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Diploma Thesis

Causes of Loan Default: A Case of some selected rural Banks in Ashanti Region

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Declaration

I hereby declare that I have worked on my diploma thesis titled "Causes of Loan Default: A Case Study of Some Selected Rural Banks in Ashanti Region" is my own, under guidance of my supervisor. I have used only academic literature and information resources mentioned in overview in the end of the diploma thesis. As author of the diploma thesis, I further declare that I have not breached copyrights of third parties when working on the diploma thesis.

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Acknowledgement

I would like to offer my profound appreciation to PhD. Oldřich Ludwig Dittrich, Ph.D., for his important suggestions and constructive criticisms of the content, construction and preparation of this report.

I would like to thank to my parents Mr. and Mrs. Appiah through whose sacrifice, support and encouragement I have come this far. I thank the workers of Sekyere Rural Bank Limited, Kumawuman Rural Bank Limited and Nsutaman Rural Bank Limited for their great help towards this study. I am forever grateful to the Omnipotent God for sustaining me in my quest for higher ducation.

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Causes of Loan Default: A Case Study of Some Selected Rural Banks in Ashanti Region

Summary :

Loan form a substantial amount of assets of rural banks because it is the predominate source of interest income. The first quarter of 2012 default rates of the selected rural banks were 11.72%, 24.44% and 60.43% for Sekyere Rural Bank, Kumawuman Rural Bank and Nsutaman Rural Bank respectively. These loans when defaulted tend to have serious effect in the financial health of the banks through making provision for bad debts. Hence the need for this study to examine the likely causes of loan default among selected rural banks in Ashanti Region. The study looked at the bank's loan default rate and the sectors loan default rate during the first quarter of 2012 and the likely factors that account for loan default. The study identified loan misapplication, high interest rate and poor economic activities in a particular sector of the economy as the major factors accounting for loan default. Primary and Secondary data were used in the study. To improve the quality of the rural bank's loan portfolio, then there must be best practices of appraisal of loan applicants in order to minimize loan default within the rural banks.

Keywords: Loan Default, Rural Banks, Ashanti Region-Ghana

Příčiny nesplácení úvěrů: případová studie vybraných venkovských bank v Ashanti regionu

Souhrn:

Půjčka tvoří podstatnou část aktiv venkovských bank, protože je zdrojem převládajících úrokových výnosů. V prvním čtvrtletí roku 2012 míra selhání u vybraných venkovských bank byla 11,72 %, 24,44 % a 60,43 % pro Sekyere venkova banky, Kumawuman venkova banky a Nsutaman venkova banky. Tyto úvěry mají tendenci mít vážný dopad na finanční zdraví bank proto, že pak vyžadují tvorbu rezerv na nedobytné pohledávky. Proto je třeba pro účely této studie zkoumat pravděpodobné příčiny nesplácení úvěrů u vybraných venkovských bank v Ashanti regionu. Práce se zaměřila na úvěr výchozí sazby banky a míry defaultu odvětví úvěru v průběhu prvního čtvrtletí roku 2012 a pravděpodobné faktory, které souvisí s nesplácením úvěrů. Studie určila úvěr nesprávné, tj. vysoké úrokové sazby a špatné ekonomické aktivity v určitém odvětví ekonomiky, jako hlavní faktory, na něž připadá nesplácení úvěrů. Ve studii byly použité primární a sekundární údaje. Chceme-li zlepšit kvalitu úvěrového portfolia venkovské banky, pak musí být použity osvědčené postupy posuzování žadatelů o úvěr, aby se tak minimalizovalo nesplácení úvěrů u venkovských bank .

Klíčová slova: Neplácení úvěru, venovské banky, Ashanti Region-Ghana

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CHAPTER ONE

LIST OF ABBREVIATIONS/ACRONYMS

AGMs	Annual General Meetings
ARB	Apex Rural Bank
BAAC	Bank for Agriculture and Agriculture Co-operatives
BKK	BadanKreditKecamantan
BIS	Bank for International Settlement
BoB	Board of Directors
BoG	Bank of Ghana
BNI	Bureau of National Investigation
BUD	Bank Rakyat Indonesia Unit Desa
CAMPARI	Character, Ability, Margin, Purpose, Amount, Repayment, Insurance
CBs	Commercial Banks
GB	Grameen Bank
IMF	International Monetary Fund
IFA	International Fund for Agricultural Development
KRB	Kumawuman Rural Bank
LARUTI	Lagos State Rural Transport Initiative
LGD	Losses-Given-Default
Ltd	Limited
LTV	Loan to Total Value
MiDA	Millenium Development Authority
MFI	Microfinance Institution
MASLOC	Microfinance and Small Loan Scheme
NBFC	Non-Banking Financial Company
NBFI	Non-Bank Financial Institutions
NGO	Non-Governmental Organization
NPL	Non-Performing Loan
NRBL	Nsutaman Rural Bank Limited
OLEM	Other Loan Exceptionally Mentioned
RCBs	Rural and Community Banks
SARB	South African Bank
SRBL	Sekyere Rural Bank Limited

SFO Serious Fraud Office

SMEs Small and Medium-scale Enterprises

SPSS Statistical Package for Social Science

UBS United Building Society

INTRODUCTION

Lenders of funds in the formal financial sector use the deposits of their clients whilst lenders operating in the informal sector use mainly use their own funds to advance money to borrowers. The transactions are expected to lead to a recoup of the financial capital. If this does not happen, borrowers benefit at the expense of lenders.The thesis is structured into five chapters. Chapter one will discuss the statement of the problem and the aims or goals of the study. Chapter two will discuss the methodology of the thesis, chapter three will deal with the literature review and chapter four deals with the results and findings of the study and the final chapter deals with the summary, recommendations and conclusion.

GOALS AND METHODOLOGY OF WORK

The specific objectives for the study include:

- To determine the rate of loan default in the selected rural banks in the Ashanti Region of Ghana
- To find the factors that causes loan default in rural banks.
- To examine the effects of loan default on the rural banks and their borrowers.

Sampling Techniques and Sample Size

The sample size of the study focused on the borrowers and loan officers of Sekyere Rural Bank Limited, Kumawuman Rural Bank Limited and Nsutaman Rural Bank Limited.

The research was conducted by interviewing a sample size of two loan officers from each bank and forty borrowers from each of these three rural banks. The study was conducted using a non-probability sampling technique. A non-probability sampling technique is sampling method where the probability of selection cannot be accurately determined. The type of non-probability sampling technique used was convenience sampling.

CHAPTER ONE

INTRODUCTION

1.0 Background of the Study

Lenders of funds in the formal financial sector use deposits of their clients whilst lenders operating in the informal sector use mainly their own funds to advance money to borrowers. In either case, the transactions are expected to lead to recouping the financial capital. If this does not happen, borrowers benefit at the expense of lenders. Assuming this continuous, bankruptcy will be the ultimate result and this will reduce the financial intermediation.

The financial system is the vessel that carries life-blood through the economic system. It plays very pivotal role in every economic development agenda of nations. In fact, the financial system mobilize huge amount of savings from surplus units and allocate them effectively among deficit units. This forms one of the core functions of banks-collection of society savings and allocation of them among firms and sectors that need capital as an impact in their economic activities. Thus the banking sector affects every sphere of the economy and can determine and alter the path of economic progress in markets with least developed capital for alternative financing sources. By offering payments system services and protecting deposits, banks may become a cornerstone of economic prosperity.

The system is, however, now plagued by persistent crises. Even some of the countries that have followed fiscal and monetary policies have become engulfed in the default of a loan by borrowers. It has become the order of the day. The generally recognized most important cause is, however, excessive and imprudent lending by the banks. ‘‘One cannot blame banks for this, because, like anyone else, they wish to maximize their profits in a materialist cultural environment when maximization of income and wealth is the highest measure of human achievement’’ (Mishkin, 1997, p. 62).

The experiences of these institutions have, however, not been satisfactory. Sunderante (1978), for example, reported that many countries in Africa, the Middle East and the Latin America experience high rate of default ranging from fifty percent(50%) to as much as ninety five 95(%).The issue of loan default can fuel banking crises and result in the collapse of some of these institutions with their attendant repercussion on the economy as a whole. Kare and Rice (2001) stated that at the peak of financial crises in Benin, 80% of total bank loans portfolio which was about 17% of GDP was in default in the nineties.

The loan defaulted result in bad debt which affect banks earnings on such loans. These defaulted loans become a cost to the banks in terms of their implications on their profitability and performance. The phenomenon of persistence loan default is widespread in developing world. This is evident by the undercapitalization and illiquidity in a research carried out by the World Bank (1993). The problem of loan default is not common only in Ghana but it is also in other countries where the problem has led to the liquidation of some banks.

In light of the above, the issue of causes of loan default has raised some concern among stakeholders of the institutions. The study therefore seeks to find out how loan default affects the financial performance of Rural Banks in Ghana specifically in the areas of loan interest income, lending funds and profits. Again the study aims at offering some suggestions to minimize loan default, focusing on the case of Sekyere Rural Bank Ltd, Kumawuman Rural Bank Ltd and Nsutaman Rural Bank Ltd in Ashanti Region.

1.1.Statement of the Problem

Loan default has negative repercussion on the financial institutions and the economy as a whole. Indeed, in a situation of high loan defaults in the banking system, the ability to make interest payments on deposits is weakened. This in turn reduces depositor's confidence in the banking industry as well as the survival of the various banks. Hence leading to financial crises. In Ghana, non-performing loans ratio increased from 6.4% in 2007 to 7.7% in 2008. (Bank of Ghana Report, 2009). Also according to Monetary Policy Committee of the Bank of Ghana (BOG), between 2009 and 2010 non-performing loan ratio deterioted from 18.2% in December 2009 to 17.6% as at December 2010 (Myjoyonline, Wednesday 23 Feb, 2011). This development has impacted negatively on the performance and profitability of financial institutions in the country (Bank of Ghana 2006). It seems efforts by financial institutions in the country to curb the issue of loan default have been far from successful (ghanabizmedia). In the review of relevant literature, it was found that few studies on loan default have been conducted in Asia but not in Africa. Field and Pande (undated) using randomized trial on microfinance institutions in India studied repayment frequency and default among financial institution. In their study, no significant effect for type of repayment schedule on client delinquency or default was observed. Rosenberg (1999) also argues that client delinquency is considered to be an important correlate of rural bank loan default. CGAP (1999) asserts that delinquency tends to be more volatile in Rural Banks than in Commercial Banks. Unfortunately, not much has been done in Ghana specifically in Rural Banks. The study therefore explores the causes of loan default in rural banks. This is the motivation behind the study.

1.2. Objectives of the study

The general objective of this study is to identify the factors influencing loan default in Sekyere Rural Bank Ltd, Kumawuman Rural Bank Ltd. and Nsutaman Rural Bank in Ashanti Region. The specific objectives for the study include:

i. To determine the rate of loan default in the selected rural banks in Ashanti Region.
ii. To find the factors that causes loan default in rural banks.
iii. To examine the effects of loan default on the rural banks and the borrowers.

1.3. Research Questions

Evolving from the problem statement above, the study aims at providing answers to the following questions:

i. What is the rate of loan default within Rural Banks?
ii. What are the factors that cause loan default in the context of Rural Banks and borrowers?
iii. What are the effects of loan default on the rural banks and on the borrowers?

