes towards risk taking and hedging Smith and Stulz (1985). Theory also explains a possible mismatch of interest between shareholder management and debtholders due to asymmetries in earning distribution, which can result in the firm taking too much risk or not engaging in positive net value project (Smith and Stulz, 1987). Consequently, agency theory implies that defined hedging policies can have important influence on firm value (Fite and Pfleiderer, 1995).

2.8 Causes of Non-Performing Loans

Ahmad, (1997), highlights some key factors that cause loan defaults. These factors include: lack of willingness to pay loans, diversion of funds by borrowers, willful negligence and improper appraisal by Credit Officers. In addition to this, Hurt and Fesolvalyi (1998), corporate loan default increases as real gross domestic product decline, and that the exchange rate depreciation directly affects the repayment ability of borrowers. Balogun and Alimi (1988) also identified the major causes of loan default as loan shortages, delay in time of loan delivery, small farm size, and high interest rate, age of farmers, poor supervision, and non-profitability of farm enterprises. According to Olomola (1999), loan disbursement lag and high interest rate can significantly increase borrowing transaction cost and can also adversely affect repayment performance. Poor monitoring of loans by project officers has contributed much to the incidence of NPLs in Rural Banks. Some loan officers do not often monitor the loans they have recommended for approval after disbursement of such credit facilities. Such loans which are often left not being monitored result in non-performing loan. Also, poor credit appraisal as indicated above result in non-performing loans in banks. Some customers may not be qualified for credit facilities when detailed appraisal is done. In view of this some officer, in their own narrow interest present such business in way worth financing to the credit committee for approval. When this happens the loans may often not

be repaid either in the interest of principal amount. Often credit officer complain that, they are not fully resourced to do the monitoring. It must also be established that, diversion of loan purpose as mentioned by Ahmad, (1997), is a major contributor of non-performing loans. As soon the purpose of credit facility is diverted it affects the repayment of such facilities. Another cause of non-performing loan is loan by speculation. When people go to the banks for loans based on speculation they often willingly do not want to pay back such loans. Some of the have the believe that, the money given to them as loans are from government and government money is their own money at all they pay tax to the government through the local assembly. Business failure is another cause of non-performing loans in rural banks in Ghana. Business failure in Ghana is attributable to several factors but in all forms whenever it happens it affects the banks especially when the collapsing business has taken credit facility from the banks.

2.9 Effects of NPLs on Bank Operations

Return on equity (ROE) and return on asset (ROA) are commonly used to measure the profitability of banks. The efficiency of a bank can be properly evaluated on the basis of return on equity since it shows that banks reinvest its earnings to generate future profit (Njanike, 2009). A strong measure of any company's performance is its return on equity (ROE), which is a measure of how well the bank uses its reinvest earnings to generate additional earnings. A bank makes profit by earning more money than what they pay in expenses. The bulk of a bank's profits come from the interest that it earns on its loans and fees that it charges for its service. It therefore means that non-performing loans have huge negative impact on the profitability of banks which discourages investors.

2.10 Reducing Non-Performing Loans in commercial banks

The incidence of NPLs can be reduced by ensuring that loans are granted to only applicants who demonstrate the ability to repay the loan at the agreed date. Credit analysis of the prospective borrower should be carried out to determine their risk profile and to reach a sound credit decision. Again, loan repayment should be constantly monitored and whenever there is a default in repayment a quick action should be taken. The banks should also avoid granting loans to the risky customers or for speculative ventures, monitor loan repayments, and renegotiate loans whenever borrowers get into difficulties (Kay Associates Ltd, 2005). Golden and Walker (1993) also identify the 5Cs of bad credit, which represent things to guard against to help prevent the incidence of NPLs.

1. **Complacency** refers to the tendency to assume that because things were good in the past they will be good in the future. Common examples are over reliance on guarantors, reported net worth or past loan repayments success because things have always worked out well in the past.
2. **Carelessness** involves poor underwriting typically evidenced by inadequate loan documentation, lack of current financial information or other pertinent information in the credit files and a lack of protective covenants in the loan agreement. Each of these makes it difficult to monitor a borrower's progress and identify problems before they become unmanageable.
3. **Communication** ineffectiveness refers to when a Lender's credit objectives and policies are not clearly communicated. This is when loan problems can arise. Management must effectively communicate and enforce loan policies and loan officers should make management aware of specific problems with existing loans as soon as they appear.

4. **Contingencies** refer to lenders' tendency to play down or ignore circumstances in which a loan might result in default. The focus is on trying to make a deal work rather than identifying downside risk.
5. **Competition** involves following competitor's behavior rather than maintaining the lender's own credit standards. Doing something because another lender is doing it does not mean it is a prudent business practice.

2.11 Bank of Ghana Report on NPLs

The 2018 Bank of Ghana report on non-performing loans pointed out that the private sector, with the bigger share in total credit compared with the public sector, accounted for the bulk of NPLs in the industry - though its share declined from 97.5% in April 2017 to 90.7% in April 2018, with the public sectors share increasing from 2.5% to 9.3% over the same comparative period. The sectoral breakdown of NPLs by economic activity indicated that the Commerce and Finance sector – with the greatest share of the outstanding balance at 25.1% also contributed the most to the industry's NPLs, accounting for 29.2% of the total in April 2018.

