CHRISTIAN SERVICE UNIVERSITY COLLEGE

SCHOOL OF BUSINESS

ACCOUNTING AND FINANCE DEPARTMENT

TOPIC

THE EFFECT OF LOAN LOSS PROVISION ON PROFITABILITY (A CASE STUDY OF FORTY (40) SELECTED RURAL BANKS IN THE ASHANTI REGION)

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A THESIS SUBMITTED TO THE DEPARTMENT OF ACCOUNTING AND FINANCE, CHRISTIAN SERVICE UNIVERSITY COLLEGE SCHOOL OF BUSINESS IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF A DEGREE IN BARCHELOR OF BUSINESS ADMINISTRATION

MAY 2015

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We hereby declare that the preparation and presentation of the dissertation were supervised in accordance with the guidance on supervision laid down by Christian Service University College.

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We hereby declare that, with the exception of references from other books, journals and articles, this book is the result of our own work and no part of it has been presented for another program in this institution or elsewhere.

DEDICATION

We dedicate this research work to our parents, uncles, siblings and all friends.

ABSTRACT

This research work examines the effect of loan loss provision on profitability of forty selected rural banks in the Ashanti Religion. The researchers used both qualitative and quantitative data collection to obtain relevant data from the selected rural banks for the study. Convenient sampling method was used in choosing the respondents for the study.

In this research work, the researchers used financial and non financial factors that can affect banking profitability. These factors include: loan loss provisions, interest charged per year, percentage of loan loss that goes into provision, the influence of loan loss on provision and some others

The finding indicates that loan loss provision has influence on banks profitability. When good policies and measures are outline and effectively implemented to lower loan loss provision, banks profitability will increase to their advantage.

ACKNOWLEDGEMENT

We acknowledge Jehovah God for making it possible for us to reach this level in our educational endeavour.

We acknowledge Dr. Solomon Arhin, for without his guidance, supervisions, contributions and insistence on the right thing to be done; this research work would not have been possible and successful.

Also, we acknowledge all the lecturers at the department of Accounting and Finance for their great work.

Lastly, we acknowledge the management and staff of all the rural banks that provided us with the information needed for this study.

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CHAPTER ONE

GENERAL INTRODUCTION TO THE STUDY

1.1 Background of the study

Banks make higher provisions for the deterioration of their asset quality. This may drive capital below minimum requirements especially when capital is more expensive or simply unavailable for weaker institutions. When capital shortages are faced by banks: accounting for a large share of total lending to the economy resulting into credit contraction may have systemic implications.

This research suggests that the shortages of banks' profitability is not cause by only the risk based regulation of bank capital (asset) but most prominently to the lack of risk based regulation of banks' loan loss provisioning practices. The blame for pro-cyclical effects associated with capital shortages could therefore shift to some extent from the content of currently proposed capital regulation to its inadequate comprehension.

The generalized recognition that bank capital should provide a buffer to unexpected losses is in fact based on the implicit assumption that expected losses have already been absorbed by properly set loan loss reserves. When, instead, loan loss reserves are inadequate, expected losses will affect banks' capital and the impact of capital shortages on the real economy will be significant. As a result, for economies where sound provisioning norms are not embedded in bank practices – as it is the case for most emerging economies – the lack of a coherent and internationally accepted regulation of loan loss provisions reduce the usefulness of minimum capital regulation.

The regulation of banks' loan loss provision have attracted a very small attention relative to banks' minimum capital notwithstanding its relevance, The difficulty faced by the regulation of banks' provisioning practices – and therefore its delayed formulation lies in the presence of agency problems of difficult solution between different classes of banks 'stakeholders such as banks' outsiders" (minority shareholders or the fiscal authority) and banks' "insiders" (bank managers and majority shareholders)

Lacking a well defined and internationally agreed code of conduct, we face a multiplicity of institutional solutions. In several cases the protection of "outsiders" claims to banks' income may be too rigid or too extensive providing a disincentive to adequate loan provisioning with negative repercussions on the stability of the banking system.

1.2 Statement of the problem

Every bank aims at enjoying financial stability and being in business in perpetuity, in view of this. Management adopts specific measures or tools that enable them mitigate or even prevent financial crises to be able to guarantee economic operations into the unforeseeable future. Among banks economic operations is the granting of loans to customers. Some of these customers the banks have been granting loans to default in the payment of the loan.

1.3 Objective of the research

The objectives of the research are:

1. To find out the effect of loan loss provision on the selected rural bank profitability
2. To find out which of the variables that contribute most to the selected bank's profitability

3. To find out the association between the profitability and the bank size of the selected rural banks

1.4 Research Questions

Banks make provision for the loan loss. Hence the question:

- Why do banks make provision for loan? and
- What is the effect of loan loss provision on profitability?

1.5 Significance of the study

Bank loans are, by their economic nature, private, there is not enough market-based information to estimate their current value, so that loan-loss provisions could be estimated. This research work will serve as a useful tool to banks anytime they are taking a loan loss provision (Reserve) decision. The study will continually help entrepreneurs and individuals who get hold of it to know the contribution of banking system to them and the economy at large. It could also be used as a research tool for student who would like to write about matters of this nature.

1.6 Scope/Limitation of the Study

This study is restricted to rural banks in Ashanti Region, specifically forty rural banks. The researchers have restricted themselves to rural banks for the following reasons:

- Rural banks are financial institutions which are back by law to grant loans to their client, some of these clients do not have collateral that the bank could use to defray the loans in case of a default making provision for loan losses inevitable, we are confident of

accessing adequate and reliable date for the purpose of carrying out the research in attainment of the research objectives.

- The researchers have limited themselves to only 40 banks out of about 50 rural banks in the Ashanti region because of lack of time and financial resources

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter focuses on the review of relevant literatures on the effect of loan loss provision on profitability and other core aspect of the topic under consideration such as definition of terms, relevant studies, conceptual framework and definition of key terms.

2.2 Definition of Terms

A provision is defined as: a liability of uncertain timing or amount" (international Accounting Standard (IAS 37). A liability is then defined as: obligations of an entity to transfer economic benefits as a result of past transaction or event". The IAS 37 requires that a provision should be recognized when:

1) an entity has present obligation (legal or constructive) as a result of a past event;
2) it is probable that a transfer of economic benefits will be required to settle the obligation; and
3) A reliable estimate can be made of the amount of the obligation. The standard is saying that if any of these conditions is not met, no provision may be recognized. The standard furthered that the amount recognized as a provision should be:
    - a realistic estimate
    - a prudent estimate of the expenditure needed to settle the obligation existing at the balance sheet date
    - Discounted whenever the effect of this is material.

