Examining the Credit Granting Process in a Commercial Bank

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Abstract:

Purpose: The purpose of this paper was to examine the credit granting process in a commercial bank in Ghana. Commercial banks play a critical role to emerging or developing economics like Ghana where borrowers have no or limited access to capital markets.

Design/methodology/approach: The study adopted both qualitative (case study) and quantitative methods respectively. Banks were selected to gather data, which was acquired from answers obtained from our administered questionnaires. The population of the survey constituted the management and non-management staff and customers of Ecobank (EBG), Ghana Commercial Bank (GCB) and UT Bank.

Findings: The data gathered for the study were analyzed using correlation. Results of the study showed that there is a high positive correlation between the constructs of credit risk and banks operation.

Keywords: credit risk, credit granting process and Ghanaian banking industry.

1. INTRODUCTION

Credit has been given various definitions by different authors. The international dictionary of management defines credit as “borrowing” up to certain amount given by financial institutions like the bank to an individual of an organization”. According to Lidger Wood. (1993), credit is derived from a Latin word ‘credre’ which means ‘believe’. From this, he defines credit as an expression of belief in a person’s ability and willingness to repay a loan. Miller and Van Horne (1993), also consider credit from two definitions;

First, they see it as an asset and secondly as a liability. To them, credit represents a future receipts to the lender and as a future obligation to the borrower. They therefore defined credit as a transfer of title to real goods and services. Lidger Wood (1993) summarized it all by defining credit as borrowed funds with specified terms for repayment. Based on the above definition and explanation of credit, it can also be deduced as making or offering some advances under specified repayment terms by a bank to its customers with the belief that such loans shall be repaid as agreed. Finance is either by internal or external injection of fund. Sole traders and partnerships are frequently dependent in varying degrees on bank credit facilities as source of funds for the growth of their businesses.

In the commercial banking industry, it seems as if we really have not understood our borrowers or their industries as much as we should. Inevitably, this fundamental failure has produced significant credit problems. Most commercial banks have taken the main ingredient needed for quality assets for granted. Asset quality problems are therefore the consequence of ignoring the fundamentals of credit. In retrospect, most commercial banks are guilty of lending excesses that sourced and turned into credit problems. There should be a transition in the fundamental economies of lending precipitated by poor credit risk management habits and an obvious decline in credit underwriting standards. The tendency to disregard structuring, strong loan documentation, and diligent monitoring and servicing of credits have increased the credit impairment of most rural banks in Ghana thereby making them less profitable. The researchers complement and extend this stream of the literature by examining the credit granting process in a commercial bank in Ghana.

The remainder of this paper is structured as follows. Section 2 will be present the theoretical background to this study. Section 3 provides the research methodology of the study. In section 4, the researchers present the statistical results and discussions of finding. Finally, this study in section 5 discusses the conclusion of the study.

2. LITERATURE REVIEW

According to Greuning and Bratanovic (2003), the integrity and creditability of the lending process depend on objective credit decisions that ensure an acceptable risk level in relation to expected return. Lending process in a bank should include analysis of credit manuals and
other written guidelines applied by various departments of the bank and of the capacity and actual performance of all departments involved in credit function. Credit function should cover origination, appraisal, approval, disbursement, monitoring, collection, and handling procedures for the various credit functions (Greuning and Bratanovic, 2003). On-going administration function is basically a back office activity that support and control extension and maintenance of credit (Basel, 1999).

Greuning and Bratanovic (2009) observed that credit granting process should comprise a detail analysis and approval process that includes samples of loan application forms, internal credit summary forms, internal manuals and loans files showing appraisal and approval of loans; criteria for approving loans, determining loan pricing policy and lending limits at various levels of the bank’s management and for making arrangements methods and practices concerning revaluation of collateral and files related to collateral; administration and monitoring procedures including responsibilities, compliance and controls; a process for handling exceptions.

Credit risk rating plays very important role in granting of loans to borrowers. Credit risk rating is summary indicator of a bank’s individual credit exposure. An internal rating system categorizes all credit into various classes on the basis of underlying credit quality.

According to Santomero (1997), if rating systems are meaningful they should be able to signal changes in expected level of loan losses. A well-structured credit rating framework is an important tool for monitoring and controlling risk inherent in individual credits as well as in credit portfolios of a bank or a business line. The importance of internal credit rating framework becomes more eminent due to the fact that historically major losses to banks stemmed from default in a loan portfolios. While a number of banks already have a system for rating individual credits, all banks are encouraged to devise an internal rating framework. An internal rating framework would facilitate banks in a number of ways such as credit selection, amount of exposure, tenure and price of facility, frequency or intensity of monitoring, analysis of migration of deteriorating credits and more accurate computation of future loan. As with the decision to grant credit, the assignment of ratings always involve element of human judgment. Even sophisticated rating models do not replicate experience and judgment rather these techniques help and reinforce subjective judgement.