The Service sector, the report noted, accounted for 13% of total NPLs outstanding as at end-April 2018 and the Mining and Quarrying sector, 3.5%. The report, however, noted that efforts by the Bank of Ghana to address these weaknesses are expected to improve the sector's performance in the medium-term, and are aimed at ensuring that the banking system is sound and capable of effectively playing its role in supporting and development of the economy.

So far, the central bank has moved to dissolve two banks- UT and Capital, placed UniBank under the administration of KPMG for 6 months, and appointed a special advisor to Sovereign Bank. These moves are expected to sanitize the already fragile sector and protect depositors' funds.

Apart from these moves, the Bank of Ghana has increased the stated capital from GHC 120 million to GHC 400 million with a deadline of December 2018; and introduced several guidelines to streamline risk management and corporate governance.

These guidelines and regulatory measures include publication of the corporate governance directive, in April 2018, to promote stronger corporate governance and risk management practices in the banks; the introduction Basel Regulatory Capital Requirement Directive, along with plans to roll out the Basel II/III supervisory framework; and an ongoing review of guidelines, directives and regulations to the industry in line with the new banks and specialized deposits-taking Institutions Acts, 2016 (Act 930).

To underscore rising NPLs and moves to curtail them, the report noted that bank loans and advances saw a marginal decline from GHC 30.99billion in April 2017 to GHC30.84 billion representing a -0.5% growth in April 2018. Changes in banks' overall investment in bills and securities indicated a shift in preference toward longer-dated securities in April 2018, the report said. While banks' investments in securities (long-term investment instruments/bonds) grew by 126.3% to GHC 15.7billion in April 2018, short-term investments (bills) of 19.36billion grew by 8.5% year-on-year in April 2018, compared with a growth of 43.3% in April 2017.

2.12 Other Challenges facing commercial banks

According to Mabvure et al (2012), the key challenges confronting the commercial banks in developing countries such as Ghana include Inadequate funding for capacity building, inadequate and expensive infrastructure base, Inadequate credit delivery and management, the inability to target the vulnerable and the marginalized, information gathering and dissemination, regulation and supervision, consumer protection and research, monitoring and evaluation.

(i) Capacity Building

The growing competition, poaching of staff and lack of training and increasing demand for higher pay levels make human resources one of the most intractable problems in the sector. Capacity building in the form of a skilled and professional human capital base and adequate access to funding is essential for the building of a sustainable and efficient microfinance sector.

(ii) Inadequate and expensive Infrastructure base

Inadequate and expensive infrastructure such as communication, information technology, roads and electricity results in high operational cost within the microfinance sector. The current limited supply of these resources limit operations and drives up cost. In respect of infrastructure development, there is the need to establish a solid base and provide adequate logistics such as telecommunications and information technology to support the operations of microfinance institutions to make them more efficient.

(iii) Inadequate Credit delivery and management

The mechanism for credit delivery within the microfinance sector is inadequate and the microfinance institutions do not have the expertise to categorize their client into the various poverty categories so as to meet their specific needs.

(iv) Information Gathering and Dissemination

Lack of adequate and reliable information remains a challenge to the microfinance industry. These problems adversely affect the ability to properly target the right clients in order to meet the specific needs of such clients. There is also a paucity of information on microfinance institutions and their operations.

(v) Regulation and Supervision

Microfinance institutions in the formal sector operates within a rigid regulatory and supervisory environment which presents some challenges for innovation, outreach and overall performance of the institutions. There is also an absence of specific BoG regulatory guidelines for the apex bodies in the semi-formal and informal sectors for the supervision of their members.

The next chapter will deal with methodology and procedures involved in the research work and underlying basis for selecting such methods in conducting the research and it also provides a contextual profile of the operational activities of Selected Commercial Banks in Ghana.

2.13 Empirical Reviews

Basel (2013) using estimation technique method and panel data set Covering 75 countries over ten-year period from 2005 to 2010 studied the macroeconomic determinants of non-performing loans. The Analysis presented that real GDP growth was the main driver of non- performing loan ratio. In addition, exchange rate depreciations lead to an increase of non-performing loans in countries with a high degree of lending in foreign currencies to un-hedged borrowers.

Salas and Saurina (2002) investigated the determinants of problem loans of Spanish Commercial and Savings Banks using a dynamic model and panel dataset covering the period 1985-1997. The finding of the study was that real growth in GDP, rapid credit expansions, bank size, capital ratio and market power all explain variation in NPLs.

Warue (2012) used a causal comparative research design based on bank structures was adopted and studied the effects of Bank Specific and Macroeconomic factor on non-performing loans in commercial bank in Kenya. The period under this study was 1995 to 2009. The study found

evidence that bank specific factors contribute to NPLs performance at higher magnitude compared with macroeconomic factors.

Idowu & Awoyemi (2014) assessed the impact of credit risk management with focus on the commercial banks in Nigeria. The study found the significance of these credit risk variables on the profitability of the banks. This outcome was realized through the application of panel regression on seven different commercial banks over seven-year period each from 2005 to 2011. Specifically, the study found the ascending rate of non-performing loans amongst the banks, an indication of very poor risk management practices within the country.