1.4. Justification of the study

Eliminating entirely the incidence of risk and loan default from the operations of Rural Banks might not be possible. However it is prudent that due to the significance of lending in our economy, there is the need to collectively understand these issues and manage them effectively. It is expected that the outcome of this research work will offer opportunity to the following category of people:

I. Customers of the selected Rural Banks (Sekyere Rural Bank Ltd, Kumawuman Rural Bank Ltd and Nsutaman Rural bank Ltd) and for that matter other financial institutions. The survival of the financial institutions largely depends on its customers. This research study will help them build their businesses by being able to access all forms of loans without any charges of default on any loan agreement.
II. Managers and creditors of Rural Banks and other financial institutions will gain knowledge as a result of this research and review their lending processes and loan portfolio.
III. By determining the probability of default, it will help credit rating agencies in rural areas screen potential borrowers more effectively and therefore improve their loan repayment record.
IV. Since the Bank of Ghana is the mother of all financial institutions and has responsibility to regulate the activities of the banking sector in the country, it can review its supervision and regulations based on the outcome of the research.
V. Researchers and students could use this research outcome as a source of reference for further study.
VI. Finally, policy makers in government and non-governmental organizations in various places in the country could also benefit from the outcome of this research work.

1.5 Scope of the Study

The researcher covered some selected Rural Banks located in Ashanti Region. They include Sekyere Rural Bank Ltd, Kumawuman Rural bank Ltd and Nsutaman Rural Bank Ltd. The study sought to find the causes of loan default, the rate of loan defaults and its effects in the selected Rural Banks. Borrowers and loan officers were used in the research. The examined key concepts are Review of Ghana's Financial Sector in Ghana, Overview of Rural Banks in Ghana, Rural Banks and their goals, Ownership and Governance of Rural Banks, Loan Classifications and Provisions, Loan, Loan default, Loan default rate, Causes of Loan Default, Effects of Loan Default for banking Institutions, Risks in Banking.

1.6. Limitation of the Study

There are several rural banks operating in Ashanti Region that are helping to improve the lives of the people. However, due to time and resource constraints, the researchers limit themselves to Sekyere Rural Bank Ltd, Kumawuman Rural Bank Ltd and Nsutaman Rural Bank Ltd. The researcher had a limitation in getting access to the list of borrowers of the various banks and also the secondary data (loan classification and ageing analysis).

The researcher was limited also by time in that the period allocated to this research was too short for a comprehensive research to cover all aspects of the findings of the research. In addition, financial constraints prevented the researcher from covering statistically significant samples.

1.7. Organization of Study

The studies were organized into five chapters. Chapter one relates to the background of the study, the problem statement, objectives of the study, research questions, justification of the study, and limitations of the study and the organization of the study. Chapter two deals with literature review on concepts and theories relevant to the study. Chapter three deals with sample size and techniques, method of data collection and analysis, the organizational profile of the selected rural banks studied covering a brief history of the operations of the banks, mission, vision, core values and products and services .Chapter four deals with data presentation, results and discussion. Finally, chapter five provides the summary of the findings, recommendations and conclusion.

CHAPTER TWO

METHODOLOGY

2.0 Introduction

This chapter presents two broad issues. First, the methodology adopted and used for the study was discussed. These include the research design, sampling, data collection and analysis techniques. The second issues that were discussed were the profile of the selected Rural Bank and they include Sekyere Rural Bank Ltd, Kumawuman Rural Bank Ltd and Nsutaman Rural Bank Ltd. The focused was on brief history of the bank, scope of activities, vision and mission statement, products and services, core values, lending goals.

2.1. Sampling Techniques and Sample Size

The sample size of the study focused on both the borrowers and loan officers of Sekyere Rural Bank Limited, Kumawuman Rural Bank Limited and Nsutaman Rural Bank Limited. To obtain the sample size for our study, we follow Sanders (2000) by using the following formula:

The sample size for borrowers will be calculated as: $n^a = n \times 100 / re\%$

Where; $n^a$is the actual sample size;

n is the minimum (or adjusted minimum) sample size; and

re% is the estimated response rate experienced in percentage (Saunders, 2007)

A response rate of 75% was used and a sample size of 120 borrowers was used in the study. The total population for the three rural banks was 8464.

Then, $n^a = \frac{120*100}{75}$ = 160 borrowers

The research was conducted on a selected sample size of two loan officers from the rural banks making the loan officers six in numbers and forty borrowers from three rural banks. By the formula, a total of one hundred and twenty (120) respondents were selected. The study was conducted using a non-probability sampling technique. Non-probability sampling technique is any sampling method where some of the elements of the population have no chance of selection or where the probability of selection cannot be accurately determined.

The type of non-probability sampling technique used was a convenience sampling or

accidental sampling. Convenience sampling is a type of non-probability which involves the sample being drawn from that part of the population which is close to hand (Saunders, 2007). It was used as a result of difficulty in accessing a wider population due to time or cost constraints. In this case, the respondents selected were those to obtain information for the sample and the study. This type of sampling was done through meeting the borrowers at the premises of the rural banks and also talking to them on phone.

Table 2.1 Sample size of Rural Banks

Rural Banks	Loan Officers (Population)	Loan Officers (Sample Size)	Borrowers (Population)	Borrowers (Sample Size)
SRBL	*Five*	*Two*	*5233*	*40*
KRBL	*Four*	*Two*	*2734*	*40*
NRBL	*Three*	*Two*	*497*	*40*

Source: Author's own construct, July 2013

2.2. Data Collection

Three methods were used. They included administration of questionnaires, personal interviews and telephone interviews. Written questionnaires were used because they are easy to analyze. Personal interviews were conducted with the loan officers of the selected rural banks and some of their customers who borrow from them. The personal interview helped to record more information than the verbal responses of the interviewees (loan officers and borrowers of the rural banks), which are often superficial. The telephone interviews helped to talk to some of the borrowers of the rural banks especially those who cannot be contacted either using the questionnaires or the personal interviews.

2.3. Instruments

Questionnaires were the major instrument that was used to collect the data. The questionnaire was used in order to get a standard form of answers or response. The questionnaires were structured in a simple form to make it easy to understand. The questionnaire contained simple opened and closed ended questions. Two questionnaires were designed. One for the rural bank credit officers with the following information: Banks characteristics, Loan Provision Procedure, Collection Procedure, Issues about loan default and the other questionnaire were designed for the rural bank borrowers also with the following information: Borrowers Characteristics, Loan History, Supervision Visit, Loan and Loan Repayment. Personal interviews and telephone interviews were conducted as a supporting instrument for the study.

2.4. Sources of Data

The data were collected from primary and secondary sources. The primary sources comprised basically questionnaires and interviews which contained closed-ended and open-ended questions. The secondary sources were sourced from brochures, published and unpublished research and reports. Some materials were also obtained from the internet. The secondary data information was the ageing analysis (sectoral default rate) and loan classification (banks default rate) of the various rural banks which covered a period from January-March 2012(1st Quarter of 2013) since they prepare the information every quarter. Access to the data was a problem since it was not for public consumption. This category of data was mainly in quantitative form. The researcher benefited in so many ways from the use of this type of information for the study. It afforded the researcher the opportunity to collect high quality data which would not have been of the same quality if the researcher were to collect it in its primary form. Saunders et al, (2007) quote Stewart and Kamins (1993) as stating that secondary data are likely to be of higher-quality than could be obtained by collecting empirical data.

2.5. Data Analysis

The data upon gathered was scrutinized to determine the suitability, reliability; adequacy and accuracy. The data was analyzed using simple frequency, percentage distribution, and tables with the help of Statistical Package for Social Science (SPSS) and Microsoft Excel 2007. The data were then edited for completeness and consistency after which data extraction were performed. Coding of the data was then followed by data entry, after which results were run and presented in tables and charts.

2.6. Profile of Selected Rural Banks

The selected Rural Banks used for the study are Sekyere Rural Bank Limited, Kumawuman Rural Bank Limited and Nsutaman Rural Bank Limited all in Ashanti Region.

2.7. Sekyere Rural Bank Limited

2.7.1. Corporate Profile

Sekyere Rural Bank was set up and commissioned in 1983 the Jamasi in the Ashanti Region of Ghana. The role of the bank is to play an intermediary role between surplus fund holders and those in need for their economic activities in the communities in which the bank operates. Sekyere Rural Bank is dedicated primarily to the mobilization of resources from its operational area for on lending to individual savers, groups, small and medium scale enterprises.

The bank is registered under Ghana's Company Code 1963 (Act 179) and licensed under the Banking Law, 2004(Act 73) to operate the business of banking.

2.7.2. Vision

To continue to grow into a recognized financial institution locally and abroad and always offer value-added service to clients.

2.7.3. Mission

To be a unique financial service provider in the rural and peri-urban area in Ghana, propelled by a motivated workforce customized, customized products and services than our competitors, sustain the payment of returns to our shareholders and seen as a vehicle for development.

2.7.4 Products and Services

Savings account, Current Account, Fixed Deposit, Western Union Apex, Commercial Loan, Medaakye, BronyaAnidaso, AkuSika, Funeral Loan, Agric Loan

2.7.5 Branches

Jamasi (Head Office), Agona, Ntonso, Mamponteng, Ahwiaa, Abrepo Junction, Afrancho, Kronon.

2.7.6 Corporate Value

Sekyere Rural Bank operates in accordance with the highest standard in all relationship with customers, suppliers, the environment and the economy.

2.8 Kumawuman Rural Bank Limited

2.8.1 Company Profile

Kumawuman Rural Bank Ltd. was established on 29th October 1982 as a Financial Institution authorized on by the Bank of Ghana to provide financial services to its catchment areas. The Bank was established under the auspices of KumawumanBiakoyeKuo by Kumawu Citizens resident in Greater Accra Area.

2.8.2 Mission

The mission is to provide reliable cost efficient and effective banking services to the general public and make good returns for shareholders.

2.8.3 Vision

The vision of the bank is to be the best five Rural/Community Banks in Ashanti Region by the next five years and also the best ten in the country.

2.8.4 Corporate Values

1. To develop our branches and agencies to become customer friendly.

2. Provision of excellent customer services.

2.8.5 Branches

Kumawu (Head Office), Effiduase Branch, Ahensan Branch, Amakom Branch, Bonso Branch, Bodomase Branch, Drobonso Agency.

2.8.6 Products of the Bank

Savings Products, Current Account, Apex Link Transfer, Commercial loans, Group loans, fixed deposit, Susu Scheme.

2.9 Nsutaman Rural Bank Limited

2.9.1 Corporate Profile

The Nsutaman Rural Bank Limited was formally operating as a branch of the Ghana commercial bank but due to circumstances beyond their control the bank has to fold up. Itwas around this time that some key personalities within the area normally referred to as the promoters, headed by Mr. Yaw Manu Sarpong decided to start the Rural Bank. They pooled resources together to obtain the share capital for the beginning of the Rural Bank. There were other people who contributed to the share capital and this numbered up to seventy (70) shareholders. This Rural Bank was to serve the people within the Nsuta traditional area.

2.9.2 Mission

The central purpose and role of NRB is as follows:

NRB is dedicated to meeting the financial service needs of individuals, groups, and businesses in selected communities, delivering quality products and services.

2.9.3 Achievement

The bank continues to maintain a steady yearly turnover. The bank however broke even in the 2009 financial year whereby no profits or losses were recorded. As part of the bank's social responsibility, they render a sponsorship programs to brilliant but needy students, girl child education and provide some farm tools such as cutlasses to farmers during the farmers' day

2.9.4 Vision

The vision of NRB in three years time is expressed as follows:

Our vision is to become the catalyst for development and achieve the greatest possible impact in support of the communities we serve, building exceptional value for customers and shareholders.

2.9.5 Branches

Nsuta (Head Office), Breman

2.9.6 Products and Services

Western Union, Money Gram, salary loan, fixed deposit, susu savings account, current account.

CHAPTER THREE

LITERATURE REVIEW

3.0 Introduction

This chapter is about the reviewed of relevant literature. It is in four (4) parts. Parts one (1) is about the Review of Ghana's Financial Sector, part two (2) is about Rural Banks and their main goals, part three (3) also talks about Loan Classification and Loan provision while part four(4) is also about Risk in Banking.