Financial Dictionary defines loan loss provision as “a non-cash expense for banks to account for future losses on loan defaults”

Investopedia defined loan loss provision as “an expense set aside as an allowance for bad loan (customer defaults, or terms of a loan have to be renegotiated etc)”. It is also known as “valuation allowance” or “valuation reserve”.

Investing Answers defined loan loss provision as “an expense that is reserved for default loans or credits. It is an amount set aside in the event that the loan defaults”.

The literature review for this study covers the following: the empirical and theoretical consideration on loan loss provision and other research conducted on loan loss provision in developed and developing countries. The empirical consideration covers the Banking system and Economic development, relationship of bank size loan size and profitability. In addition the theoretical consideration covers portfolio diversification, Statistical nature, accounting nature and an agency approach to general loan loss provisions.

2.3 Related Studies

Banking has long been recognized as an important factor in economic development. Historically, economists focused much on this sector. Walter Bagehot (1873) and Joseph Schumpeter (1911) emphasized the critical importance of banking system in economic growth and highlighted the circumstances when banks actively spur innovation and future growth by identifying and funding productive investments. Joan Robinson (1952) argues that banks respond passively to economic growth. It has important implications for the growth and development of the emerging economies, as numerous authors suggest critical link between the efficiency of bank intermediation economic growth. Banks grant loans to corporate institutions

and SMEs which result in expanding their activities by reducing unemployment problem, attending to their social and environmental obligation hence improving standard of living. Quaden (2004:2) for example, argues that a more efficient banking system benefits the real economy; therefore the key variable in financial system is the profitability.

Loan-loss provisioning policy is critical in assessing financial system stability, in that it is a key contributor for fluctuations in banks' profitability and capital positions, which has a bearing on banks' supply of credit to the economy (Batty and Liao). In principle loan loss provisions allow banks to recognize in their profit and loss statements the estimated loss from a particular loan portfolio(s), even before the actual loss can be determined with accuracy and certainty as events unfold and are actually written off. In other words, loan-loss reserves should result in direct charges against earnings during upturns in the economic cycle, as banks anticipate future losses on the loan portfolio when the economy hits a downturn. When these anticipated loan losses eventually crystallize, banks can then draw on these reserves, thereby absorbing the losses without impairing precious capital and preserving banks' capacity to continue extending the supply of credit to the economy. Ideally, the level of loan loss provisioning, should be able to reflect the beliefs of bank management on the quality of the loan portfolio that they have, indicating that provisions should be able to cover the whole spectrum of expected credit losses if they are to think of provisions as a measure of true credit risk (Dugan, 2009). For another, accounting frameworks only allow provisioning for losses that have already been incurred as of a financial statement date which does not really address the concept of "expected losses" (Li, 2009). Moreover, a surplus of funds relative to the appropriate level of prudent loans being granted could lead to the chasing of yields and the lowering of credit risk perception, and hence corresponding provisions. If provisions are not able to cover the whole spectrum of potential

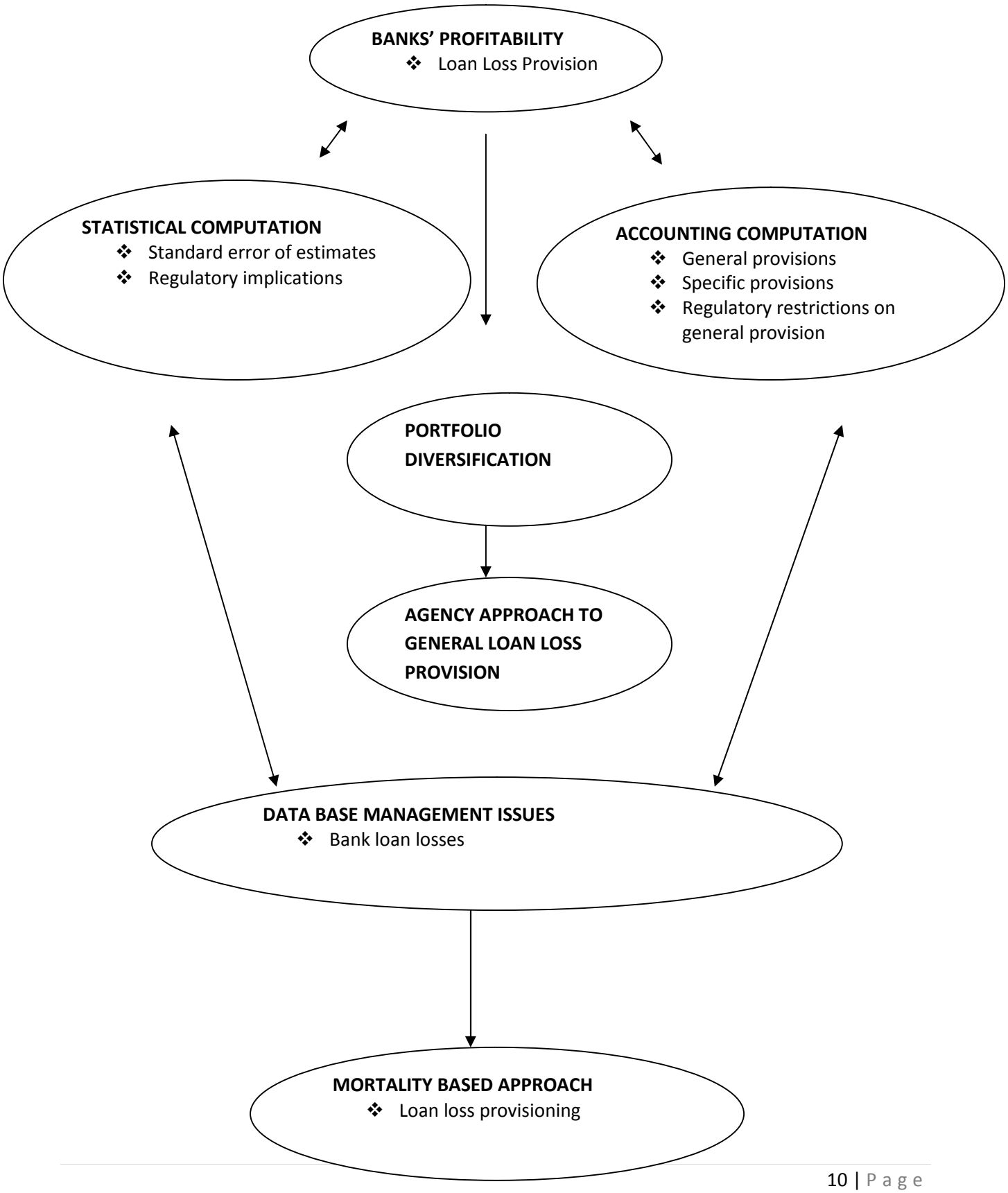
loan defaults due to an economic downturn, then naturally, the bank will need to cover the excess loss from its capital.