Curak et al (2013) further examined the determinants of non-performing loans with evidence from the southern Europeans banking systems. This study was realized with the use of dynamic panel analysis by the application of the General Method of Moment (GMM) on annual data from 2003 to 2010 for 69 banks in 10 different countries. The results found the decreasing economic growth of the countries, high inflation and higher interest rate to be the major causes of the non-performance of loans in the banking sector. Additionally, the credit risk is affected by bank-specific variables such as bank size, performance (ROA) and solvency. Wangai et al (2012) also undertook a study in Kenya on some microfinance banks by assessing the impact of the NPL on their profitability. They employed primary source of data which the survey made use of due to the small target population of 66. The quantitative analysis found the negative impact of credit risk on profitability as a result of increasing NPLs.

In the Ghanaian front, Afriyie & Akotey (2013) examined the credit risk management and profitability of rural banks in the Brong Ahafo region of Ghana. This research was made possible by the use of annual secondary data from 2006 to 2010 of 10 rural banks in the region. Through

the panel analysis on the CAR and NPL as credit management tools, the study found only NPL to be the major determinant of profitability of these rural banks in the region. CAR per the study did not have any significant influence on profitability. The study found an increasing level of profits despite their poor credit risk management in the form of high NPL. This was attributed to the fact that these banks transfer the risk of loan impairment to other customers in the form of high interests.

Mills & Amowine (2013) also worked on the rural bank profitability relationship in Ghana. With the application of quite a large sample of fifty rural banks over the period 2002 to 2011 and the use of panel regression, the study found the size of GDP and monetary expansion to be the major external forces that influence the profitability of rural banks in Ghana. To ensure the total transformation of the profitability of these banks, the government is thus encouraged to ensure economic growth and stability.

Also Nair & Fissha (2010) also analyzed the financial performance and the service delivery of 12 rural and community banks with evidence from Ghana. The financial performance they found to be mixed despite the good service delivered by these RCBs. This they attributed to the high and unacceptable percentage of NPL of about 16 percent which was far about the global average of 10 percent. An obvious indication that large amount of loans are never repaid by customers

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter presents the research methodology used for the study. It describes the methods and the procedures used to collect and analyse responses from the participants. The chapter will thus, be discussed as follows: research design, data collection methods and data analysis technique.

3.1 Research Design

According to Kerling (2014), research design is the overall plan to obtain answers to research questions. A research design constitutes the blueprint for collection, measurement and analysis of data (Creswell, 2009). The subsequent sub-sections will discuss the research method and approach used for the study.

3.1.1 Research Method

The purpose of this study is to examine credit officers' perspectives on the causes of non-performing loans in commercial banks in Ghana. Therefore, the study adopts qualitative method. This is because qualitative research seeks to uncover trends in thought and opinions, and dive deeper into a problem such as the topic under study. Qualitative research holds that understanding a phenomenon or situation or event comes from exploring the totality of the situation, often with access to large amounts of "hard data". It helps the researcher gain an in-depth understanding of the perspectives of the managers through extensive probing (Yin, 2003). Information on perspectives can be captured in the words, actions and comments of participants through the message they put forth. The study also focuses on interpretation rather than quantification; an

emphasis on subjectivity rather than objectivity and therefore quantitative method is not appropriate.

The use of qualitative methods can also be justified because the study is exploratory in nature. Saunders et al (2007) described exploratory studies as a valuable means of finding out, seeking new insights, asking questions and assessing a phenomenon in a new context. Creswell (2014) argues that qualitative research is an approach for exploring and understanding the meaning individuals or groups ascribe to a social or human problem. The process of research typically involves developing questions, collecting data in the participant's setting and inductively analyzing and interpreting the data. According to Wimmer and Dominick (2011) and Headlam and MacDonald (2009), the unique nature of qualitative research is its ability to give a complete, detailed description of what is observed.

The use of interpretative qualitative research was also influenced by some philosophical assumptions. This study adopted the interpretivist approach which assumes that access to reality is only through social constructions such as language, consciousness, shared meanings and instruments (Myers, 2008). This allows me to relate with participants to gain understanding of their views and use their responses to establish a case for my study.

3.1.2. Research Approach

This study employs Case Study method. Gall and Borg (2007) define case study as an in-depth study of one or more instances of experience in a real-life context that reflects the perspective of the participants involved in these experience. According to Punch (2005), case study aims to understand a particular case in detail, and in its natural setting, recognizing its complexity and its

context. It also has a holistic focus, aiming to preserve and understand the completeness of the case. According to (Yin, 2003) a case study design should be considered when the:

- (a) The focus of the study is to answer “how” and “why” questions;
- (b) You cannot manipulate the behaviour of those involved in the study;
- (c) You want to cover contextual conditions because you believe they are relevant to the phenomenon under study.

Typically, the case study researchers neither aim at discovering broad truth, nor look for cause-effect relations as quantitative researchers do, instead, they focus on describing, explaining and evaluating a fact (Cohen, Manion & Morrison, 2007). In order to achieve these aims, the researcher is compelled to spend adequate time in the context of the study to collect extensive data using multiple instruments to develop in-depth understanding of the facts under study.