3.1. Review of Ghana's Financial Sector

Ghana's financial sector is composed of banks and non-banking financial institutions (NBFIs). The country has about 23 major banks—including 3 development banks, 4 commercial banks, and 16 universal banks—representing about 90 percent of the total assets of the banking and nonbanking sector. The NBFI subsector includes 36 institutions accounting for 5 percent of the total assets of the financial sector. The NBFIs include 17 saving companies, 13 saving and loans companies, 4 leasing companies, 1 discount house, and 1 mortgage company. Many of these institutions provide services in urban and peri-urban areas. Their service outlets are largely concentrated around the major urban centers of the Greater Accra, Ashanti, and Eastern regions, with little outreach to rural and remote areas. In addition to formal financial institutions, informal and semiformal institutions—including 380 credit unions, 80 financial nongovernmental organizations, and 4000 Susu collectors (individuals)—are important financial service providers in Ghana. RCBs and their agencies represent about 5 percent of the total banking assets and account for about half of the total banking outlets in the country, and they are especially significant in rural areas. Formal financial service providers such as commercial banks represent about 40 percent of the money supply in the overall financial sector. The remaining amount is believed to be outside the formal system (IFAD 2008) and mainly in rural areas. Thus, institutions such as RCBs and informal and semiformal service providers play an important role in addressing the lack of access in these areas.

3.2 An Overview of Rural and Community Banks

The Rural and Community Banks (RCBs) are owned by members of the rural community through equity and are licensed to provide financial intermediation in the rural areas. The rural banks started their operations in 1976 with an aim to mobilize savings and provide credit facilities in rural areas that were not being serviced by the commercial banks. These banks expanded rapidly in 1980s. A major reason for expansion was government's introduction of special checks instead of cash payment to cocoa farmers. Poor financial management, weak supervision and natural calamities led to deterioration of the financial viability of rural banks; for example, in 1992 the Banking Supervision department of BOG considered only 23 (19%) of the one hundred and twenty -three (123) RCBs to be functioning satisfactorily (Steel &Andah, 2003). In 1999, twenty-three (23) distressed RCBs were closed down and the depositors compensated by the Bank of Ghana. This sent a strong signal to the remaining RCBs to improve their financial position in order to achieve a satisfactory status. As a result the number of RCBs performing satisfactorily increased from 46% in 1999 to 76% in 2001 (Steel &Andah, 2003).

One hundred and thirty- three (133) RCBs are functioning in Ghana. The total combined assets of RCBs are about US $ 165 million of which about 23 million (14.2%) is shareholders capital. On average RCBs have about 8500 clients (Kowubaa, 2000). The total deposit base of the RCBs is US $ 126 million, the loan portfolio is about US $ 47 million, and the investments in Treasury Bills and Government Bonds is about US $ 72 million (BOG, 2004). The average loan cycle for micro entrepreneurs is 4-6 months and rate of interest is 40% simple. Some of them have adopted community assessment of loans.

In 1994, BOG had disallowed RCB participation in Clearing. RCBs' dependence on commercial banks for clearing, treasury functions and currency supply put them at serious disadvantage and resulted in loss of credibility and customers. This has been mitigated by the setting up of the ARB Apex Rural Bank (under the Rural Financial Services Project being implemented since 2002) which now handles clearing, special management and capacity building for the RCBs.

3.2.1 Rural Banks and their Goals

Rural and community banks (henceforth referred to as rural banks or RCBs) are a network of one hundred and twenty-seven (127) independent unit banks in Ghana. They are regulated by the Bank of Ghana and thereby form part of the regulated financial sector in Ghana. These banks are the largest providers of formal financial services in rural areas and also represent about half of the total banking outlets in Ghana (IFAD 2008).

The Ghanaian government, through the Bank of Ghana, introduced the idea of rural banking into the country in 1976. According to the Association of Rural Banks (1992), "The aims of Rural Banks are:

a. to stimulate banking habits among rural dwellers;
b. to mobilize resources locked up in the rural areas into the banking systems to facilitate development; and
c. to identify viable industries in their respective catchments [areas] for investment and development."

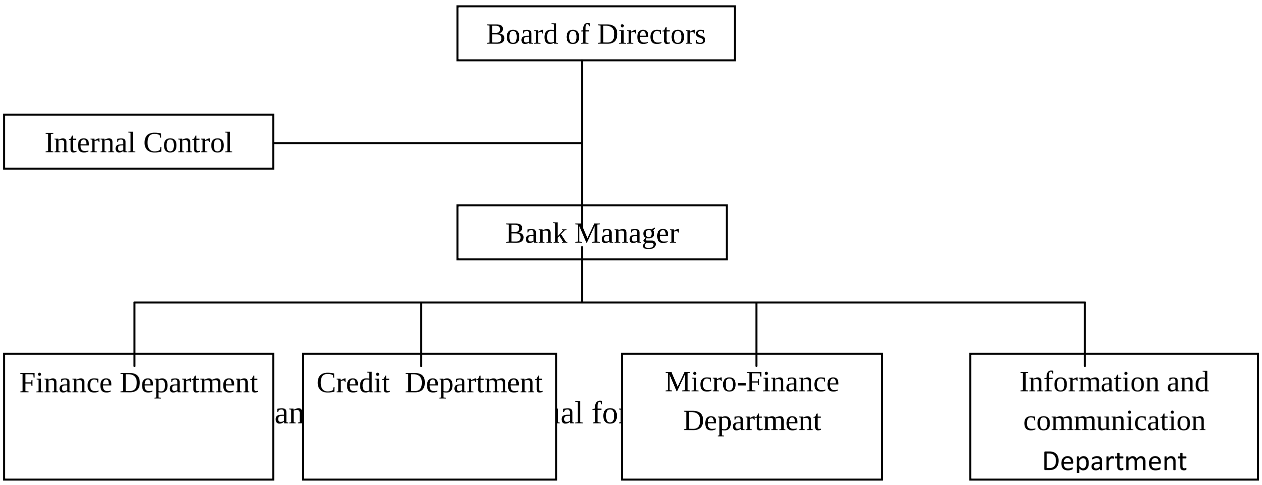
3.2.2 Ownership and Governance of Rural Banks

Rural banks are incorporated as limited companies under the Companies Code of 1963 (Act 179) of Ghana and are required to be owned by shareholders from the local community in which they operate. At first, Bank of Ghana (BoG) owned up to 43 percent of shares in rural banks as preference shares. This practice was stopped in the 1990s. In the early years of RCBs, the shareholding levels for an individual and a corporate body were capped at 10 percent and 30 percent, respectively. These levels have been revised to 30 percent (30%) for an individual and 50 percent (50%) for a corporate body. An identifiable group can also own 40 percent (40%) shares in a bank. The governance structure of RCB comprises a board of directors that represents shareholders within the bank and supervises the management of the bank. Boards of directors are elected by the shareholders from the communities where the banks are located. Election of board members takes place during Annual General Meetings (AGMs). Directors are elected on the basis of their reputation in the community and professional qualifications. The individuals nominated by the shareholders are validated by the BoG before assignment is effective. The board elects chairperson and a vice chairperson from among the directors. In many cases, the chief executive of the bank serves as the secretary of the board. A board member is elected for a three-year term but can be reelected for an unlimited number of terms by the shareholders. At every AGM, one-third of the board members need to retire but are eligible for reelection, in accordance with the Companies Code of Ghana. The minimum size of a Board of Directors (BoD) is five, and the maximum is eleven (11). The board of a rural bank has three to five supervisory subcommittees covering the main aspects of managing and operating the Bank. Members of the supervisor subcommittees are elected from the board based on specialization and interest.

Figure 3.2.3

Shows the typical organizational structure of a rural bank. The management staff is headed by a chief executive officer (typically called a supervising manager or general manager), who reports to the Board of Directors. The core management staff of RCBs includes an internal auditor supported by assistant accountant; a finance officer; a credit head supported by credit officers and project officers in charge of the microfinance portfolio; and a system administrator, if a bank is computerized. Some larger banks have additional departments, such as research and business development support units. At the branch level, the structure typically includes a branch manager, an accountant, credit officers, clerks and cashiers, and support staffs. Rural banks that provide susuproducts have sususupervisors and susucollectors at thebranch levels.

Figure 3.2.3 Organizational Structure of Rural and Community Bank



3.3. Loans

Legally, a loan or credit facility refers to a contractual promise between two parties where one party, the creditor agrees to provide a sum of money to a debtor, who promises to return the said amount to the creditor either in one lump sum or in installments over a specified period of time. The agreement may include provision of additional payments of rental charges on the funds advanced to the borrower for the time the funds are in the hands of the

debtor. (htt://en.wikipedia.org/wiki/loan). 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 amount lent. Indeed these additional payments when made in accordance with the loan contract constitute income to the lender or the creditor. A loan may therefore be considered as performing if payments of both principal and interest charges are up to date as agreed between the creditor and debtor.

Bank of Ghana classifications of loans indicate that loans that are current are those for which the borrower is up to date in respect of payments of both principal and interest. It further shows that an overdraft would be considered as current or performing if there were regular activities on the account with no sign of a hardcore of debt building up. (Bank of Ghana, 2008)

The foregoing reveals that loans that are up to date in terms of principal and interest payments are described as performing facilities. These types of loans constitute quality asset portfolio for banks in view of the interest income generated by such assets.

3.3.1 Loan Classification and Provision

The level of provisioning made would be in line with Bank of Ghana guidelines as detailed below.

3.3.2 Loan Classification

Loan portfolios of banks are classified into various classifications to determine the level of provisions to be made in line with banking regulations. Loans are classified into five categories. They include Current, Other Loans Especially Mentioned (OLEM), Substandard, Doubtful and Loss (Bank of Ghana, 2008).

The classifications indicate the level of provisions banks are required to make to reflect the quality of their loan portfolio. Indeed the various classifications clearly group loans into performing and nonperforming, in line with banking regulations. These categories further help banks to know the structure of their loan portfolio and for that matter their assets quality.

3.3.3 Loan Provisioning

In Ghana, a major factor considered in making loans is the ability of the borrower to repay the loan. However, to mitigate the risk of default, banks ensure that loans are well secured.

Though advances shall be granted on the basis of the borrower's ability to pay back the advance and not on the basis to pledge sufficient assets to cover the advance in case of default, it is highly desirable for all advances made to customers and staff to be well secured. This means that in the event of default the bank shall fall on the collateral used in securing the facility to mitigate the effect of loss of principal and interest. (Banking Act, 2004).

In view of the above, banks take into account the assets used in securing the facility to determine the level of provision to be made. Bank of Ghana regulations indicate that certain amount of provisions are made on the aggregate outstanding balance of all current advances, and aggregate net unsecured balance of all other categories as shown in the table below:

Table 3.0: Categories of Loans and their Provisions

CATEGORY	PROVISION (%)	NO.OF DAYS DELIQUENCY
Current	1%	0-less than30
OLEM	10%	30-less than 90
Substandard	25%	90-less than 180
Doubtful	50%	180-less than 360
Loss	100%	360 and above

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

3.3.4 Procedure in making loan

Bank lendinginvolves a bank, providing a loan in return for the promise of interest and principalrepayment in the future (Kay Associates Limited, 2005).

Available literature on lending indicates the lender's role in ensuring good decisions relating to provision of loans in order to minimize credit risk. Rouse (1989) explained that a lender 'lends' money and does not give it away.In view of these credit risks that might lead to bad loans, banks have some loan request procedures and requirements contained in their credit policy documents to guide loan officers in the processing of loans for customers. The following are some of the factors considered in granting loans:

- Applicant’s background.
- The purpose of the request.
- The amount of credit required.
- The amount and source of borrower’s contribution.
- Repayment terms of the borrower.
- Security proposed by the borrower.
- Location of the business or project.
- Technical and financial soundness of the credit proposal.

(Rural Bank Desk Diary, 2009)

Among the criteria outlined above, Kay Associate Limited (2005) identified loan evaluation tools or techniques of credit vetting known as the CAMPARI framework used in assessing a customer’s application for credit.