Pilloff and Rhodes (2002) discuss the positive relationship of the size with bank's profitability. The bank-size also affected by the operating efficiency. Molyneux and Seth (1998); Ramlall (2009); Sufian (2009) found the positive relationship of banks size with banks profitability and examined that bank size depends on the economies of scale because the larger banks were more profitable than smaller banks, whereas the empirical evidence also discuss the negative relationship of bank size with profitability (Koasmidou, 2008; Spathis, Koasmidou & Doumpos, 2002). Demirguc-Kunt and Maksimovic (1998) identified a positive relationship between size and profitability. They found out that higher funds can easily meet their rigid capitals so that they can have extra funds for giving loans to borrowers and thereby increase their profits and earning levels. Ramlall (2009) & Miller and Nuolas (1997) stated the negative relationship between credit risk and profitability. It shows that whenever there is a negative relationship between then, then it signifies that there is a greater risk linked with loans, and so higher level of loan loss supplies are made which thereby create a trouble at the profit-maximizing strength of a bank.

Vong & Chan (2005) conducted a research on determinants of banking profitability in which the bank-specific variables were examined, with a sample of five different banks. He found that a higher loan-to-total assets ratio may not necessarily lead to a higher level of profits. Due to the competitive credit market condition and the successive cuts in interest t rate, the interest spread, i.e. the important determinant of profitability, becomes narrower. A lower spread together with a higher loan-loss lead to lower profitability. Therefore, instead of loan size, it is the spread and the quality of the loan that matter.

A capital crunch could result in the reduction of total bank assets or alternatively in a shift toward less risky assets such as government bonds. An extensive survey of the empirical evidence available for industrialized economies, has concluded that "there is some evidence that bank capital pressures during cyclical downturn in the US and in Japan may have limited lending in those periods and contributed to economic weakness in some macroeconomic sector" (Basel committee on Bank supervision, 1999). Recent empirical evidence shows that the introduction of more severe capital regulation may have reduced bank credit supply also across emerging economies (Chiuri etal, 2002). These concerns have recently been addressed by policy makers as well. The Financial Stability Forum, for instance has raised the question whether several features of the new capital regulation currently discussed by the Basel Committee on Banking Supervision could increase the cyclical fluctuations of the economy. In response, the Basel Committee has confirmed that risk-based capital requirements are inevitably pro-cyclical (more capital is required during recessions exactly because credit risks in banks' portfolios increase in cyclical downturns) and suggested that the cyclicality question should be addressed by means of different instruments. For example, national supervisors (under Pillar 11 of the new accord) could request banks to comply with higher than minimum capital requirements and leave bank capital free to fluctuate above that level.

2.4 Conceptual Framework



At a theoretical level, an explicit treatment of the impact of capital requirements on the level of economic activity is provided by Holmstrom and Tirole (1997) in a model that provides a rationale for applying lower solvency ratios in recessions. They find that, in a world where agents both in the real and in the financial sector may be capital constrained market-determined solvency ratios are pro-cyclical, i.e. they are higher during expansions and lower during recessions. More precisely, they show that a negative shock to banks' capital negatively affects the level of economic activity and that the lower level of investment generated by the capital crunch requires a reduction of market determined solvency ratios. Tirole and Dewatripont (1994) also remark that the lack of discrimination between idiosyncratic and macroeconomic shocks may have undesirable effects negatively affecting bank manager's risk taking incentives. Bank managers would in fact be punished both for idiosyncratic shocks that are under their control, and for macroeconomic shocks, that are independent from their control. They conclude that Basle standards are "excessively tough on bank managers in recessions"

Regulatory capital provides adequate buffer against adverse occurrences to banks' balance sheets. This is not the only relevant buffer bankers can resort to. The prevailing conceptual framework recognizes the two existence categories of shock absorbers: (1) loan loss reserves and (2) capital. Regulatory capital should cope with the occurrence of "unexpected losses" that is loses that are large but infrequent and that therefore can be located far in the tail of the frequency distribution of loan losses. Loan loss reserves should, instead, cope with "expected losses" that is losses which occur on average and can be measured by the mean value of the frequency distribution of loan losses. The conceptual distinction between expected and unexpected components of loan losses has several important implications about the distinctive role and

functions of bank capital and loan loss reserves in the domain of risk management, of risk measurement and of accounting procedures.

Portfolio Diversification

One of the consequences is that loan loss provisions cannot be reduced through portfolio diversification. Differently from capital-which is related to measures of dispersion and can be reduced through portfolio diversification-provisions for individual loans are related to the mean value of the loss distribution and are additive over a portfolio of assets. The same loan will require the same amount of provisions whether it is a part of the vastly diversified portfolio of an internationally active bank or of the concentrated portfolio of a small cooperative bank preposition from the standpoint of a risk manager it has some desirable regulatory implications. In fact, it make it possible to envisage a relatively simple regulatory `approach to loan loss provisioning which unlike capital regulation needs not differentiate among institutions of different complexity and is not affected by the composition of banks' loan portfolio.

Statistical Computation of Provision

The computation of provisions is of statistical nature, where the standard error of statistical estimates of percentile levels of probability distributions and the associated level of capital-increases are involves. In fact, the new regulatory approach set out by the Basel Committee on Banking Supervisions requires that capital be equal to credit losses located at given percentile levels-such as the 1 percent or the 0.1 percent –of the highly a symmetric distribution of loan losses. Provisions, instead, should be equal to the mean value of the same distribution.