Since this study focuses on the causes of non-performing loans through the perspective of credit officers and provides information on which sound conclusions would be drawn, the researcher deemed this research approach very appropriate for conducting the study because it helps in getting insights into issues in their natural setting.

3.2 Data Collection Techniques

According to Ternor (2011), the methods of collecting data should take into consideration the nature of investigation, objective and scope of inquiry, financial resources and available time among other things. The following data collection methods were used: in-depth interview and questionnaire.

3.2.1 Population and Sampling Techniques

The target population of this study includes all credit officers in commercial banks in Ghana.

Per the objectives of this study, the purposive sampling technique was employed. Lindlof and Taylor (2002) suggest that purposive sampling refers to the sites or cases chosen because there may be good reason to believe that ‘what goes on there’ is critical in getting answers to your research questions. Purposive sampling may be defined as selecting units based on specific purposes associated with answering a research study’s questions (Teddlie & Yu, 2007). Furthermore, a purposive sample includes respondents or subjects that are selected for possessing specific characteristics, thereby eliminating those that fail to meet the criteria (Yin, 2012).

Snowball sampling and convenience sampling were used to complement the purposive sampling in those rare cases when the population of interest cannot be identified other than by someone who knows that a certain person has the necessary experience or characteristics to be included and are available for the study. Credit officers who have worked for over a five-year period were selected for their experience in the field and possibly the diverse issues they may have encountered over a long period of time.

3.2.2 Data Collection Techniques

As mentioned earlier, the study adopted interpretive qualitative approach. The Interpretive approach is based on naturalistic approach of data collection such as interviews, observations and analysis of existing texts (Myers, 2008). These methods ensure an adequate dialog between the researcher and respondents in order to collaboratively construct a meaningful reality (Myers, 2013).

Data was collected through interviews, non-participatory observations, publicly available documents, reviewed journals and books on the topic. The subsequent subsections will discuss the instruments employed in the study as follows:

3.2.2.1 Interviews

There are three types of interviews which include: structured interview, semi-structured interview and unstructured interview. A Semi-structured interview was used for this study for a number of reasons.

First, the semi-structured interview method was most appropriate because it allows more and greater depth information from respondents (Kothari, 2004). It allows a researcher to organize his thoughts through proposed questions and further ask questions based on the responses from respondents for greater depth information about the respondents' responses (Myers, 2013). Mahoney (2006) adds that semi-structured interviews help the researcher to obtain rich and detailed material that can be used in the analysis. They are also characterized by extensive probing which gives a detailed description of events. It is important to note that this would not have been possible if structured interview or questionnaires were used as they would have limited the explanations to be given by respondents (Myers, 2013).

Second, the interview session also allowed for clarity of any ambiguity to any response by the respondents and also enables follow-up questions for more clarifications (Myers, 2013). This would not have been possible if questionnaires were used. Boyce and Neale (2006) gave an all-inclusive description of semi-structured interviews by explaining that it involves conducting intensive individual interviews with a small number of respondents to explore their perspectives on a particular idea, program, or situation. To them, semi-structured interview is useful when a researcher wants detailed information about a person's thoughts and behaviours or wants to explore new issues in depth. Legard, Keegan and Ward (2003, p.141) describe semi-structured interviews as "a form of conversation with a purpose". Legard, Keegan and Ward (2003) argue that the semi-structured interview combines structured questions with flexibility. They noted that

even if a researcher decides to use unstructured interviews, the researcher will have some themes in mind they wish to explore. With semi-structured interviews, interview guide setting out the key areas of the research is highlighted.

Third, it allows assessment of respondents' posture and facial expressions to make an impression about the responses from the respondents (Myers, 2013) and this greatly helped in the analysis.

Finally, it also allowed us the flexibility to change or adjust questions when the respondent is not comfortable with the nature of questions asked (Cassell & Symon, 1994).

In this study, a semi structured question guide will be used to enable the researcher keep track of the topic under study as well as allow the respondents to freely give their responses. The respondents will be selected based on the fact that their activities fall within the non-performing loans. Two weeks was dedicated for the interviews. Interviews was conducted in the comfort of the respondents' homes, work places and some at their leisure time to ensure naturalness and ease of responses. Tools that will be used for the interview are the researcher himself, printed out interview guide and a recorder.

3.2.2.2 Publicly Available Documents and the Internet

For the purpose of this research, publicly available document, journals and literature relevant to this topic were used to complement the interview data thereby benefitting from the advantages of data triangulation (Blaike, 1991). The use of relevant publicly available documents on non-performing loans, particularly, banking sector report from Bank of Ghana and Chartered Institute of Bankers provided me with an insight and understanding of non-performing loans situation in Ghana. The internet was also employed extensively for up-to-date materials on the topic.

3.2.3 Data Collection Process

An introductory letter was obtained from the Department and sent to the Human Resource department of commercial banks in Ghana to seek permission to interview credit officers. The permission was granted by commercial banks to carry out the research. Meetings with the respondents were subsequently scheduled. On occurrence of meeting, the data collected were recorded in two folds: I audio recorded the interview and jotted down salient points. This was made clear to the respondents before the interview was conducted. The interviews were later transcribed. The transcribed data gives indication of the participant's non-verbal communication. The data was also sent back to participants for data cleaning, where participants gave feedback on the transcribed data to increase reliability of the data. It was realized that too much writing will require the researcher to focus solely on what the respondents were saying. Writing everything would have withheld the opportunity of making gestures with the interviewees. This would have taken away the conversational nature of the interviews. The audio recording also ensures that no detail is left out. The transcription was done within the week of the interview.