C-Character: integrity, history and background

A-Ability: managerial and technical competence, business ability and legal ability to borrow.

M-Margin: varying interpreted as the percentage of loan to value (LTV) of the asset. The lower the LTV, the higher the margin available to the lender.

P-Purpose: purpose for which the finance is required.

A-Amount: adequacy of amount of loan required and how it will be drawn down.

R-Repayment: source from which and period over which loan will be repaid.

I-Insurance: collateral security offered

After subjecting the loan application to credit analyst, a decision is then made either to grant or not to grant the loan.

3.3.5 Loan Default

The term loan default is also termed non-performing loans as identified in Fofack (2008). Burger and De Young (1997) also consider these types of loans as “problems loans”. There is no definition of default. Different definitions are used for different purposes. Even the

International rating agencies like S.P, Moody's and Fitch, use different default definitions. However, a measured loss at default depends on the definition so it is important to make the definition clear.

According to the Bank for International Settlement (BIS), default is a situation when an obligor is unlikely to pay credit obligation or the obligor is past due more than 90 days on any material credit obligation. Following the general practice of the financial institutions, we define defaults if a loan is written off, or after the delay in repayment exceed 90 days or a client is classified by the bank as substandard, doubtful or loss making during the observed period. With a few exceptions, the bank terminated the relationship with defaulting companies after either eventual repayment of the obligations or the company becomes bankrupt. Murray (2009) also asserts that a default on a loan occurs when the borrower does not make required payments on or in some other way does not comply with the terms of the loan. Loan default is closely related to corporate bankruptcy. The causes of bankruptcy are problems in the field of profitability, liquidity and solvency (Altman, 1968).

Available literature gives different description of loan default. Some researchers noted that certain countries use quantitative criteria for example number of days overdue scheduled payments while other countries rely on qualitative norms like the information about the customer's financial position about future payments (Bloem and Gorter, 2001). Berger and De Young (1997) used quantitative criteria for identifying loan default. According to their findings, loan that is outstanding for ninety days or more is considered a non-performing loan. Such loans can be injurious to the financial performance of banking institutions. Caprio and Kliengebie (2002), cited in Fofack (2005) also reported that during the banking crises in Indonesia, non-performing loans represented about 75% of total assets in 1997.This means that banks holding huge default loans in their books can run into bankruptcy if such institutions are unable to reverse their bad debts.

3.3.6 Factors Causing Loan Default

Lenders of funds give out loans to borrowers. In this case, the transaction is that, lenders are expected to recoup their financial capital. But what happens is that, borrowers default their debt obligations i.e., borrowers benefit at the expense of lenders. When this continues, bankruptcy will be the ultimate result and this will reduce financial intermediation.Research findings and publications show that bad loans occur as a result of some factors.Berger and De Young (1997) identified poor management as one of the major causes of problem loans. They argue that managers in most banks with problem loans do not practice adequate loan underwriting, monitoring and control. A World Bank policy research working paper on Non-performing Loans in Sub-Saharan Africa revealed that loan defaults are caused by adverse economic shocks coupled with high cost of capital and low interest margins (Fofack, 2005).

Rouse (1989) indicated in his work that problem loans can emanate from overdrawn account where there is no overdraft limit, overdraft taken on an account which has not been actively operated for some time and overdraft taken in excess of reasonable operational limit.

Bloem and Gorter (2001) indicated that non-performing loans may rise considerably due to less predictable incidents such as prices of key export products, foreign exchange rates or interest rates change abruptly. A timely study by Dr.QuziKholiquezzaman Ahmed (2007), President of the Bangladesh Economic Association, has revealed that the effective rate of interest charge by Rural Banks including the Grameen Bank turns out turns out to be as high as 30-45 percent (30% - 40%). This causes serious hardship to borrowers in servicing their debt. They are often constrained to not only sacrifice essential consumption but also borrow from lenders. This engulfs them unwittingly into an unending debt cycle.

They also stated that deficient bank management, poor supervision, overoptimistic assessments of creditworthiness during economic booms, and moral hazard that result from generous government guarantees are some of the factors that lead to bad loans.

According to Kassim et al. (2008), the causes of loan default can be divided into two categories. Some of the causes may be from the Banks and other causes may be from the borrower.

Some causes of loan default from the Banks are:

- Multiple loans taking from other banks.

Banks are not ready and prepared to answer status enquiries. Rural Banks do not have accessible database to monitor customers' loan. It may happen that Rural Bank recipients have taken several loans from different banks and since there is no systematic database that keeps the records of rural bank recipients, this affords the opportunity for the recipient to apply for more than one loan from the same bank.

- Influx of banks and other non financial institutions in the credit market.

These institutions in their bid to increase their market share may overlook certain important indicators (improper selection) leading to adverse selection hence increasing the risk of default. Improper selection on the part of the lender can also lead to loan default. The borrower might not be eligible for the loan.

- Unrealistic terms and schedule payments.

Some payments schedules are known to the borrower to be unrealistic but they still go in for the loans. There may be conflicts associated with repayment period between the customer and the bank. The bank may want to lend at a shorter period while the customer will also like to borrow and pay at longer period.

- Lack of follow up measures

Following up is very crucial in lending but some banks tend to leave this out. Follow up measures taken regularly and systematically keeps the borrowing unit under constant vigil of the financial institution.

Some causes of loan default from borrowers are:

- Beneficiaries not actually working out their options or payback capacities.

Some of the borrowers do not really plan well as to how their loans will be paid back.

- Not keeping the due dates in mind and actually working hard to meet them.

Most of the clients if not prompted or reminded of the payment date tend to forget about paying the loan back.

- Deficient analysis of the project viability.

Many borrowers do not analyze their projects well. They do not really estimate the money needed and the skills even needed to know if they are competent.

- Some borrowers create a smooth and convenient atmosphere for their projects making it difficult for the loan officers to even see the bad side of the project. Rosy pictures of the projects are shown to the loan officers by the borrower. They can sometimes even bring pictures or take the loan officers to places where they do not own but claim to.
- Not keeping the lender informed in cases of change of addresses or contact information. Borrowers often forget or intentionally leave out their obligation to notify their lenders when they change their addresses of residency or work.
- Not contacting lender for other options in cases where beneficiaries realize that they might not be able to pay the loan on time.
- Taking more money than actually needed and can't pay back.

Some borrowers take more money instead of the small amount of money they need. Some banks also give more money to the borrowers in order to cushion them in the case of liquidity problems. Besides, it is possible that there are other serious factors that are causing bad loans in Ghana which have not been revealed in the literature reviewed. It is because of these reasons that it has become necessary to identify the causes of these bad loans in the Ghanaian banking environment, looking at selected rural banks in Ashanti Region. This would form the basis for cogent recommendations to be made towards solving the problem.

3.3.7 Rate of Loan Default

A defaultrate is simply defined as the rate at which borrowers default on their loans. It is one of the most critical pieces of information, especially for lenders who may be saddled with significant losses in the event of a default. A defaultrate can be applied in the context of personal loans or business loans. The sole study on default rate of bank loans is on a syndicated bank loans to corporate debtors (Altman and Suggitt, 2000). They base their analysis on a syndicated loans which exceed US$100 million, are rated and issued between 1991 and 1996.In their research, they found out that default rate among loans made to SME"s was 6.0%.Moreover, the default rate is much lower for natural persons than for legal bodies.

Rural Banks in Ghana are grappling with huge challenge in managing their loan loss reserves due to bad loans and poor management systems applied by the banks. As a result, majority of these Rural Banks have been rendered insolvent and could soon fold up if austerity measures are not taken to reverse the trend. According to the Micro Banking Bulletin (2011), titled, “Rural Banking in Ghana, it was discovered that the relatively high ratio of non-performingloans is a major factor affecting financial institutions performance in the country. In the sample of Rural Banks, the portion of the loan portfolio that was in default for more than 30 days was 16% compared with 3% for their global peer groups’ according to data reported in the Micro Bulletin.

Taking Grameen Bank as an example, since its inception, the bank has distributed around TK347.75 billion Philips (2001) attest to this fact of high rate of default in Grameen Bank in the sense that in 2001, about half of the loan portfolio in two Northern Districts of Bangladesh that have been used to highlight Grameens success is overdue by at least a year. For example, 19 percent of the loans are one year overdue. According to Grameen Bank, a loan is delinquent if it is not paid off two years after due date. Under this definition, about 10 percent of all bank loans are overdue.

Rosenberg (1999) argued that client delinquency is considered to be an important correlate of Rural Banks loan default. Zeller(1999) study is found that groups consisting of members facing homogenous risk exposure do not have higher repayment rates, but that their repayment rate significantly improve when groups have some type of social cohesion.

Loan default tends to be lower (i.e. recovery rate tends to be higher) when a claim is secured by collateral of higher quality. Edward (1998), Carey (1998) and Crapton et al. (2000). However, Hurt and Felsovayi (1998) show that large loans exhibit lower recovery rates. They attribute it to the fact that large loans are often unsecured, and they are provided to economic groups that are family owned.

However, Kassim et al., (2008), through field investigation revealed that the high degree of loan recovery in Rural Bank is partly contributed by some element of forced recovery imposed on the borrowers either directly or indirectly. Through their studies, in some cases where borrowers are not able to pay back their loans, they are being pressured to repay with whatever means that they have. As a result, these borrowers were forced to sell off their lands or whatever property that they have. In Africa, loan repayment performance has been poor. For example, 14% to 20% for commercial banks in Tanzania (Bagachwa, 1996) and about 45% for small agricultural loans in Ghana (Aryeetey and Nissanke, 2000).

Mabola (2004) studied the cause of low repayment for South African Khula Enterprise Finance Credit. They feel that a major contributing factor for default was beneficiary perception that the loan was free government grant.

A similar case in Ghana is the public perception that Micro Finance and Small Loan Scheme (MASLOC) was free government grants as it was over politicized due to low level of education concerning the purpose of the funds disbursed.(www.ghanaweb.com).In Ghana, default risk has an enormous repercussion on the firm, society and the country as a whole as it was elongated by MASLOC boss MsAnsah-Djan that her outfit had started working with the Bureau of National Investigation(BNI) and the Serious Fraud Office(SRO) to recover loan defaulted under the scheme. For instance MASLOC disbursed loan to individual and only 6.3 percent of about GH₵ 5 million disbursed to individual between 2007-2008 has been retrieved leaving a whopping 93.7 percent in the hands of defaulters. (www.ghanaweb.com 2010).

Empirical evidence indicates that higher loan repayment performance occurs in Asia as compared to Africa. High loan repayment performance of 80% to 98.6% was reported for four successful rural finance institutions in Asia. These are Bank for Agriculture and Agriculture Co-operatives (BAAC) in Thailand, the BadanKreditKecamantan (BKK) and the Bank Rakyat Indonesia Unit Desa (BUD) in Indonesia and the Grameen Bank (GB) in Bangladesh (Yaron 1994).

Evidence in Ghana and other several countries indicate that the subsidized schemes are not self-sustainable due to political pressure in the disbursement of loans. For example, out of 245.7 million disbursed under the PAF by the Ho District Assembly, only 16.4% has been paid back. Due to poor loan recovery performance, District Assembly has temporarily suspended further disbursement of fund (Agbelie, 2001). In the Bawku West District in Ghana, the District Chief Executive also reported that 62.12 million out of a total of 127 million disbursed to beneficiary groups and individuals for income generation activities has been recovered. This amount represents less than 50% of the total loan disbursed (Seini, 2001).The low rate of recovery can be attributed to the poor strategy used in the project appraisal. Many beneficiaries acknowledge such loans as thank you from the government therefore they do not see the need to pay back the loan. The alarming rate of non repayment of loan borrowed by rural banks customers calls for immediate action by the regulatory authorities as well as the government. In Lagos State alone, over N10 billion were being owed by these micro depositors who borrowed money from their various institutions. Most of the beneficiaries of the Lagos State Rural Transport Initiative (LARUTI) have refused to repay their loans. It has been reported that only 30 percent of them had repaid the loan while the remaining 70 percent defaulted.