Accounting computation of Provision

This part of the conceptual framework concerns itself with how general provisions, specific provisions and regulatory restriction on general provision interplay in determining the appropriate amount to set aside as loan loss provision and its impact or effect on profitability. For instance, allowing interest premiums (on the asset side but not general provisions) on the cost side to be equal to expect losses generates an upward bias of banks' operating income during cyclical upswings and a downward bias during downswings. The bias is reduced but not eliminated at the level of pre-tax profits, when charges related to loan loss provisions are fully taken into account also on the cost side. The bias, though, persists because in most countries "general" provisions are often subject to quantitative restrictions that keep them smaller than expected losses. In the extreme case where general provisions are equal to zero no charges for provisions will be made in good times and all charges will be posted as specific provisions in bad times.

According to widespread accounting practices "general" provisions refer to "exante" provisions and are related to future uncertain events. "Specific" provisions can instead be seen as "ex-post" provisions, in that they refer to certain events (such as past due payments, or other default-like events) for which a specific documentation can be produced.

"Specific" provisions are somewhat similar to write-offs and, since they can be easily documented, are no subjects to significant restrictions. General provisions instead, refer to probabilistic losses that cannot be supported by loan specific documentation and therefore can be highly judgmental, controversial and prone to manipulation by bank managers for opportunistic reasons or for tax avoidance purposes.

Regulatory restrictions on "general" provisions, such as regulatory ceilings, are therefore intended to reduce the amount of possible controversies and litigations among different groups of bank stakeholders. As a result, we observe that accounting restrictions coupled with fiscal restrictions, intended to limit tax deductibility of general loan loss provisions, often prevent loan loss provisions from reaching the level of expected losses.

An Agency Approach to General Loan Loss Provisions

If risk weighted provisions are more easily measured than capital and if a proper measurement of loan loss provisions could lead to a more faithful representation of the true underlying bank profitability why are not accounting, fiscal and prudential regulations taking advantage of these features? Our conjecture is that the definition of loan loss provisions is affected by a host of agency problems of difficult solution and that the existing regulatory framework, intended to minimize these agency costs may end up being unduly restrictive on banks provisioning practices. Banks are no exceptions to general corporate behavior and their actions result from the interactions of different stakeholders some of which (the banks' insiders employees, minority shareholders and the fiscal authority) are not formally sitting in the executive boards, while other (the banks' insiders: managers and majority shareholders) are actively involved in the bank's policy decisions. Imperfect control and monitoring ability of insiders by outsiders is for banks as for nonfinancial corporations a source of agency problems.

The allocation of banks' operating profits among provisions, income taxes, dividends and retained earnings is a highly judgmental decision which rests to a large extent on manager's autonomous judgment. The lack of transparency of these decisions has led banks' outsiders to

find different forms of protection of their claims over bank's profits. Analogously we suggest that higher dividend payments could come at the expense of sound provisioning charges.

We also suggest that corporate outsiders would be penalized through asset diversion, transfer prices and other appropriation mechanisms on the part of corporate insiders; unless they are given the right to share the firm's profits in accordance with some prorate mechanism such as defined by dividend payment policies.

Bank Loan- losses, Database Management Issues

Banks' database provide information on the industry classification, the interest rate charged on the loan, the history of the loan after default, the type of collateral or guarantees, the internal rating attributed by the bank and the number of defaults per year.

The various forms of guarantees, or collateral, are reported along the classification used by the Bank for International Settlements (Basel Committee, 2003). These include:

- Personal guaranteed
- Real estate collateral
- Physical collateral(inventories)
- Financial collateral (bank deposits, bonds or shares)

Any empirical study of credit risk and loan provisioning raises two measurement issues. Which criterion should be used to define the time of default event? Which method should be used to measure the recovery rate on a default transaction?

The criterion used for the classification of a loan in the ‘default ‘ category is critical for a study on provisions, as a different classification would lead to different results. Three ‘default’ definitions are used in the literature:

I. A loan is classified as ‘doubtful’ as soon as “full payment appears to be questionable on the basis of the available information”
II. A loan is classified as ‘in distress’ as soon as a payment (interest and/or principal) has been missed.
III. A loan is classified as default when a formal restructuring process or bankruptcy procedure is started.

Loan-Loss Provisioning, a Mortality –Based Approach

To calculate provisions, one has to first analyze recovery on bad and doubtful loans. Having access to the history of cash flows on these loans after default, we can study the time distribution of recovery. With reference to studies by Altman (1989) and Altman and Suggit (2000), Demine J. and Neto de Carvalho C. used mortality approach in their study “Bank Loan Loss Provisioning, Methodology and Application”. They applied the mortality approach to measure the percentage of bonds or loans that defaulted in years after origination. The application of mortality to loan recovery rates and provision is, to the best of our knowledge, novel.

2.5. Definition of Key Terms

Based on theory and literature, both financial and non-financial factors tend to influence the bank profitability. Even though profitability does not necessarily mean liquidity, it ensures firms survivals, growth and turn to strengthen financial position of firms. Among key factors that are

recognized by previous studies include; loan loss provisions, size, current liabilities, bank size, deposits, current assets, and political instability.

2.5.1 Return on Assets (ROA)

This indicator measures the extent using total assets to generate bank returns after tax payment.

ROA shows the profit earned per cedi of assets which reflects bank's management ability to utilize the bank's financial and real investment resources to generate profit (naceur 2003 and Alkassim2005).

2.5.2 Loans loss Provision (LLP)

The proxy used for this variable as loan loss provision over total loans granted. It is a measure of capital risk, as well as credit quality of banks. If banks operate in more risky environments and lack the expertise to control their lending operations, it will probably result in a higher loan loss provision ratio to cover this risk. Hence, the ratio is expected to have a negative relationship with profitability.

2.5.3 Current Liabilities (CL)

The ratio of current liabilities to total assets has been used to find the impact of current liabilities on the banking profitability. There is evidence that a positive association is found between the ratio of current liabilities to total assets and profitability.

2.5.4 Size (SIZE)

The total interest incomes (sales) determine the size of the bank. The size of the bank is an independent variable which account for size related economies and diseconomies of scale. The

interest incomes of the banks are used as a proxy for bank size. The study use the natural logarithms form of sales to determine size of bank and it has expected positive sign.

2.5.5 Advances (ADV)

It is computed as total advances divided by total asset. It measures income source and liquidity of the bank assets tied to loans. It is an independent variable and expected to achieve a positive sign.