3.2.4 Data Collection Period

The researcher conducted data collection over a period of three months. This afforded the researcher ample time to get in touch with sampled stakeholders for their views.

No	Name (Pseudonym)	Name of Organization (Pseudonym)	Position	Working Experience	Duration
1	Mr. Kumi	All Stars Bank Limited	Head of Corporate Credit	10 years	1 hour
2	Mr. Gat	DCB Bank Limited	Head of Credit Department	8 years	28 mins
3	Mrs. Lizi	HFO Bank Limited	Loan officer	9 years	36 mins
4	Mr. Kumi	All Stars Bank Limited	Head of Corporate Credit	10 years	20 mins
5	Mr. Gat	DCB Bank Limited	Head of Credit Department	8 years	25 mins
6	Mrs. Lizi	HFO Bank Limited	Loan officer	9 years	25 mins

3.4 Ethical Consideration

A major ethical issue upheld in this study is the assurance of anonymity and confidentiality to the respondents. This is particularly important in relation to names, addresses and other personal information. Before agreeing to partake in the various interview sessions, interviewees were assured that their personal details were going to be omitted from the final presentation of research findings to avoid their responses being linked to them. They were made to understand that no response would be directly attributed to a respondent and the information gathered from the interview was purely for academic work.

The individuals engaged as respondents in the interview for the research are considered as autonomous persons who are capable of making informed decisions about their preferences. This

indicates that individuals who agreed to give out information in aid of the research were respected. Their identity is to be well concealed so not to deter them from freely giving out information to other researchers.

The consents of the respondents were considered. Everyone to participate in this study freely consented without being coerced or unfairly pressurized. They were fully informed about what participation entails, their rights and the use of the data. They were assured that participation will not affect their career negatively. They were made to know that whenever they wanted to, they could simply withdraw from participation.

3.5 Data Analysis

The approach used in this study is the thematic analysis. Thematic analysis is a method of identifying, analysing and reporting themes (Braun & Clarke, 2006). This means that the research objectives are grouped into themes for easily identifying, analysing and reporting of the themes. Thematic analysis has been identified as the common method for descriptive qualitative research (Brick & Green, 2007). According to (Braun & Clarke, 2006), thematic analysis starts with familiarization with the data and it continues with the generation of initial codes, reviewing themes, defining and naming themes and producing the report on the findings.

Data collection and analysis took place concurrently which helped the researcher to modify the research questions in light of new findings (Hancock et al., 2007). Again, data from the interview were transcribed, recapitulated qualitatively, thematically reviewed and coded. Transcription was very necessary because it presented to us, an opportunity to get closer to the data. In order not to be overwhelmed, the data was reduced using coding. According to Farber (2006), coding involves

sifting through data to identify the themes that reflect concepts. The data was collaboratively coded by the research team with the help of the supervisor.

Data from the interviews were transcribed and after immersion into the data, themes were developed to make meaning out of it (Creswell, 2008). The raw data gathered from respondents were processed and analyzed. The data were put in themes in order to extract the meanings inherent in respondents' responses. The objectives of the research serve as the basis for the themes. The transcribed interviews were read and reread to ensure that all the salient issues as per the research objectives are brought to the fore.

3.6 Limitations of Research Approach

The quality of every research work is very essential; researchers must therefore consider the reliability and validity of a research (Joppe, 2000). The extent to which results are consistent over time and an accurate representation of the total population under study is referred to as reliability and if the results of a study can be reproduced under a similar methodology, then the research instrument is considered to be reliable.

Joppe (2000) indicates that validity determines whether the research truly measures that which it was intended to measure or how truthful the research results are. In other words, does the research instrument allow you to hit "the bull's eye" of your research object? Researchers generally determine validity by asking a series of questions, and will often look for the answers in the research of others.

The researcher acknowledges that the subjectivity of respondents; their opinions, attitudes and perspectives together contribute to a degree of bias. Therefore, as Gronlund & Linn (1990) postulate, the issue of validity in this study was seen as a matter of degree rather than as an absolute

state. This underpins the efforts to minimize invalidity and maximize validity. In the process, the researcher conceded to replace certainty with confidence in the results obtained and that, as reality is independent of the claims made for it, the accounts for reality in this study was only a representation of that reality rather than a reproduction of it.

Considering internal validity, which according to Cohen et al (2007), seeks to demonstrate that the explanation of a particular event, issue or set of data which a piece of research provides can actually be sustained by the data, the researcher used a mechanical means to record, store and retrieve data collected from the field.

CHAPTER FOUR

DATA ANALYSIS AND DISCUSSION OF RESULTS

4.0 Introduction

This chapter presents the data analysis and interpretation of results for the study. It gives an account of credit officers' perspectives on the causes of non-performing loans in commercial banks in Ghana. This chapter analyzes the findings from interviews and publicly available documents obtained from the field. Interactions with data saw the emergence of several concepts and themes that credit officers perceive about the causes of non-performing loans in commercial banks in Ghana. However, the focus of this study will be addressed in four main themes.