Data from the Bank of Ghana (BoG) shows that loan defaulting rate had increased.According to Ghana Banking Survey Report released in 2010 and authored by Price Waterhouse Coopers between the years 2007 and 2009, the rapid deterioration of the banking industry's loan portfolio negatively affected profit margins. Impairment charges for NPL over the three year period increased from GH₵60 million in 2007 to GH₵266 million in 2009.

The Central bank of Ghana also revealed that the NPL ratio which measures the ratio of loans losses to gross loan advances worsened from 16.2% in December 2009 to 17.6% as at December 2010. This high NPL ratio has contributed to reducing the market share of the country's top-five banks from 49.5% in 2009 to 45% in 2010 (Bank of Ghana Report,2010).

3.3.8 Effects of Loan Default for Banking Institutions

Loans generate huge interest for banks which contribute immensely to the financial performance of banks. However, when loans go bad they have some adverse effects on the financial health of banks. This is because in line with banking regulations, banks make adequate provisions and charges for bad debts which impact negatively on their performance. Bank of Ghana regulations on loan provisioning indicate that loans in the non-performing categories that is loans that are at least ninety days overdue in default of repayment will attract minimum provisions of 25%, 50% and 100% for substandard, doubtful and loss, respectively(Bank of Ghana Act, 2004).

According to Bloem and Gorter, (2001), though issues relating to loans default may affect all sectors, the most serious impact is on financial institutions such as commercial banks and mortgage financing institutions which tend to have large loan portfolios. Besides, the large bad loans portfolios will affect the ability of banks to provide credit. Huge non-performing loans could result in loss of confidence on the part of depositors and foreign investors who may start a run on banks, leading to liquidity problems. The provisions for bad loans reduce total loan portfolio of banks and as such affects interest earnings on such assets. This constitutes huge cost to banks. Study of the financial statement of banks indicates that bad loans have a direct effect on profitability of banks. This is because charge for bad debts is treated as expenses on the profit and loss account and as such impact negatively on the profit position of banks.

Some foreign literature indicates that bad loans can fuel banking crisis and subsequently result in the collapse of banks with huge non-performing loans. Demirgue-Kunt et al (1989), cited in Berger and De Young (1997), indicate that failing banks have huge proportions of bad loans prior to failure and that asset quality is a statistically significant predictor of insolvency.

As was indicated earlier in this research, Caprio and Klingebiel (2002), cited in Fofack (2005), also reported that during the banking crisis in Indonesia, non-performing loans represented about 75% of total loan assets which led to the collapse of over sixty banks in 1997. This means that banks holding huge bad loans in their books can run into bankruptcy if such institutions are unable to recover their bad debts.

A possible effect of loan default is on shareholders earnings. Dividends payments are based on banks performance in terms of net profit. Thus since bad loans have an adverse effect on profitability of banks, it can affect the amount of dividend to be paid to share holders.

The Banking Act of Ghana spells out that a bank shall not declare or pay dividend on its shares unless it has, among other things, made the required provisions for nonperforming loans and other erosions in assets value [Section 30 (1) of Banking Act, 2004]. The effect of bad loans on the amount of dividend paid to shareholders can also affect capital mobilization because investors will not invest in banks that have huge nonperforming loans portfolio. It is evident that nonperforming loans with their attendant negative impact on investors' earnings can affect the Ghanaian banks in meeting the minimum capital requirement.

3.4 Risks in Banking

Over the years, banks become increasingly complex institutions being exposed to an intertwined set of risks. Taking risk can almost be said to be the business of bank management. Financial institutions that are run on the principle of avoiding risk will be stagnant and will not adequately service the legitimate credit needs of the community. On theother hand, a bank that takes excessive risk is likely to run into difficulty.Bessis (2002: 11) defines bank risk as “adverse impacts on profitability of several distinct sources of uncertainty”. This definition of bank risk serves its importance in providing a sound base for risk measurement and management. Heffernan (1996: 163) recognizes that any profit-maximizing organization incurs risk in its daily operations, yet banks face a number of risks that are atypical to both financial and non-financial firms. Exposure to these various risks has resulted in the banking sector being the most regulated of all financial institutions.

The risks faced by banks in their operations are of many types: They include credit risk, liquidity risk, operational risk, solvency risk, interest rate risk, currency risk.

3.4.1. Credit Risk

Credit risk is defined by Deutsche Bank (2007: 45) as the group’s most important risk that “arises from all transactions that give rise to actual, contingent or potential claims against any counterparty, obligor or borrower”. Credit risk may occur if the asset or loan becomes irrecoverable or if there is a delay in the servicing of the loan.

Credit risk is deemed to be the most obvious risk in banking and possibly the most important in terms of potential losses. The default of a small number of key customers could generate very large losses and in extreme cases could lead to a bank becoming insolvent.

Credit risk is normally measured by exposure (i.e. the amount that can be potentially be lost if a borrower default).This amount could differ from the actual loss in the event of default because of possible recoveries. Credit risk also depends on probability of default occurring and the extent to which the risk can be mitigated in order to reduce loss should default occur (Saunders and Corrett 2006).

3.4.2 Liquidity Risk

Liquidity risk is defined by Faure (2002: 137) as “the risk of not being able to meet obligations of funds demanded by clients”.

Banks require liquidity for four major reasons:

- as a cushion to replace net outflows of funds
- in order to compensate for the non-receipt of expected inflow of funds.

- as a source of funds to undertake new transactions when desirable.
- as a source of funds when contingent liabilities fall due

Liquidity risk relates to the eventuality that banks cannot fulfill one or more of these cannot be fulfilled. Liquidity risk is often an inevitable outcome of banking operations. Since a bank typically collects deposits which are short term in nature and lends long term, the gap between maturities leads to liquidity risk and the cost of liquidity.

3.4.3 Operational Risk

Also called transaction risk. Operational risk arises from short comings or deficiencies at either technical level (i.e. banks information systems or risk measures) at an organizational level (i.e. banks internal reporting, monitoring and control systems).Operational risk affects the long-term existence of bank, and arises from breakdown in corporate governance-internal control. Such breakdown can lead to financial losses through error, fraud or failure to perform in a timely manner. According to Bessis (2002,p. 48) the Basle Committee adopts a standard definition of operational risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events.

3.4.4. Solvency Risk

Solvency risk can be described as a peculiar risk in that it is the result or end product of other financial and non-financial risks. Solvency risk is defined by Bessis (2002: 20) as "the risk of being unable to absorb losses, generated by all types of risk, with available capital". Since solvency risk is generated from one or a combination of other bank risks and primarily stems from the poor management of these risks, a greater amount of attention will be given to the contributory financial risks.

3.4.5. Interest Rate Risk

Banks can be described as intermediaries between lenders and borrowers. For competitive reasons, banks may be obliged to accept client funds with varying maturities that could potentially alter the structure of the balance sheet to an interest rate sensitive position (UBS, 1987: 37). Interest rate risk stems from assets and liabilities maturing at different times, and (according to SARB, 2000: 113) can be encompassed in three elements, namely "the margin between the rates earned on assets and paid on liabilities, the repricing potential of assets and liabilities at different points in time, resulting in mismatches in various time bands between assets, liabilities and derivatives, and, finally, the period during which these mismatches persist".

Interest rate risk can most aptly be illustrated by describing the maturity structure of a bank's assets and liabilities. Banks are usually described as being asset or liability sensitive with regard to the maturity structure of their portfolio. An asset sensitive bank has a long funded book, whereby short term assets are funded by long term liabilities. The interest rate risk in this case is that (since assets mature before liabilities) the assets need to be reinvested until they are needed to repay the liabilities. Should the bank witness a falling interest rate scenario, the reinvestment of these assets may be attained at rates that are lower than the existing rate payments on liabilities. Obviously, if rates interest rates rise the bank will prosper under its asset sensitive portfolio (UBS, 1987:

3.4.6. Currency risk

Currency risk is also commonly referred to as exchange rate risk, and is defined by American Express (2007: 1) as "the risk that the value of your investment that is denominated in the currency of another country will rise or fall with the changes in the exchange rate between the countries." Banks, especially multinational banks, are large holders of foreign assets, liabilities and derivative financial instruments in their portfolios. If, for example, the value of the currency in which these instruments are held changes unfavourably, the return and payment streams may be affected negatively. Banks most commonly use financial derivative instruments to hedge away currency risk (Bessis, 2002 and Faure, 2002).

CHAPTER FOUR

RESULTS AND DISCUSSION

4.0. Introduction

This chapter of the study presents the results and discussions. These include socio-demographic characteristics of respondents, default rates of selected banks, factors accounting for loan default, effects of loan default and minimum interest rate charged per loan.

4.1. Socio-Demographic Characteristics of Respondents

The socio-demographic characteristics of the respondents include: gender, age, marital status and educational level.

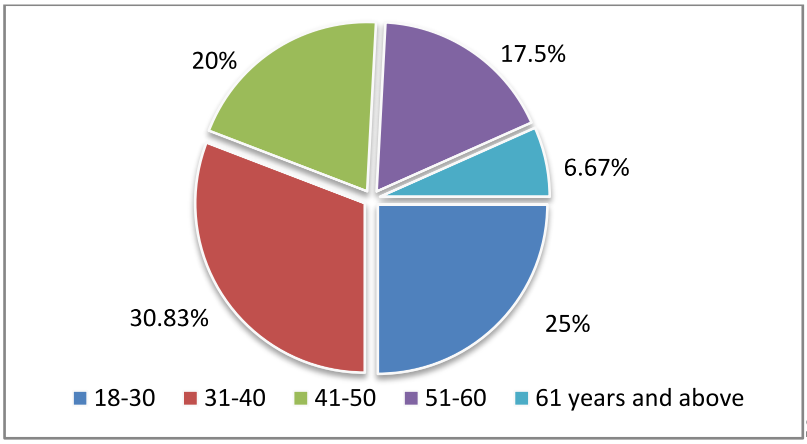
Table 4.1 Gender distribution of Borrowers

	Banks						**Total**	
	Frequency							
Gender	**n(SRBL)**	**%**	**n(KRBL)**	**%**	**n(NRBL)**	**%**	**Frequency**	**Percentage**
Male	*15*	*37.5*	*19*	*47.5*	*23*	*57.5*	***57***	***47.5***
Female	*25*	*62.5*	*21*	*52.5*	*17*	*42.5*	***43***	***52.5***
Total	***40***	***100***	***40***	***100***	***40***	***100***	***100***	***100***

Source: Field work, July, 2013

From Table **4.1**, in terms of gender, SRBL had fifteen (15) males as against twenty-five (25) females. KRBL had nine-teen (19) males with twenty-one (21) females while that of NRBL had twenty-three (23) males as against seventeen (17) females. NRBL had the highest male respondents of twenty-three (23) representing 57.5% while females also dominate in SRBL with twenty-five (25) respondents representing 52.5%. Overall, the females dominate in the selected rural banks than males representing 52.5% and 47.5% respectively. The rest of the findings are grouped as one since most of the borrowers from the three rural banks have similar characteristics.