2.5.6. Deposits (DEP)

It is a ratio of deposits to total assets and also considered as a liability. Bank deposits are the main source of funds of the bank, out of that the bank is able to give out loans. It has a positive impact on the bank profitability all things being equal.

2.5.7. Current Assets (CA)

It measures the ratio of current assets to the total assets. If it is high, it shows good solvency position of the bank but it also means those banks have retained its current assets and are not utilizing it for further investment purposes in the business. It is expected that there will be a negative relation between this ratio and profitability of bank.

2.5.8. Political instability (PII)

To analyze the political factor influence on banking profitability, the researcher employ political index denoted as **Ps**, where it has index values from 21 points scales ranging from-10 (strong autocracy) to + 10 (strong democracy). The movement between autocracy and democracy may have influence on the banking profitability. In this factor has expected negative sign.

CHAPTER THREE

METHODOLOGY

3.1 Introduction

Research methodology is very important in any scientific endeavor in order to achieve the research objective.

The researchers intend to use this chapter to address the issues of loan loss provision on profit on about 30 selected rural banks in the Ashanti region of Ghana.

This chapter will also be used to address the background of the study area, the study type, study design, source of data, population sample and sampling techniques, data collection method, data analysis and ethical considerations.

3.2 Background of the Study Area

The researchers seek to unearth the effect of loan loss provisions made by banks with specific reference to about 40 selected rural banks in the Ashanti region on their profitability.

The researchers have decided to use two types of research methods type namely quantitative and qualitative methods. There is a level of difference between these methods and according to Saunder et al (2007) these methods differ in terms of numeric and non-numeric. quantitative method is primarily used for any data collection technique like a questionnaire or statistics but generates or uses numerical data or data analysis procedure, such as graph. Qualitative method is primarily used for any data collection technique such as an interior or data analysis procedure that produces non numerical data like categorizing data.

Whiles qualitative data refers to words such as pictures and video chips that give the researcher to use reference qualitative data expressed in numerical forms (such as graphs and frequency tally's some effect can be shown only in numerical figures like interest roles and its effect on lawn defaults, on the other hand other impacts can only be indicated in descriptive manner like business experience, way of reducing loan loss provisions etc.

3.3 Study Design

The basic objective for this research is to find out effect of loan loss provision on the 40 selected rural banks profitability. Find out which of the variables will contribute most to the select e banks' profitability not and to find out whether there is any association between the profitability and the bank size of the selected rural banks.

The researchers intend to use a descriptive research design which will deal with questions and opinions of existing issues

We intend to collect data from both primary and secondary sources using qualitative and quantitative data techniques to answer the research questions mentioned.

The design will take into account the collection of data in order to understand the research objectives in the subject of the study.

3.4 Source of Data

The researchers intend to obtain data that will enable them answer the selected research question from primary sources such as interviews questions, observations and also from secondary sources such audited financial statements, websites of the selected rural banks.

3.5 Population Sample Size and Sampling Techniques.

The population for the study is made up of the management of the selected forty rural banks out of fifty rural banks in the Ashanti region.

The researchers choose the management because, most of them have been working in the banking sector for a long time and as such have rich experience on the effect of loan loss provision on profitability and can respond better to the questionnaires.

The researchers intend to adopt a convenient sampling technique for choosing the respondents for the study. Even though there is a bias in this sampling method, the researchers find it appropriate and effective, considering time and resources and thus will not negatively affect the study.

3.6 Data Collection Method

The researchers will use questions and interviews to collect qualitative and quantitative data. We intend to distribute the questionnaires personally and help the respondents in responding to the various questions that would be posed to them to enable the researchers to have access to the necessary data for the study.

3.7 Data Analysis Method

The researchers intend to scrutinize the data collected to ensure that they are reliable, suitable, adequate and accurate for the study.

The responses gathered from the management of the various banks will be coded and analyzed using Statistical Package for Social Sciences (SPSS)

3.8 Ethical Consideration

The researchers are aware of some reservations banks especially rural banks have with regards to releasing information regarding their internal operations.

We however indicate our strongest assurance that all information received or gathered would be handled with utmost care to avoid compromising the operations of the selected banks.

Confidentiality is assured by the researchers.

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION

4.0 INTRODUCTION

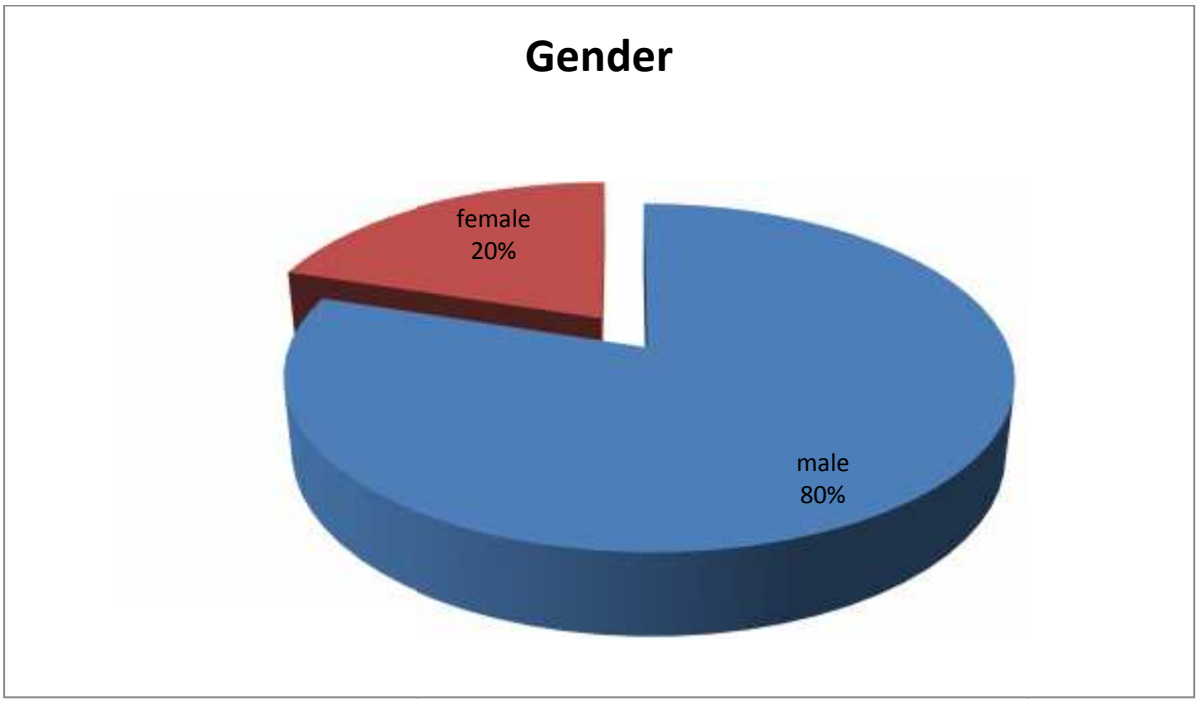
This chapter covers the presentation and analysis of the data used in the study. It shows the findings of the study which seeks to answer the research questions and the study objectives.