4.1 Loan Acquisition process

Potential applicants go through a number of processes before a loan is granted. These processes help financial institutions to effectively assess the ability of customers to make payment of the loan including interest and the principal amount. At this stage, due diligence is required in the assessment process since any careless and haphazard assessment of the loan applicant can result to non-performing loan. From the interviews, it was found that commercial banks subject loan applicants to stringent assessment procedures to ensure that loans are given to borrowers with low default risk who have the ability to pay regularly. However, all the commercial banks used for the study use a different approach. Respondent 1 explained that there are different procedures that first time and existing loan applicants go through before the loan is granted.

Respondent 1 explained that

“if a person is a first time borrower, he goes through some preliminary screening processes before the actual process comesand here you need to ask yourself if you have appetite for it...then it is forwarded to management planning committee for approval.....until you have that approval, you can't proceed.....”

However, he noted that existing loan applicants go through a simple process because they already have a credit history with the bank.

He said,

“.....if it is an existing relationship or customer, it is different. You just have to gather the necessary information and start working on it...”

He also emphasized that depending on whether the loan request is for corporate, retail, SME or personal reasons, it takes a different approach. This may be as a result of the different risk inherent in these types of businesses. It is expected that SME loan applicants will go through a tougher procedure compared to corporate loan applicant

Respondent 1 again said

“.....this is where we are talking about corporate. If it is retail, SME, the processes are different....”

He also explained that applications go through different people for approval depending on the amount that is being requested by the borrower.

“.....the application then go to the appropriate person for approval depending on the amount..... depending on a certain threshold, the person who is supposed to approve will approve it appropriately...”

It was also evident that loan applicants are advised on the use of the facility and they are also supposed to meet some pre-disbursement conditions before the facility is finally disbursed. This is to ensure that the customer use the facility for the intended purpose.

Respondent 1 emphasized that

“...Once the offer is granted, the customer is advised on the use of the facility....the customer is also supposed to meet pre-disbursement conditions before the loan is finally given to him”

The loan application process, however, was different in the second bank used for the study. It was evident that the loan application goes through several departments. The loan applicant is also required to give presentation on the loan before it is sent to the board for approval.

Respondent 2 explained that

“The accounts officer meet the customer and ask the customer to fill a term sheet.....the account officer then advised the customer whether he needs a loan, overdraft or purchasing order and then put it in a facility memorandum approval which goes through different department such as divisional head, credit administration, management credit committee where the customer is expected to do presentation and then goes to the board for approval.....”

Respondent 3 also gave a different process. She explained that the loan acquisition process depends on the loan product and the organization that the borrower finds himself. The bank also considers the credit history of the loan applicant to make sure he has good record on loan payment.

She said

“.....So the procedure depends on the loan product. If you are coming for a personal loan and you are salaried worker.....and you are from a reliable established company....with strong HR policies, the process is limited.....HR manager and accountant are supposed to endorse the form and attach your pay slip....”

This evidence confirms the findings of Afriyie & Akotey (2013) who found that loan applicants go through stringent procedures before a loan is granted and that is the reason SMEs do not consider bank credit to expand their businesses. However, these procedures are necessary for the bank to reduce default risk and for that matter non-performing loans. It helps the banks to select loan applicants who have high possibility of making payments. These findings are also consistent with central bank regulations on loans which requires that banks subject loan applicants to rigorous assessments to reduce default rate among borrowers that has the tendency of affecting the financial system and for that matter economic growth.

4.2 Determinants of Loan Approval

Financial institutions consider several factors before a loan is approved for a borrower. The loan applicant is expected to demonstrate to the bank that they will be able to meet the loan payment and in case of a default where the applicant has no control of, there is either a guarantor to make payment or an asset to dispose of to pay for the loan. It was evident from the data that commercial banks ensure that loan applicant have something substantial to rely on before a loan is approved. The interview data suggest that the common factors that are considered by commercial banks during the loan approval process includes good credit history of the loan applicant, cash flows projections of the customer, collateral security in the form of assets or a guarantor, the sector that the loan applicant is going to use the facility, financial records of the loan applicant, the status of the loan applicant (Whether the person is first timer or existing applicant), financial leverage, management structure, and regulations.

Respondent stated that

“...before you approve a loan, you want to see the business profile, corporate structure, customer records from existing banks, a-three year financials and whether the company is highly geared or not.....all these boils down to cash flow projections and that is the paramount consideration.....Besides this, depending on the amount, collateral is also required...sometimes the regulation requires that if the customer do not have collateral that has a market value of 120% of the loan facility, you cannot grant the loan and you cannot flout it.... ”

Respondent 2 also added

“...financials, poor financial records of the customer.....determining the needs of the customer is sometimes a struggle...if the customer does not provide you the necessary information it becomes difficult to approve the loan....we also differentiate between first time applicant and existing applicant.... ”

Respondent 3 also explained that

“.... strictly customer history. If you have taken loan before and you did not necessarily default but the repayment, I see penalties which is not as a result of delay in salaries but you are intentionally moving the funds, the bank will not give you the loan”

These requirements are good for the commercial banks as they ensure high certainty that loan applicants can meet repayment schedules. However, it discourages entrepreneurs and individuals who need loans. Curak, et al. (2013) find that credit history by SMEs owners and managers, poor financial records, lack of collateral security account for lack of credit to small and medium enterprises. As argued by Ruth (1987), the availability of collateral could be a signaling tool which demonstrates borrower's ability to repay loans. This, however, discourages start-ups for accessing credit facilities due to inadequate assets to serve as collateral security at the initial stage of the business. Bester (1987) also sees collateral as a screening device that protect banks; thus,

borrowers with low probability of default will reveal themselves by accepting collateral requirements and discourage high risk borrowers from accessing loans.