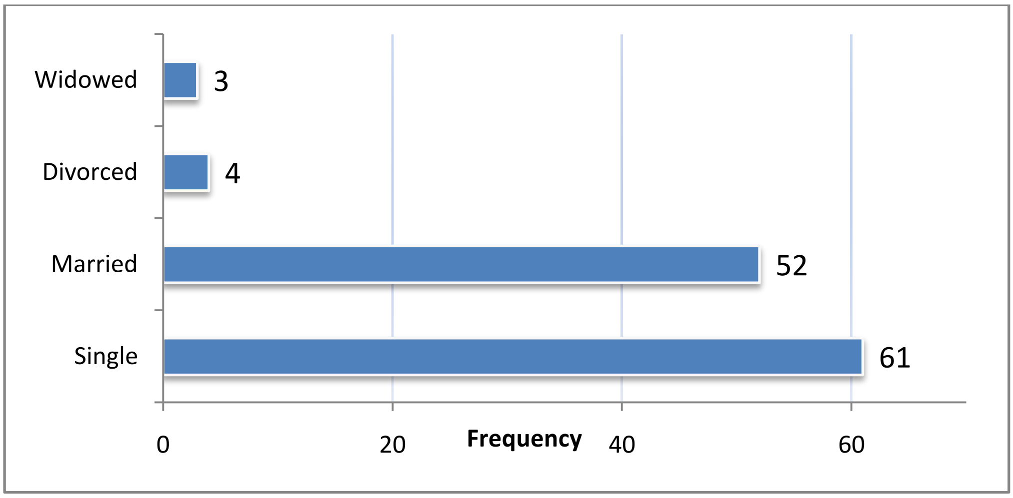
Figure 4.1 Age of Borrowers



Source: Author's own construct, July 2013

From Figure **4.1**, the borrowers were classified into age group. Thirty (30) of the respondents were between the ages (18-30) which represents 25%. Also, thirty –seven(37) of the respondents were between the ages (31-40) which represents 30.83%, twenty-four(24) respondents were between the ages of (41-50) which represents 20%, while respondents whose ages were between (51-60) were twenty-one(21) and that also represents 17.5% and those above 61 years and above were eight (8). They also represent 6.67%. Most of the respondents fall within the age's group of (31-40)

Figure 4.2: Marital Status of Borrowers



Source: Authors own construct, July 2013

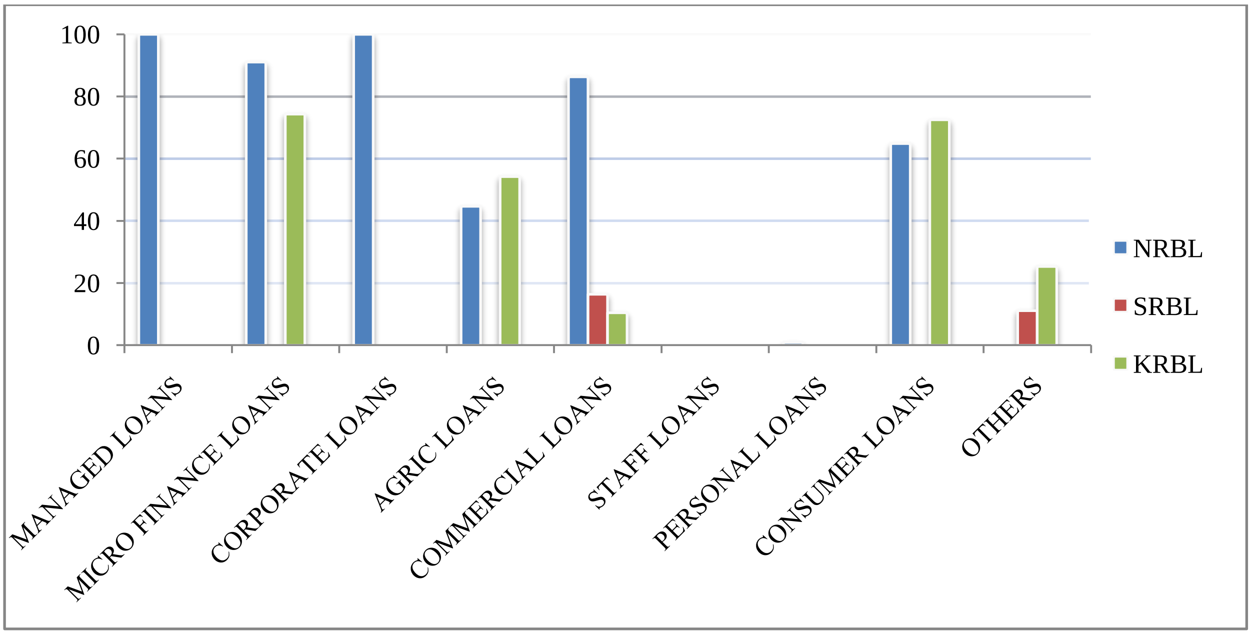
Sixty-one (61) respondents which represent 50.8% are not married. Also, fifty-two (52) respondents representing 43.3% are married. Those who are divorced were four (4) and they represent 3.33% whilst three (3) of the respondents were widowed representing 2.5%.

For level of education, twenty (20) respondents had basic education representing 16.67%, twenty –five(25) respondents had secondary education representing 20.83% ,respondents for tertiary level were forty-three(43) representing 35.83% while that of vocational training were thirty-two(32) representing 26.6%.None of the respondents respond for no education. This shows that rural banks deal with all groups of people. They do not discrimination.

4.2 Purposes of the loan

Respondents indicated that they used the loan for the following purposes. Out of the 120 respondents; thirty-nine (39) which represents 32.5% indicated that they used the loan to start a new business. For an expansion of businesses, they were twenty-five (25) which represented by 20.83%, 14.17% were for seven-teen (17) of the respondents and they used the loan for funeral purposes. For an educational reasons, they were nine-teen (19) and its being represented by 15.83%, 9.17% for eleven(11) respondents were for buying an automobile while respondents that used the money to buy land were nine(9) which is being represented by 7.5%.

Figure 4.3 Default Rate of Selected Rural Banks



Source: Field Work,July 2013

The three rural banks studied are all under the umbrella bodies set up by the Government of Ghana under the Banking Act to serve as a Central Bank for all the rural banks in Ghana. Currently most of the rural banks use the same TemenoseMerge T24 banking software. The categorization (fig.4.3) of the loans is based on the format that the software uses as detailed in the appendix A, B and C. The rate of loan default for rural banks and the various sectors were obtained from both loan classification and ageing analysis of the respective banks. This information is part of Appendix A, B, and C.

4.3. Determining the rate of default for the first quarter of 2012 for the various sectors of selected rural banks.

The rate of default is calculated by the formulae as $\frac{OverdueLoan}{GrossLoan}$ *100 both for the sectors and the rural banks where:

Overdue Loan: The summation of OLEM, Sub-standard, Doubtful and Loss of either the bank or the sectors.

Gross Loan: The total gross loan for the bank or the sectors you want to find the rate of default.

Gross total loan for all three rural banks are 9,000,948.59(SRBL), 9, 835571.89(KRBL) and 421,067.62(NRBL) as shown in Appendix A, B and C. The various sectors rate of default has been calculated and shown in Appendix A, B and C.

(A) For a managed loan: These are loans that are managed by the rural banks on behalf of governments agencies and Non-Governmental Organization (N.G.O).In this category, NRBL is the only bank with these managed loans with a default rate of 100% as shown in figure 1.

(B) Micro-Loans: These are small susu loans granted to small scale artisan and petty traders. In that category, NRBL had the highest default rate and was 91.09% and KRBL as 74.35%.There was no default for SRBL. These are shown in figure 1

(C) Corporate Loans: They are loans granted to corporate entities that are in the rural banks catchment areas. In that category, NRBL had the highest rate of default of 100%while the other two rural banks had no rate of default. This is still indicated in figure 4.0.

(D) Agric Loan sector: They are loans given to farmers. In that category, KRBL had the highest rate of default of 54.26%, followed by NRBL with 44.76% and that of SRBL had no rate of default. All these are captured in figure 4.0.

(E) Commercial loans: They are loans granted to individuals with higher income levels engaged in commercial activities Example people in the transport business that is taxi cab owners. As shown in the figure above, NRBL had the highest rate of default of 86.35%, followed by SRBL with 16.41% and KRBL with the lowest default rate of 10.46%.

(F) Staff Loan: Loans granted to workers and staffs of the banks. None of the rural banks experience any rate of default under this category.

(G) Personal Loans: Loans granted to individuals especially who are salary earners. Only NRBL had a negligible rate of default of 0.93%.

(F) Consumer Loans: Loans targeted at customers who are salary earners with the various rural banks to enable them to purchase household consumables like furniture, private vehicles for their personal use. In that category, NRBL and KRBL had a default rate of 64.88% and 72.53% respectively with no default rate under SRBL. Figure 1 depicts the information.

(G) Other Loans: They are loans apart from managed loans, micro-finance loans, corporate loans, agric loans, commercial loans, staff loans, personal loans, commercial loans. The rate of defaults include nothing for NRBL, while SRBL and NRBL experience a default rate of 11.14% and 25.35% respectively. All these are shown in figure 1.

The rates of default for all the three rural banks are 24.44%, 60.43%and 11.72% for KRBL, NRBL and SRBL respectively. NRBL had the highest rate of default, followed by KRBL and that of SRBL is the lowest. This is shown in table 4.0.

Table 4.2: Banks Loan Default Rate, Overdue Loan and Gross Loan for the 1st Quarter of 2012 Selected Rural Banks

RURAL BANKS	DEFAULT RATE (%)	OVERDUE LOAN GH¢	GROSS LOAN GH¢
KRBL	*24.44*	*2,403,784.00*	*9,835,571.89*
SRBL	*11.72*	*1,054,836.20*	*9,000,948.59*
NRBL	*60.43*	*254,461.44*	*421,067.67*

Source: Field Work, July, 2013

From Table **4.2,** it can be deduced that, the past due or the arrears rate of KRBL is 24.44% of its total portfolio, SRBL having 11.72% as its default rate of its portfolio and NRBL maintaining 60.43% as its arrears rate of its outstanding portfolio .This means that SRBL had a good portfolio quality by having the lowest arrears rate compared to the other banks under studied .Also SRBL had a huge exposure by recording the highest arrears rate compared to the other banks under studied. We can therefore conclude that SRBL is performing well, KRBL is average performing and NRBL is not performing.

4.4. Factors Accounting for Loan Default

Table 4.3 Factors accounting for loan default in rural banks

PERCEIVED CAUSES OF LOAN DEFAULT	Frequency	Rank
Loan misapplication	*20*	*1st*
Timeliness of release of loans	*12*	*3rd*
Poor economic activities in a particular sector of the economy	*20*	*1st*
Poor weather conditions	*12*	*3rd*
Unrealistic terms of payment	*15*	*2nd*
High interest rate	*20*	*1st*
Ineffective monitoring of the loan	*15*	*2nd*
Others	*6*	*4th*
Total	**120**	**-**

Source: Fieldwork, July 2013

From Table 4.3, respondents of the three (3) rural banks ranked loan misapplication, high interest rate and poor economic activities in a particular sector of the economy as the most important factor that causes loan default. Unrealistic terms of payments, ineffective monitoring of the loan were cited as the second (2nd) ranked causes of loan default to the rural banks. Poor weather conditions and timeliness of the release of the loan were the third (3rd) ranked causes of loan default of the rural banks. Other causes cited by the respondents were multiple loans taking from different banks, lack of business management knowledge.

The explanations given by the respondents for the causes of loan default in the rural banks have been explained below:

- **Loan misapplication, High Interest rate and Poor economic activities in a particular sector of the economy**

Table 4.3 above shows that loan misapplication, high interest rate and poor economic activities in a particular sector of the economy are ranked the most important factors with a score of 20 responses from each rural banks. The respondents indicated that, in the first instance, the delay in the release of the funds can contribute to this," That is of what use is a loan to a farmer who cultivates his maize after the farming season is over"? In the second instance, the percentage of the amount granted leads to be lower and this affects the working capital of the business. Eventually, the low amount granted affects the returns and the repayments of the loans. If the percentage of the amount granted is considered low by the borrower, he/she may misapply the loan, that is, use it for consumption purpose which endangers loan repayment. According to the respondents, high interest rate may encourage borrowers to use the money to settle previous loans rather than finance working capital investment. The high interest affects the ability of the poor and traders to service fully their loans. This heightens the incidence of default and constraints lending institutions ability to advance loans to clients. The table further shows that poor economic activities in a particular sector of the economy is a major cause of loan default as indicated by a score of 20 as shown in table 4.3 above. The respondents explained that poor economic environment affect prices of goods and services and their sales. Business men and women are therefore unable to meet their expected profits and this in turn affect effective payment of loans. A particular point is the case of the Euro zone Crises where individuals with mortgages default and bank had to foreclose these mortgages.