Commercial banks are required to establish responsibility for credit sanctions and delegate authority to approve credits or changes in credit terms. It is the responsibility of banks board to approve the overall lending authority structure, and explicitly delegate credit sanctioning authority to senior management and the credit committee. Lending authority assigned to officers should be commensurate with the experience, ability and personal character. It would be better if institutions develop risk-based authority structure where lending power is tied to the risk ratings of the borrower. Commercial banks may adopt multiple credit approvers for sanctioning such as credit ratings, risk approvals etc to institute a more effective system of check and balance. The credit policy should spell out the escalation process to ensure appropriate reporting and approval of credit extension beyond prescribed limits. The policy should also spell out authorities for unsecured credit extension beyond prescribed limits. The policy should also spell out authorities for unsecured credit policy, Basel (1999).

A typical credit administration unit of bank should ensure completeness of documentation of loan agreements, guarantees, transfer of title of collaterals in accordance with approved terms and conditions. Commercial banks should always track and follow up on all outstanding documents to ensure execution and receipt from customers (Basel 1999). Banks credit administration team should ensure that the loan application has proper approval before entering facility limits into computer systems. Disbursement should be effected only after completion of covenants, and receipt of collateral holdings. In case of exceptions necessary approval should be obtained from competent authorities in the bank. Clear establishment process for approving new credits and extending the existing credits has been observed to be very important while managing credit risk (Heffernan, 1996). Commercial banks should ensure that all security documents are kept in fireproof safe under dual control. Register for documents should be maintained to keep track of their movement. Banks should establish procedures to track and review relevant insurance coverage for certain facilities or collateral.

Also, Commercial banks should physically check on security documents on regular basis. Banks must operate within a sound and well-defined criteria for new credits as well as the expansion of existing credits. Credits should be extended within the target markets and lending strategy of the commercial banks. Before allowing a credit facility, the bank must make an assessment of risk profile of the customer and/or transaction. This may include credit assessment of the borrower’s industry, and
3. RESEARCH METHODOLOGY

3.1. Research Design
Research is a process of steps used to gather and evaluate information in order to increase understanding on an essential topic. It consists of three steps, namely posing a question, collecting data to answer the question, and presenting an answer to the question (Creswell, 2009). The research design for the current study refers to a quantitative form. This research concentrates on the relationship among variables more than on testing activity impact, and uses correlation design. Based on the described research objective, this study will adopt a correlation design. Correlation design allows us to predict an outcome and know the relation between variables.

3.2 Study Area
The study was conducted in Accra the capital city of Ghana. The location of the city makes it the commercial center and a nodal point from which roads radiate to the central business areas of the region. Ecobank (EBG), Ghana Commercial Bank (GCB) and Unique Trust (UT) Bank in Ghana were chosen because it has greatest market share in the industry.

3.3 Population and Sampling
The population of the survey constituted the management and non-management staff and customers of Ecobank (EBG), Ghana Commercial Bank (GCB) and UT Bank in Ghana. The researchers used the simple random sampling. The study used a sample size of six hundred (450) and due to adequate time the researchers devoted for the data collection, the researchers were able to get five hundred and forty-five (409) questionnaires that were administer.

4. DATA ANALYSIS
We examined the credit granting process in a commercial bank in Ghanaian banking industry. Based on analysis of the collected data and using description statistics for demography, it was found that most respondents were male at 58.2% and the most of the research participants (51.9%) are aged between 25 and 40. Additionally, most people (49.4%) have some undergraduate education level and most respondents are married (58.7%).
Table 1: Correlations between the application decision, the credit approval decision and the loan rate setting decision.

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<th>The Application Decision</th>
<th>The Credit Approval Decision</th>
<th>The loan Rate setting Decision</th>
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<tr>
<td>The Application Decision</td>
<td>Pearson Correlation</td>
<td>1</td>
<td>0.700**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td></td>
<td>0.000</td>
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<td>N</td>
<td>409</td>
<td>409</td>
</tr>
<tr>
<td>The Credit Approval Decision</td>
<td>Pearson Correlation</td>
<td>0.700**</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>0.001</td>
<td>0.003</td>
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<tr>
<td></td>
<td>N</td>
<td>409</td>
<td>409</td>
</tr>
<tr>
<td>The loan Rate setting Decision</td>
<td>Pearson Correlation</td>
<td>0.611**</td>
<td>0.604**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>0.000</td>
<td>0.002</td>
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To achieve the research objective the relationship between the application decision, the credit approval decision and loan rate setting decision should be assessed, and from table 1, the Pearson correlation was utilized. There is a strong relationship between the application decision and the credit approval decision with a correlation coefficient of 0.700 at the 0.01 level (2-tailed), the application decision and loan rate setting decision with a correlation of 0.611 at the 0.01 level (2-tailed), the credit approval decision and loan rate setting decision with a correlation coefficient of 0.604 at the 0.01 level (2-tailed).

5. CONCLUSION

The Ghanaian banking industry is one of the fastest growing kinds of industry and its products and services are in high demand since customers use it daily. Moreover, the application decision, the credit approval decision and loan rate setting decision guarantee profitability, and they play pivotal roles for companies within this industry, consequently.

REFERENCE