Fig 4.1 Age Distribution

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	20-30 years	8	20.0	20.0	20.0
	31-40 years	19	47.5	47.5	67.5
	41-50 years	13	32.5	32.5	100.0
	Total	40	100.0	100.0	

The result indicate that 20% of the respondents were within the age of 20 to 30 years, 45.5% were within the ages 31 and 40 years, 32.5% of the respondent were also within the ages 41 and 50 years.

Fig 4.2 Gender



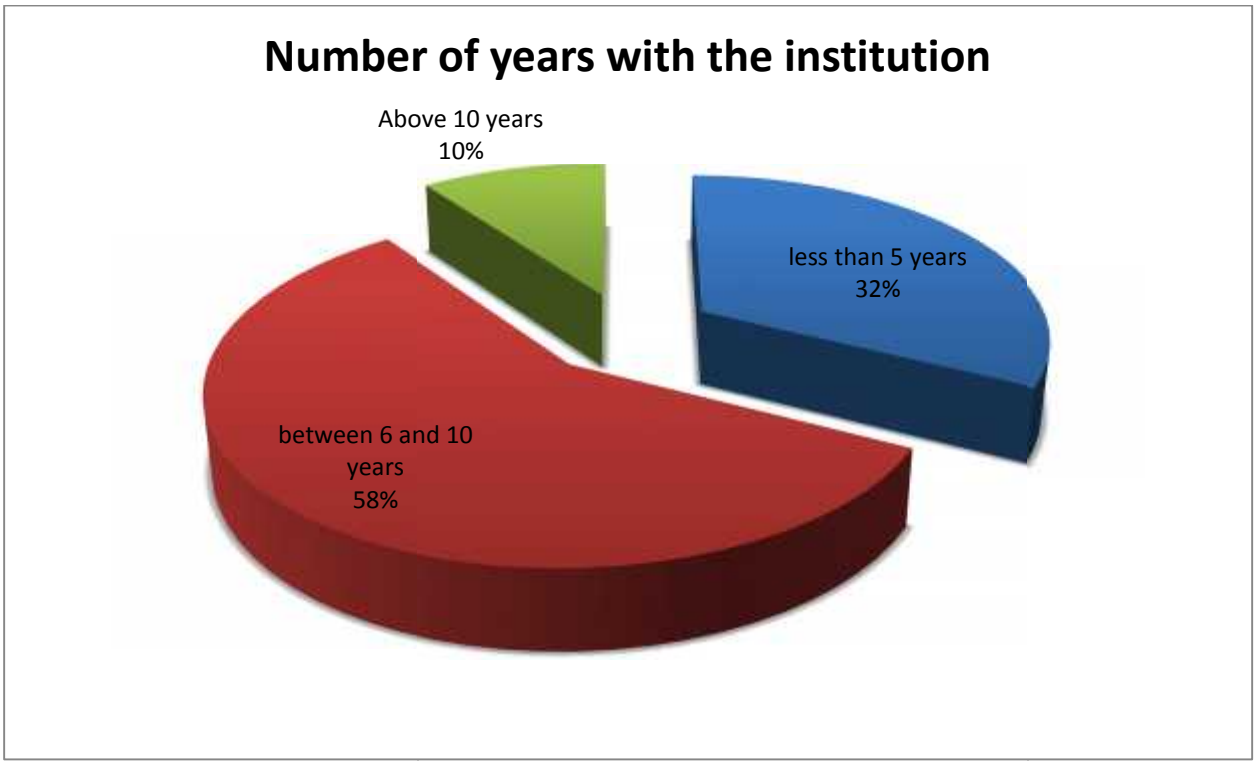
The figure above depicts a graphical representation of gender distribution. The “BLUE” portion represents the number of male respondents and the “RED” portion represents the number of female respondents.

Fig 4.3 Which of the following best describes your level of education

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	University and above	29	72.5	72.5	72.5
	Diploma	10	25.0	25.0	97.5
	Professional Training	1	2.5	2.5	100.0
	Total	40	100.0	100.0	