4.3 Causes of non-performing loans

The interview data reveal that several factors ranging from business challenges, economic conditions, legal considerations, lack of collateral security and industry challenges are the main causes of non-performing loans in the operations of commercial banks in Ghana. These factors will be discussed in the subsequent sub-sections.

4.3.1 Lack of due diligence and ineffective monitoring

Banks operate in a competitive environment and therefore compete among themselves to attract loan applicants as interest on loans contribute significant proportion to their income generating capacity. As a result, they are likely to bypass stringent procedures in a quest to meet its interest income target. This may lead to lack of due diligence in the credit process. When this happen, it is likely to cause non-performing loans. This was evident from the responses from respondents.

Respondent 2 said

“I think lack of due diligence in the credit process is the main cause of non-performing loans...ineffective monitoring of loan applicants also plays a role....”

Respondent 3 added

“.....HR also plays a role especially if you do not assess the HR properly... ineffective monitoring also contributes to non-performing loans....”

Lack of due diligence and ineffective monitoring during the credit process allows loan applicants to divert the funds to other projects that are more risky compared to the original intent of the borrower. This is consistent with Ahmad (1997) who find that lack of due diligence in the credit process should be blamed for non-performing loans in the books of commercial banks. Some

customers may not be qualified for credit facilities when detailed appraisal is done, however, credit officers in their own narrow interest present such business in way worth financing to the credit committee for approval and later turn out due diligence was not followed. The findings also support Balogun and Alimi (1988) claims. They asserted that some loan officers do not often monitor the loans they have recommended for approval after disbursement of such credit facilities. Such loans which are often left not being monitored result in non-performing loan.

4.3.2 Business and Industry Challenges

Cash flow projections which serve as the main criteria for granting loans are based on assumptions that the business and the industry environment will remain calm throughout the loan term for repayment. However, it is worthy to note that a particular industry may fade out as a result of change in taste and preference of consumers, technology improvement and lack of raw materials. Also, a specific business may face new competitors who may develop a new product line that customers are more attracted and thereby reducing cash flows of the business. Again, business failure also contributes to non-performing loans especially when the collapsing business has taken credit facility from the banks.

This was evident as respondent 1 explained that

“...assume that the customer has produced the good and he has to sell and the sales do not go as plan. The customer will not be able to generate enough funds to pay you”

This supports the findings of Hennie (2003) who posit that business failure as a result of not meeting revenue target is a cause of non-performing loans in Ghana. The financial clean-up exercise by Bank of Ghana has displaced a lot of businesses. Some of these businesses may have taken credit facility from commercial banks and because their businesses has failed, it is evident

that they will not be able to meet their repayment schedule and as a result lead to non-performing loans. Another example is the collapse of Menzgold where people took loans to invest in this company but was found to be dealing in fraudulent activities and consequently Securities and Exchange Commission shut it down. Many loan applicants were affected in this regard and could not honour their loan obligations.

4.3.3 Economic Conditions

Economic conditions such as exchange rate, recession, inflation and general confidence in the economy are phenomenon that cannot be controlled by banks or loan applicants. Changes in these economic variables, particularly, in the negative direction also play a role in causing non-performing loans. The empirical data suggest negative economic conditions also contribute to non-performing loans.

Respondent 1 lamented that

“.....it could be an issue of economic conditions. For instance, you have given a facility to a customer for a purpose of purchasing things from outside.... which he is supposed to sell in cedis.....Let’s say exchange rate at the time of the loan was 4 cedis but it has increased to 5 days...because the exchange rate has moved against the customer negatively...he has to pay more and this can lead to non-performing loan.....”

This is in line with Hurt and Fesolvalyi (1998). They find that corporate loan default increases as real gross domestic product decline, and that the exchange rate depreciation directly affects the repayment ability of borrowers. Basel (2013) also find even though, real GDP growth is the main driver of non- performing loan ratio, exchange rate depreciations lead to an increase in non-performing loans in countries with a high degree of imports. Ghana is a country with continuous trade deficit, thus it imports more than it exports. Its currency also suffers constant depreciation

against foreign currencies. These unfavourable economic conditions adversely affect businesses and for that matter loans that are needed to be converted into foreign currencies at the maturity date to make payment of the loan. The depreciation of the cedi requires that loan applicants pay more at the time of maturity and this can put pressure on the cash flows of the importer and make it difficult to honour their debt obligations.

4.3.4 Legal Amendments and New Regulations

Government continually makes changes to its laws concerning some sectors of the economy especially if it poses a great danger to its citizens. A sudden change in law usually affects businesses and their ability to pay loans. Government may also want to enforce its own existing laws that ensure sanity in the business environment which may adversely affect many businesses that are linked to such enterprises. Credit officers noted that legal amendment and government actions could also lead to non-performing loans as a result of the inability of the loan applicant to continue his business after these actions.