- **Ineffective Monitoring of the loan, Unrealistic terms of payment**

The respondents believed that ineffective monitoring of the loan (see table 4.3) above is one of the second major factors that account for loan default. Monitoring of loans entails keeping track of the loans customers' activities in relation to the loan on regular basis to ensure that the terms and conditions of the facility are complied with as contained in the loan agreement. This include on- sight and off-sight monitoring. It came up that mostly; credit officers ignore on-sight monitoring which has to do with field visits to determine how customers are faring on their activities and their ability to repay loans promptly. The problem of ineffective monitoring is due to inadequate resources such as logistics that aid effective monitoring.

According to the respondents,unrealistic terms of payments schedules are known to the borrower to be unrealistic but they still go in for the loans. The lender is interested in short time payment while the borrower is also for a longer time to make payment with a lower interest rate.

- **Timeliness of release of loans and Poor weather conditions**.

Respondents also indicated timeliness of release of the loan and poor weather conditions which is ranked third in table 4.3. It was found out that the procedures and processes for loan approval tend to be bureaucratic and time consuming. In table 4.3, respondents explained that for instance, an amount of GH¢1000.00 and above has to be approved by the bank'sBoard ofDirectors. This causes undue delays because the Board meets once in a month and in the event where the board is unable to meet, a loan approval can delay for almost two months or more. The result is that beneficiaries receive their loans late and are not able to apply them at the right time. Inevitably, the delay affects output and their ability to pay back the loan as well. The table further shows that poor weather conditions also causes loan default. These are caused by poor rain pattern, flooding, crop and animal diseases among others. A respondent cited for example that the black pot disease has affected cocoa production over the years. This coupled with adverse weather conditions have resulted in huge bad loans on cocoa loan scheme which account for bad loans in the agriculture sector in figure 4.3

4.5. Effects of Loan Default in Selected Rural Banks

Zero delinquency is an attitude the whole organization must adopt if it is to become a force to reckon within its industry because loan default can eat away at a portfolio without anyone realizing it and then suddenly explode out of control like a hidden beast.

The key informant interviewed were six (6) credit officers, two (2) each from the three (3) banks and they revealed the following as some of the effects of loan delinquencies. They primarily fall in one of the two broad classes.

4.5.1 Effects on the bank as an institution

It gives a bad image about the organization. Organization image is the way in which it is viewed by the public. The way it handles its relationship with borrowers is part of its image. Persistence loan default will create an impression that the institution is a relief or donor organization.Also, loan default leads to postponement of interest income of the institutions. When loan is repaid, it includes both the interest and the principal. If the amount is not paid on schedule, the cash flow will drop and liquidity management will be affected which will lead to a run on the bank forcing it into liquidation.

Another effect of loan default is increment of loan loss provision. This is normally shown in the income statement of the financial institutions. The higher the default rate, the higher the provision for loss which eventually increases expenses and reduces income in the profit and loss account. Investors will use the net profit ratio in making an informed decisions and reduction of profit will have adverse effects on the organization.

More so, loan default affect the quality of the organization portfolio .When the principal amount is not repaid the institution is exposed to risk and for that matter its portfolio at risk will be very high. The loan loss provision represents the amount of outstanding principal that is not expected to be recovered. It is the credit balance on the asset side of the balance sheet (a 'negative asset') and reduces the outstanding portfolio.

4.5.2 Effects on the individual borrower

- Properties may be attached in case of default to defray the debt. Assets of the beneficiary may be seized in order to defray the debt. This means closure of business or other assets like houses or machinery to defray the amount owed.
- Additional cost may be paid on default. Penalties may be added to the total amount in arrears. A beneficiary may have to pay more interest on the loan which is mostly calculated by the number of days of default. Additional collection fees and costs associated with loan collection can substantially increase the loan too.
- There will be bad credit history which can affect decision for future assistance in credit referencing. Borrowers who had defaulted are now facing the problem of additional charges on their loan. They also said if borrowers default they will have a low credit rating with credit referencing and this makes it difficult for them to get loans from other financial services. The future chances of a loan defaulter getting financial aid are almost nonexistent. This is because the credit rating of the borrower declines.
- In extreme cases, legal action may be taken. A beneficiary might end up in prison for not paying back the loan and that can cause a lasting effect on his or her life or business. This is an extreme enforcement of repayment of a loan though.

Figure 4.4: Types of training for Credit Officers.

Source: Fieldwork, July 2013

In Figure **4.4,** Loan Officers interviewed were asked about the type of training and the number of times rural banks have organized for them. The three banks cited that the training were both within and outside. Loan Portfolio and Delinquency Management, Credit Management training, Effective Lending (Canons of Lending) were being conducted for credit officers of SRBL and it was thrice in a year. Trans- Universe training (Organized by Retired Banking Expert) , ARB Apex Bank training, MIDA/ACP training were for KRBL Credit Officers and it was two times in a year. That of NRBL was MIDA Agricultural Credit programmed training, National Banking College training, ARB Apex Bank training, RTIMP Agric training and it was organized for their loan officers twice in a year Credit.

4.6. Credit Evaluation

The rural banks consider certain factors in evaluating credit requests. The credit officers of the three rural banks chose feasibility studies, collateral, track record, character based assessment, business relations, financial statements of clients, ability of projected cash flow to accommodate repayments and industry analysis as the factors they use in evaluating credit requests. In the research, the rural banks credit officers interviewed used credit bureaus in evaluating their loan requests.

Table 4.4: Amount of Loan requested by Borrowers

Loan Amount Requested	SRBL GH¢	KRBL GH¢	NRBL GH¢
Maximum	*50000*	*100,000*	*30000*
Average	*800*	*300*	*1000*
Minimum	*300*	*100*	*100*

Source: Fieldwork, July 2013

4.6.1 Loan Provision Procedures

The loan processing time for the three rural banks is one to two weeks. If the amount requested for by the borrower is more thanGH¢1000, then a board has to meet and sit on it whether to grant the amount or not. The delays occur most often because of lack of documents or delays in the documentation and inspection of the supported collateral or documents.

According to NRBL, the time period for disbursement of loan depends on the clients' ability to meet their requirements, the time for submission of the loan application, and the type of loan the applicant is requesting. To minimize default in the repayment of loans, banks in general request for collateral. From the point of view, this seems tenable but from the borrowers point of view this seems difficult to satisfy. This study attempt to look at the type of collateral and guarantees demanded by the financial institution. The outcome shows that rural banks have modified their requirements. They no longer insist on immovable assets. The types of collateral expected of borrowers of the rural banks are asset collateral, personal guarantee, group guarantees and compulsory savings. The maximum amount given by KRBL was higher, followed by SRBL and that of NRB was the smallest. This is shown in table 4.4. All the rural banks reviewed gave their loans to both individuals and groups.

4.6.2 Loan Services

Both NRBL and KRBL interviewed give loans to only customers who saved with the bank. That of SRBL gives loan to non-savers. That type of loan is called pay roll loan which is given to such customers and they are being asked to open a current account and deposit a post - dated cheque whereby the bank will take the cheque for clearance. The post datedcheque is secured by three (3) salary guarantors who take their salaries from any branches of the bank. Loans given out in these rural banks have a short term (within one year) and medium term (between two years and five years) maturity profile. From the research, 98% of the loan requests were granted to the borrowers taking into consideration CAMPARI to determine whether the individual qualifies for the loan. Some of the reasons for not granting the remaining part were because they did not qualify by not having the needed documents or collateral or guarantors to support their requests.

4.6.3 Loan Approval

With visits before loan approval, 95% percent of the total population said the credit officers paid visits to them before the loans were approved. This was especially done to the business loan borrowers. Their workplaces and shops were inspected and accounts checked before they were granted the loans. With the personal loan borrowers, they were also visited to ensure that their collaterals were inspected and made authentic.

4.6.4 After-loan Financial Services

The rural banks provide after loan financial services. For KRBL, they educate borrowers on the need to use the money judiciously in order to avoid diversion. On part of NRBL, if the borrowers are farmers, they link them to silo operator to minimize post harvest loss which is crucial in agricultural loan repayment. Those of SRBL as part of their monitoring, relationship officers’ visit borrowers occasionally and give them credit education.

Table 4.5: Minimum Interest Rate Charged per Loan for a year (2013)

Credits	SRBL(%) p.a.	KRBL (%) p.a.	NRB (%) p.a.
Education	-	*28*	
Salary	*28*	*28*	*32*
Transport	*32*	*28*	*35*
Susu	*36*	*28 for 6 months period*	*18*
Agricultural	*25*	*28*	*34*
Funeral	*10 flat*	*10 flat*	*10-(Not exceeding one month) flat but additional 3% will be charged in case of default*
Staff	*5*	*5*	*5*
Construction	*32*	*28*	-
Microfinance	*36*	*28*	-
Pension	-	*28*	*32*
Managed Loans-IFAD	*Not stable*	-	*Moves with T-Bill Rate*
Savings	*4*	*28*	*4*
Others	*28*	*28*	*33*
Fixed Deposit	*13*	*10*	*6*
Trading	*32*	*28*	*34*
Service Charges	.GH¢2.*00per month*	*Commitment fee of 3% of the amount granted.*	GH¢2.*00 per month/* GH¢*3.00 per month on salaries from* GH¢*400.00 and above.*
Special Rate	-	*Negotiable(Not fixed)*	*Negotiable(Not fixed)*

Source: Fieldwork, July 2013

Table 4.5 shows the interest rate charged per loan for the various rural banks .All the three(3) rural banks uses fixed rate and the loan amount is calculated on a straight line basis. For instance a loan of GH¢1000 with an interest rate of 32% payable in 12 months is GH¢83.33 every month.

CHAPTER FIVE

Summary of Findings, Recommendations and Conclusion

5.0. Introduction

This chapter of the study provides a summary of findings, the recommendations for improved performance of rural banks and a statement of the way forward on loan default.

5.1. Summary of findings

The rural banks reviewed were SRBKL, KRBL and NRBL. The credit officers have gone through short term training and some include:

(i) Loan portfolio and delinquency management, ARB Apex Bank training and MIDA Agriculture Credit programme.

(ii) From the study, all the rural banks used factors such as feasibility studies, collateral, track record, character based assessments, financial statements of clients and ability of projected cash flow to accommodate repayments to evaluate credit requests.

(iii) Rigorous appraisals of the loans are made before they are approved. Most of the loans granted take a week and at most a month between loan application and disbursement. The types of collaterals expected of borrowers are asset collateral, personal guarantees, group guarantees and compulsory savings.

(iv) For the default rate NRBL has the highest rate of default of 60.43% of its outstanding portfolio which means that they are not performing, KRBL is averagely performing with a default rate of 24.44% of its portfolio while that of SRBL had the lowest default rate 11.72% of its portfolio which means they are performing.

(v) The causes of loan default were loan misapplication, high interest rate, timeliness for the release of the loan and poor weather conditions. It effects on the bank include bad image of the organization, postponement of interest income and increase in loan loss provision and also the effect on the borrowers include seizing of properties, future credit assistance will be limited and in an extreme cases legal action are taken on the defaulters.

5.2 Recommendations

5.2.1 Rural Banks

Most delinquency is caused not by bad borrowers, but by institutions that have not implemented an effective credit methodology. Below are some of the recommendations for Rural Banks.