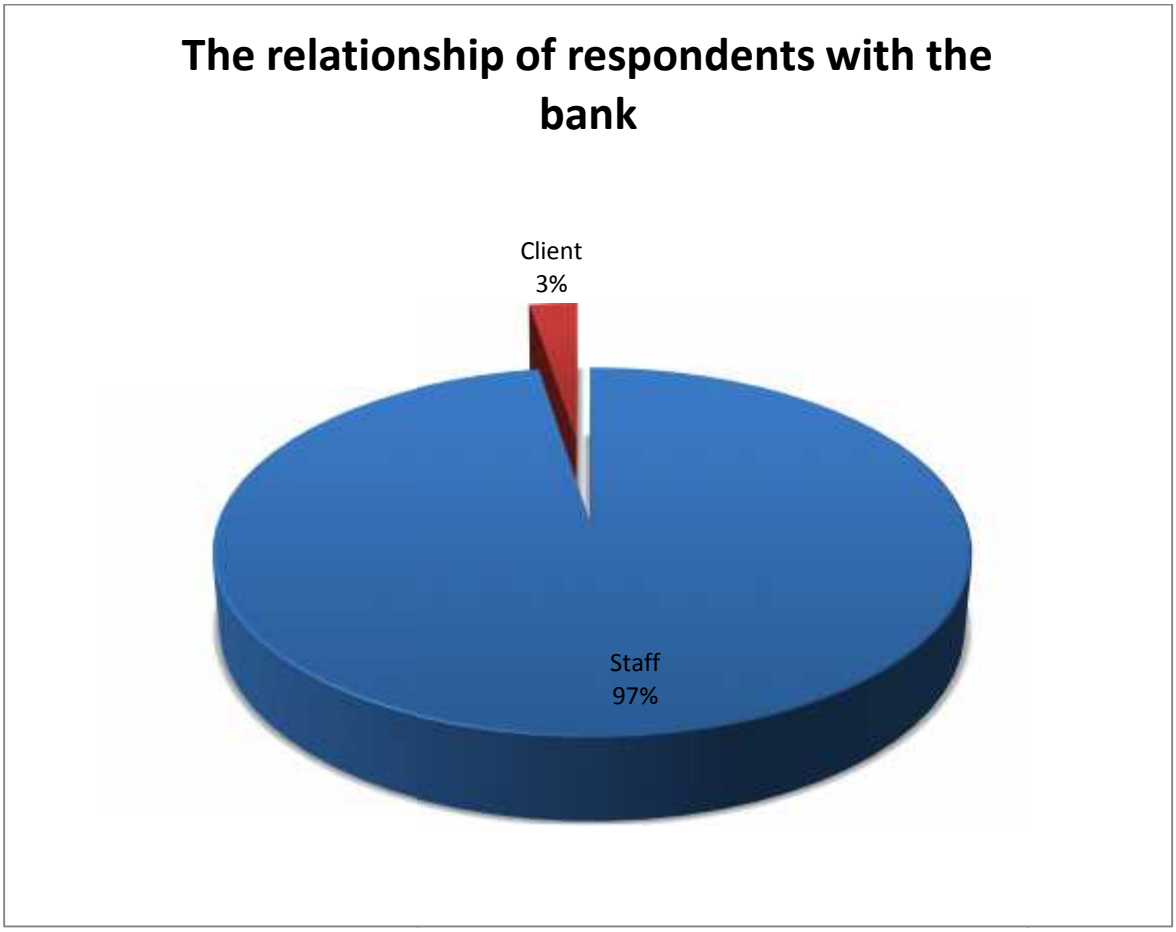
The study revealed that, 29 (72.5%) of the respondent were graduates from universities and above, 10 (25%) were diploma holders and 1 (2.5%) was a professional training. The result is as shown in table 4.3.

Fig 4.4 Number of years with the institution



The diagram above shows the number of years the respondents spent with the financial institution. It also indicates that majority of the respondents have spent between 6 to 10years with their institutions as shown by the “RED” portion of the diagram.

Fig 4.5 Relationship with the bank



The figure above presents an overview of the relationship of the respondents with the financial institutions. It also shows that majority of the respondents are staff represented by the “BLUE” portion of the pie chart.

Fig 4.6 The average interest charged per year

	N	Minimum	Maximum	Mean	Std. Deviation
What is the average interest charged on loan per year?	40	1.00	9.00	3.1750	1.08338
do you think high interest rates can cause default?	40	1.00	2.00	1.2250	.42290
does loan default influence the provision you make for loan loss?	40	1	2	1.15	.362
What percentage of your bad debt is recovered when there is default	40	1.00	6.00	2.9250	1.57525
Valid N (listwise)	40				

Fig 4.6 above analysis the average interest charged per year and produces the highest mean among other factors indicating that the bank is doing well with its average interest charged per year.

Fig 4.7 Does loan default influence the provision you make for loan loss?

	N	Minimum	Maximum	Mean	Std. Deviation
What percentage of your bad debt is recovered when there is default	40	1.00	6.00	2.9250	1.57525
What is the average interest charged on loan per year?	40	1.00	9.00	3.1750	1.08338
do you think high interest rates can cause default?	40	1.00	2.00	1.2250	.42290
does loan default influence the provision you make for loan loss?	40	1	2	1.15	.362
Valid N (listwise)	40				

Fig 4.7 analysis the effect of loan default on the provision made. The table shows an effect with a mean value of "1.15" but this mean value is the least among other factors, indicating that the banks are not doing well in making provision on loan loss.

Fig 4.8 The rate of loan default

	N	Minimum	Maximum	Mean	Std. Deviation
Is your profit affected in any way when bad debt is high?	40	1.00	2.00	1.1500	.36162
Do you think high interest rates can cause default?	40	1.00	2.00	1.2250	.42290
Does loan default influence the provision you make for loan loss?	40	1	2	1.15	.362
What is the rate of loan default in your institution	40	1	3	2.47	.599
Valid N (listwise)	12				

The researchers have decided to isolate the influence loan default have on provision for loan loss among other factors. It can be seen that, the rate of loan default in the selected rural banks is high with a mean value of “2.47” we therefore deduce from the mean value that the influence loan default has on provision for loan loss is high.

Fig 4.9 The percentage of total loan granted that goes into loan loss provision

	N	Minimum	Maximum	Mean	Std. Deviation
What percentage of your total loans granted goes into loan loss provisions.	40	1	10	2.62	2.192
What percentage of your loan go bad, kindly state	40	1	5	1.48	1.037
Do you think high interest rates can cause default?	40	1.00	2.00	1.2250	.42290
Do you recover bad loans from clients through "seizure of collateral and company assets"?	13	1.00	1.00	1.0000	.00000
Valid N (listwise)	13				

The table above (i.e Fig 4.9) analyses the percentage of total loan granted that goes into provision for loan loss; we identify a mean value of "2.62" signaling the banks are doing well with regards to the percentage of total loan granted that goes into loan loss provision

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This chapter briefly comments on the research findings, the methods used in obtaining data for the study and draws reasonable conclusion thereon. In addition, cogent recommendations that flow from the findings of the effect of loan loss provision on profitability of selected rural banks are made. The recommendations will help lay bare the implication of the findings and the possible measures that could help mitigate the effect of loan loss provision on profitability of the selected rural banks.

5.1 Summary of Findings

Descriptive form of analysis was used in arriving at the results of the effect of loan loss provision on profitability of the selected rural banks.

Several factors were revealed in the study as influencing loan loss provision and thus having an effect on the profitability of the selected rural banks in the Ashanti Region. Among these factors are: Average Interest Charged Per Year; Loan Default; The Rate of Loan Default and The Percentage of Total Loan That Goes Into Provision. These factors were emphasized by the respondents as having a huge effect on profitability.

The study also reveals that, loan default and the rate of loan default arise out of the difficulty in locating and monitoring clients.