Respondent 1 noted that

“.....assuming you have a customer who is into hiring of excavators to people who are in a “galamsey” and there is new regulations which has banned “galamsey”..... This person will not be able have people renting his equipment and so he will not be able to generate the cash flows to pay for it.

These legal amendments and new regulations affect the ability of the borrower to continue business and generate enough cash flows to meet its obligations. This is consistent with the findings of Richard (2011) who finds that legal amendments and new regulations can also be blamed as the cause of non-performing loans.

4.3.5 Inadequate Collateral

Collateral security is one of the most important factor that banks consider in granting loans to loan applicants. This is because it serves as a cushion to the bank in times of default. Collaterals form part of the five “Cs” in evaluating a borrower’s ability to repay a loan. Inadequate collateral from a loan applicant increases the risk of the bank since in any event of default, the bank will not be able to rely on the collateral to pay for the loan. This was revealed by credit officers interviewed for the study.

Respondent 1 emphasised that

“....and one thing is when your fall back is weak.....where you not have adequate collateral. If something happen, you will not have anything to hold the customer....”

These assertions support several studies who found that collateral security is as one of the main challenges facing loan applicants in accessing credit facilities in Ghana. Abor & Biekpe (2006) finds that collateral security is one of reasons that discourage loan applicants financing by financial institutions in Ghana. Quartey, Turkson, Abor, & Iddrisu (2017) also find that collateral requirement is an impediment to loan applicants in accessing loans across Africa. As argued by Ruth (1987), the availability of collateral could be a signaling tool which demonstrates borrower’s ability to repay loans. This, however, discourages start-ups for accessing credit facilities due to inadequate assets at the initial stage of the business. Bester (1987) also sees collateral as a screening device that protect banks; thus, borrowers with low probability of default will reveal themselves by accepting collateral requirements and discourage high risk borrowers from accessing loans. In a study in Nigeria, Azende (2012) showed that loan applicants such as SMEs has difficulty in accessing funds from formal sources because of stringent collateral security requirement and inadequate risk mitigating schemes for formal sources of finance.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.0 Introduction

This chapter concludes the research work on the study credit officers' perspectives on the causes of non-performing loans in commercial banks in Ghana. It provides a summary of the findings, discusses the implications of these findings and provide recommendations on dealing with the positive and negative issues identified in the findings.

5.1 Summary of Findings

The study reveals that commercial banks subject loan applicants to stringent loan requirement process to ensure that loans are given to borrowers with low default risk who have the ability to pay regularly. This was consistent with central bank regulations on loans which requires that banks subject loan applicants to rigorous assessments to reduce default rate among borrowers.

Also the study reveals that factors that are considered by commercial banks during the loan approval process includes good credit history of the loan applicant, cash flows projections of the customer, collateral security in the form of assets or a guarantor, the sector that the loan applicant is going to use the facility, financial records of the loan applicant, the status of the loan applicant (Whether the person is first timer or existing applicant), financial leverage, management structure, and regulations.

The study also finds that several factors ranging from lack of due diligence and ineffective monitoring, business and industry challenges, economic conditions, legal amendments and new

regulations and inadequate collateral security are the main causes of non-performing loans in commercial banks.

5.2 Implications

A strong measure of any company's performance is its return on equity (ROE), which is a measure of how well the bank uses its reinvest earnings to generate additional earnings. The bulk of a bank's profits come from the interest that it earns on its loans. Non-performing loans reduce interest on loans and thereby impacting profitability of banks negatively. This reduce both return on equity and return on assets and as a result has the potential of discouraging investors and depositors from continuing doing business with the associated bank. Non-performing loans also discourages banks from granting loans to critical sectors of the economy such as road construction and other social intervention programmes which are relevant to the nation but investors continue to default due to initial challenges that they face. This affects the whole financial systems and has the potential of slowing down economic growth as banks become more aggressive and cautious in granting loans to deficit units who have business prospects.

5.3 Conclusion

The study examined credit officers' perspectives on the causes of non-performing loans in commercial banks. The study adopted interpretative qualitative research using case study approach. The instruments used were interviews and publicly available documents. The data was analyzed using thematic analysis. The study reveals that there are many causes of non-performing loans in commercial banks ranging from bank specific factors, business and industry challenges, economic conditions, collateral security issues and changes to existing laws. NPLs affect the whole financial systems and has the potential of slowing down economic growth.

5.4 Recommendation

In dealing with the implications of the study, commercial banks should ensure due diligence and effective monitoring of loans granted to loan applicants.

The banks should also communicate constantly with loan applicants and adjust the payment terms if they are going through any business crises that threatens their cash flows.

Again, there should be proper credit referencing bureau that allows banks to share customers' credit history among themselves

Most of the credit officers interviewed for the study claims that they do not have enough resources for monitoring, therefore the monitoring team should be well resourced to do constant monitoring of loan applicants.

The bank should also be able to do sectoral and industrial forecast to know ahead the future prospects before giving out loans to applicants.

Banks should not be complacent about existing loan applicants. They should do due diligence and effective monitoring of all loans applicant

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