- They should create an image and philosophy that does not consider late payments acceptable. The benefit of creating disciplined borrowers is critical to the success of the Rural Banks.
- Establish an incentive system that uses both financial and non-financial incentives to encourage on time repayments. Example larger loans, follow up loans, interest rebates, and access to training (or disincentives-penalty fees, no further access to loans, collection of collateral, legal action.)
- Design an incentives system for the field staff / loan officers that include on time payments as an important variable. It can motivate officers to look for and eliminate the causes of arrears.
- Ensure that from the borrowers perspectives the benefits of on time repayments and costs of late repayment far outweigh the benefits of late repayments and cost of on-time repayment.
- Clients must value the credit service. Loan products should suit needs, the delivery process should be convenient, and clients should be made to feel that the organization respects and cares about them. Incentives will not work if clients do not value the access to the credit.
- The Use of Credit Bureaus or Credit Reference Agencies

The bank should use credit reference agencies in line with the Credit Reporting Act, 2007 (Act 726) for the purpose of determining the creditworthiness of borrowers as a means of minimizing bad loans. Credit bureaus keep information on people for the purpose of assessing their creditworthiness in the granting of credit to them. According to Bank of Ghana (2007), this credit reporting system is to provide timely, accurate, and up-to-date information on the debt profile and repayment history of borrowers. This would enable the bank identify good customers and thus minimize loan default. The management of the bank should therefore ensure that all credit officers and loan approving authorities utilize the services of these institutions when conducting credit appraisals before loans are granted. It is further suggested that management can ensure the use of credit bureaus in processing loans by incorporating it into the bank's credit policy for all credit officers to adopt. This would minimize bad loans and as such improve upon the quality of the bank's loan portfolio.

- Regular Training Programmes for Credit Staff

It is recommended that management should organize regular training programmes for credit staff in areas like credit management, risk management and financial analysis. This would sharpen the knowledge and skills of credit officers so as to improve on the quality of credit appraisal, prevent delayed loan approvals, enable credit officers appreciate the need to comply with credit policy and further enhance monitoring of credit. It is also believed that through training programmes, credit staff would be able to conduct effective analysis of loan portfolio structure of their branches and give much attention to loans with warning signals. Management should also ensure that credit officers give such loan facilities more than the normal attention to prevent them from falling into non-performing categories. Management can achieve this by engaging experts or consultants in the aforementioned areas to provide quality training for credit officers under the respective Area Offices on regular basis, under the strict supervision of Area Managers. It is essential to mention that management can ensure the successful implementation of this suggestion by showing commitment in terms of providing the needed resources for these training programmes.

5.2.2. Borrowers

- Purpose of loan

Borrowers should know the type of loan they want and should use it for that same purpose. If there should even be a diversion, it should be communicated to the rural banks before it is diverted. They should check and see if the loan they are going in for is really suitable for the purpose they want to use it for before they even go in for them.

- Usage of the loans

They are to use the amounts given them when it is convenient. They are to get in-depth knowledge of when it is profitable to get loans to help their businesses grow. Some borrowers keep the loans given till they want to use it. If this is done, the rates get accumulated on the principal and this causes default.

- Repayment of loans

Borrowers must remember their obligation to repay their loans when they go for them. Doing this will always make them repay and not default. Borrowers should always try and understand what the rural banks say and try to go by them. This will help them to be able to negotiate with the rural banks even when there is a default.

5.3 Conclusion

Loan default is associated with lending and even though it cannot be completely eliminated, it can be reduced to a minimal level. This study, therefore, was conducted to help minimize the risk of default in rural banks. This study was done by interviewing respondents through questionnaires, face-to-face and telephone calls. The respondents used were the loan officers of the three rural banks (SRBL, KRBL and NRBL) and their borrowers.

For the default rate NRBL has the highest rate of default of 60.43% of its outstanding portfolio which means that they are not performing, KRBL is averagely performing with a default rate of 24.44% of its portfolio while that of SRBL had the lowest default rate 11.72% of its portfolio which means they are performing.

As indicated in the study, the respondents interviewed cited the causes of loan default in rural banks to include loan misapplication, ineffective monitoring, high interest rate charge by the rural banks, poor weather conditions, timeliness of the release of the loan, poor economic activities in a particular sector of the economy. Measures employed to help defaulters pay back their loans included taking over of collateral, freezing of interest rate, taking over of property and to the extreme, legal actions taken.

The effects of loan default to the rural banks were decrease in capital and high interest rates charges to cover up for the loss of loans given out. This decrease in capital can eventually cause the collapse of the rural banks. The effects on the borrowers were confiscation of collateral. Borrowers who had defaulted are now facing the problem of additional charges, low credit rating of the individual and added charges and interest to the loans. This in turn affects the economy since if there’s decrease in capital, more people do not get access to money to invest in their businesses.

The rural banks were advised to take their loan processing procedures seriously and done with little or no subjectivity. They were also advised to use proper screening methods like inspections of businesses and investigations to limit the adverse selection problem. Borrowers are also obliged to pay back their loans to help get more money so that more loans will be lent. They were also advised not to use the loans taken for other purposes.

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Myjoyonline.Wed 23, Feb, 2011

APPENDIX 1

Questionnaire (for Borrowers of Rural Banks)

Dear Respondent,

This questionnaire forms part of a research on the Causes of loan default: A case study of selected Rural Banks in Ashanti Region. The questions below are asked to enable me gather information to undertake this study. Answer where it applies to you. Thank you for your co-operation.

Borrower Characteristics

(Please tick the correct answer)

1. Gender: Male [ ]   Female [ ]

2. Age: 18-30 years [ ]   31-40 years [ ]   41-50 years [ ]   51-60 years [ ]   60 yrs and above [ ]

3. Marital Status: Single [ ]   Married [ ]   Divorced [ ]   Widowed [ ]

4. Have you had any formal education? YES [ ]   NO [ ]

5. Level of education

    Basic education [ ]

    Secondary education (Advanced Level) [ ]

    Tertiary Level [ ]

    Others (Specify)………………………………………..

Loan History

6. Have you taken a loan before? YES [ ]   NO [ ]

7. What is the main reason for taking the loan?

Starting a new business [ ]

Expansion of business [ ]

Personal Problems [ ]

Others (Specify) ………………………………………………..

8. How much loan did you apply for? ………………………………………………

9. Was the loan given to you at the right time? YES [ ] NO [ ]

10. How long did it take you in getting the loan after applying?

1-2 weeks [ ] 2-4 weeks [ ] 4-6 weeks [ ] 6-8 weeks [ ] others (specify)……..

11. Did the amount requested for given to you? YES [ ] NO [ ]

12 .How did you find the attitude of the credit officer assigned to you/the group?

Excellent [ ] Good [ ] Average [ ] Poor [ ] Very Poor [ ]

Supervision Visits

13. Did the bank visit your premises before approving the loan? YES [ ] NO [ ]

14. How often does the bank visit you?

Regularly [ ]

Only when defaults occurs [ ]

Others (Specify) ………………………………………

15. Were you briefed about the loan contract before you signed it? YES [ ] NO [ ]

16. How well did you understand the loan contract?

Excellent [ ]   Very Good [ ]   Good [ ]   Poor [ ]

Loan and Loan Repayment

17. Which of the following was the most important in motivating you to repay the loan?

Not to use collateral [ ]

To keep social status [ ]

Expectation of getting another loan [ ]

Knowing that paying Bank loan is an obligation [ ]

Others (Specify) …………………………………………

Causes of Loan Default

18. How would you rank the following factors as the likely causes of loan default using a scale of 1-5 with 5 being the highest and 1 being the lowest?

Poor weather conditions [ ]

Loan misapplication [ ]

Timeliness of the release of the loan [ ]

Unrealistic terms of payment [ ]

Ineffective monitoring of the loan [ ]

Poor economic activities in a particular sector of the economy [ ]

Others (Specify) ………………………………….

19. Is the repayment period enough? YES [ ]   NO [ ]

20. If NO, what do you think should have been suitable repayment period?

21. How often do you pay the loan amount and interest?

Monthly [ ]   Quarterly [ ]   Semi-annually [ ]   Annually [ ]   Others (Specify)...........

End of Questionnaire

APPENDIX 2

QUESTIONNAIRE (for Rural Bank Credit Officer)

Dear Respondent,

This questionnaire forms part of a research on the Causes of loan Default: A case study of selected Rural Banks in Ashanti Region. The questions below are being asked to enable me gather information to undertake this study. Answer where it applies to you. Thank you for your co-operation.

Banks Characteristics

Please tick the correct answer

1. Do your bank give credit? YES [ ]   NO [ ]

2. If YES, what types of credit and the interest rate charge per loan?

3. What factors do you consider before given out credit

Financial Statement of the client [ ]

Collateral [ ]

Family Connection [ ]

Feasibility Studies [ ]

Others (Specify) ……………………………………………….

4. What is the educational level of the credit officer?

DBS [ ]

H.N.D [ ]

Degree [ ]

Others (Specify) ……………………………………

5. How many credit officers do you have in the bank?

1-2 [ ]   3-4 [ ]   Others (Specify) …………………………

6. How many clients does each credit officer handle?

1-50 [ ]   51-100 [ ]   101 and above [ ]   Others (Specify) …………………

7. Are credit officers trained in a year? YES [ ]   NO [ ]

8. In your opinion, which of the following factors account for loan default?

Delayed loan approval [ ]

Poor credit appraisal [ ]

Lack of status enquiry [ ]

Diversion of loan [ ]

Others (Specify) …………………………………………..

9. Do you give loans to only people who saved with your bank? YES [ ]   NO [ ]

10. Who are the largest categories of borrowers?

Public servants [ ]

Medium and Large scale enterprises [ ]

Petty traders & Artisans [ ]

Corporate Bodies [ ]

Others (Specify) …………………………………………………

11. Which of these lending approaches do you practice?

Individual based lending [ ]

Group based lending

Both group and individual based lending [ ]

12. Do you provide after loan financial services to borrowers?

Explain…………………………………………………....................

13. What is the maturity profile of your loan?

Short term (within 1 year) [ ]

Medium term (between 2 years and 5 years) [ ]

Long term (over 5 years) [ ]

Others (specify) ………………………………….

Loan Provision Procedure

15. Processing time between loan application and disbursement:

One week [ ]

One month [ ]

Others (specify) …………………………………………..

16. What type of collateral is expected of borrowers?

Asset collateral [ ]

Personal guarantees [ ]

Group guarantees [ ]

Compulsory saving [ ]

17. What type of interest rate do you use?

Fixed [ ] Floating [ ] Both [ ]

18. What is the minimum interest rate you charged per loan? ....

19. Do your customers complain about the interest rate? YES [ ]   NO [ ]

Collection Procedure

20. How do you get information on potential borrowers before loan decisions are made?

Community and neighboring ties [ ]

Transaction in other market [ ]

The company's own records [ ]

Others (specify)……………………………..

21. What is the percentage of applicants who pay before the due date?

1-30% [ ]   31-50% [ ]   51-70% [ ]   71-100% [ ]

22. Is there any incentive provided to make client repay loans on time? YES [ ]   NO [ ]

If YES, what are the incentives? ………………………

Loan Default

22. How do you protect yourself against possible loan default?

Lending against collateral [ ]

Lending against cash security [ ]

Thorough rigorous appraisal [ ]

Giving discount or other incentive to promote payment [ ]

Strengthen physical follow-up [ ]

Sanctions or penalties for late payment [ ]

23. Has the credit officer taken short term training related to credit management? YES [ ]
NO[ ]

24. If YES, explain the nature of training

Is it within or outside the organization? ……………………………

25. On average, how many training are conducted for credit officers per year? ……….

26. What alternative measures do you take to improve loan repayment?

Loan rescheduling [ ]

Additional loan [ ]

Frequent promotion [ ]

Others (Specify) ………………………………………………..

End of the questionnaire