The findings revealed that, the selected rural banks are doing well with the average interest charged per year with an approximate mean value of “3.18”

This interest rate contributes hugely by increasing the profitability of the selected rural banks.

The study revealed a high loan default rate mean value of “2.47” by the selected rural bank with a negative effect on profitability.

The percentage of total loan granted that goes into provision for the selected rural banks is also high with a mean value of “2.62”. This indicates that, the profit position of the banks will dwindle.

The finding starkly revealed in the face of the forgoing statistics (i.e. “2.47” mean value for the rate of loan default and “2.62” mean value for the percentage of total loan granted that goes into provision) that the selected rural banks do little in making provision available for loan default with the effect of making the banks look profitable while in reality provisions have not been taken care of. This is revealed in the mean value of “1.15” generated for how loan default influence the provision the selected rural banks make.

5.2 Conclusion

The summary of the findings above necessitate some conclusions that could be drawn on the research topic: “The Effect of Loan Loss Provision on Profitability”.

It is clear from the findings that, banks have huge loan portfolios but they do little in terms of monitoring due to difficulties in locating client to retrieve the loans with a long term effect of influencing provisions hugely.

It is also clear that, notwithstanding the rate of loan default which affects provision and thereby profit, the banks have decided to siphon the amount that should go into provisions and thus swelling profit to present a misleading picture of the banks’ profitability.

5.3 Recommendation

Based on the key summary of finding that the study pinpointed, the following are the cogent recommendations being made:

When banks grant more loans it gives room for a high percentage of the total loan granted going into provision resulting in a marginal decrease in profitability when loan customers default in payment. In the light of this management should put very effective measures in place to know their customers in order to give them advice on how to make effective use of the loan granted them, monitoring them by maintaining constant contact with them and tasking the credit officers to visit them on monthly basis for retrieve the loan from the customers to prevent loan default.

The banks should formulate and establish good policies that will enable them regulate the trend of diverting more funds into loan portfolio with a high rate of default. This can be done by placing a limit on how much could go into loan portfolio and how much goes into other investment portfolio.

Management should insist that the right amount of provision is set aside against loans granted. This is because provisions are treated as expenses and if the right amount is not made in proportion to total loan granted for the year, a rosy picture would be created of the profitability of the banks.

Management of banks should be dynamic in introducing attractive products and services to

increase their customer base in order to increase profitability instead of relying on huge loan portfolio with high uncertainties as a driver of profit.

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QUESTIONNAIRE

CHRISTIAN SERVICE UNIVERSITY COLLEGE

DEPARTMENT OF ACCOUNTING AND FINANCE

QUESTIONNAIRE

TOPIC: THE EFFECT OF LOAN LOSS PROVISION ON PROFITABILITY

Dear Respondent,

This research work is being undertaken by some students from Christian Service University College, Department of Accounting and Finance. You have been selected to respond to this questionnaire for the study of the "Effect of Loan Loss Provision on Profitability". You are assured that any information you provide is solely meant for the research and nothing else. Your response to the questions shall be kept confidential.

Please choose the option that applies to you by placing a tick in the bracket of your choice. Please give only ONE answer.

SECTION A: Personal Information

1. Gender: [ ] Male [ ] Female
2. Age: [ ] 20 – 30years [ ] 31 – 40years [ ] 41 – 50years [ ] 51 – 60years
3. Number of years with the institutions:

[ ] Less than 5years [ ] Between 6 and 10years

[ ] Above ten years

4. Which of the following best describes your level of education?

[ ] University and above [ ] Diploma [ ] Professional Training

[ ] Secondary Education [ ] Middle School/Basic Education

[ ] Any other, please specify……

5. What is your relationship with the Bank?

[ ] Staff [ ] Client

Any other, please specify…….

SECTION B: For Management

6. What is your rank in the bank, please state……..

7. What type of credit facilities are normally applied for in your bank?

[ ] Funeral Loan [ ] Overdraft [ ] Salary Loan [ ] Susu Loan [ ] Commercial Loan [ ] Any other, please specify……

8. What is the processes for applying for loans in your institution, please state…….....……
……..

9. What documents are necessary for processing the facility?

.....

10. What is the loan repayment period for your facility?

[ ] 1- 5months [ ] 6 – 12months [ ] 13 – 24months [ ] 25 – 36months [ ] 37months and above.

11. What is the rate of loan default in your institution? [ ] High [ ] Low [ ] Moderate

12. Do you have operational difficulties due to the rate of default?[ ] Yes [ ] No

Kindly give reason(s) for your answer.

……..

13. Kindly indicate among the following factors the ones that cause loan default in your institution.

[ ] Under Financing [ ] Terms of Loan [ ] Marketing Problems

[ ] Delays in Loan Approvals [ ] Unwillingness to Repay Loans [ ] Ineffective monitoring [ ] Poor Weather Conditions [ ] Any other, kindly specify……
……..

14. What problems do you encounter in loan recoveries?

.....……
…….

15. Does non-compliance with the credit policies of the bank cause bad loans?

[ ] Yes [ ] No

If yes which of the following account for that? [ ] Pressure from Customers

[ ] Pressure from Management [ ] Pressure from the Board

Any other, kindly specify

……

……

16. How do you recover bad loan from clients? [ ] seizure of collateral and company assets

[ ] Through court action [ ] Complaint to guarantors

[ ] Sale of collateral provided by clients

17. What percentage of your total loans granted goes into loan loss provisions, kindly state

……..

18. What percentage of your loans go bad, kindly state

……

19. What percentage of your bad debt is recovered when there is default?

[ ] 5-10% [ ] 11-20% [ ] 21-30% [ ] 31-40%

[ ]41-50% [ ] 100%

20. Is your profit affected in any way when bad debt is high?

[ ] Yes [ ] No

If yes, kindly explain……

……

21. Is there any measure in place to reduce loan loss provision?

[ ] Yes [ ] No

Kindly explain your answer……

……

……

22. What is the average interest charged on loan per year?.....……
……..

23. Do you think high interest rates can cause loan default?

[ ] Yes [ ] No

24. Does loan default influence the provision you make for loan loss?

[ ] Yes [ ] No

25. In your opinion do clients feel satisfied after being served?

.....……
…….

26. Does their level of satisfaction have influence on loan default and thereby affecting your loan loss provision?

.....
……
…….