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The lending process of Banks: A case study of Barclays Bank Ghana

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Abstract
A case study design was used where data was collected to discover the lending processes of Barclays Bank Ghana. The study revealed that credit appraisal, collateral, credit scoring, credit-evaluation; credit documentation and disbursement were among the lending processes that are followed at the bank. From these determinants factors the respondents consistently demonstrated that credit evaluation procedure is the initial step embraced amid the credit organization. The bank also considers the five “Cs”. These are; character, credibility, capital, collateral and cycle (economic conditions) in addition to the 5 Cs, an expert may also take into consideration the interest rate. The study recommends that bank in an attempt to reduce loan default must strictly go by these strategies which include credit scoring or grading, relationship banking, past due reports, risk reports credit committee procedures, expert system and financial ratio.

Keywords: commercial lending, lending process, loan terms, banking relationship

1. Introduction

An evaluation of the traditional bank lending channel framework naturally begins with a reconsideration of the concept of the money multiplier. Inherent in this view is that policy changes are implemented via open market operations that change the amount of bank reserves. Binding reserve requirements, in turn, limit the issuance of bank deposits to the availability of reserves. As a result, there is a tight, mechanical, link between policy actions and the level of deposits. Lending to individual and small business can be difficult to financial institutions because of informational opaqueness, moral hazard, and adverse selection problems. The lender-borrower relationship has long been studied in the literature. There are two sides to the lender-borrower relationship, the demand side and the supply side. One would expect that factors from both sides have effects on loan yield spreads. An important strand of research focuses on borrower effects on this relationship and on the setting of loan contract terms. Taking the determination of collateral as an example, Ivashina, & Scharfstein, (2010) [22], show that, in cases where the lender and the borrower have different opinions about the borrower’s project, collateral will be offered by the borrower when the lender’s valuation of the project is lower than the borrower’s. Higher quality borrowers signal their creditworthiness by offering more collateral.

Another strand of research addresses the effects of lender characteristics on loan contract terms. Bharath, Dahiya, & Srinivasan, (2011) [6], incorporate another lender attribute, bank financial health, and show that low-capital banks tend to charge higher loan rates than well-capitalized banks. Agier, & Szafarz, (2010) [1], examine further lender characteristics, and state that bank monitoring ability, bargaining power, risk and syndicate structure have significant influence in determining loan maturity and pricing. However, studies of lender effects on the lender-borrower relationship and especially the determination of loan contract terms remain scarce in this literature. The provision of credit has increasingly been regarded as an important tool for raising the incomes individual and businesses especially the rural populations, mainly by mobilizing resources to more productive uses. As development takes place, one question that arises is the extent to which credit can be offered to these people to facilitate their taking advantage of the developing entrepreneurial activities. However, at low levels of income, the accumulation of such capital may be difficult. Under such circumstances, loans, by increasing family income, can help the poor to accumulate their own capital and invest in employment-generating activities (Hofmann, 2010) [20]. Commercial banks and other formal institutions fail to cater for the credit needs of groups, however, mainly due to their lending terms and conditions. It is generally the rules and regulations of the formal financial institutions that have created the myth that especially the poor are not bankable, and since they can’t afford the required collateral, they are considered un-creditworthy. Improving the availability of credit facilities to people is one of the incentives that have been proposed for stimulating its growth and the realization of its potential contribution to the economy. Despite this emphasis, the effects of existing institutional problems, especially the lending terms and conditions on access to credit facilities, have not been addressed. Recognizing the important influence of the number of banking relationships on the lender-borrower relationship and insufficient attention paid to lenders’ effects on the setting of loan contract terms in the literature, this paper further explores and examine the appropriateness of lending process used by Barclays Bank Ghana.

2. Literature Review

2.1 Overview of the Banking system in Ghana

Even though banking is as primitive as human society, it has gone through changes in many ways world-wide throughout the years. Most banks today offer a wide range of products and services than ever before, and their central functions of putting the community‘s surplus funds (deposits and investment) to work by lending to people remain unchanged as it has always been. These changes came as a result of government policies, globalization, economic deregulation and information, communication technology (Amidu and Hinson, 2006) [2]. In fact, banks are vital to the health of a nation‘s economy; monies collected by the bank from the community are given back to the community in the form of loans to buy houses and cars, to start and expand businesses, to pay children‘s school fees and for other numerous purposes. In Ghana, the banking industry has not only increased in products and services, but also increased in terms of numbers. The first bank, the Bank of British West Africa (now Standchart Bank) was established in 1896. Kishan, & Opiela, (2010) [23], testified that within a short time the bank was able to acquire the business of maintaining the Government accounts and introduced the use of cheques in settlement of Government accounts which helped to educate the public on the usefulness of banking. Kishan, & Opiela, (2010) [23], further testified that due to successful operation of the above mentioned bank, another bank, the Colonial Bank now Barclays Bank Ghana was also establish in 1918. The largest indigenous financial institution in the country, Ghana Commercial Bank was established in 1953. The Bank of Ghana which is the central Bank of the Republic of Ghana was formed in 1957. The Agricultural Development Bank (ADB) was set up by an Act of Parliament (Act, 286) in 1965 to promote and modernize the agricultural sector through appropriate but profitable financial intermediation. Its original name then was the Agricultural Credit and Co-operative Bank and the establishing Act gave its main objective as "to provide credit facilities to agriculturists and persons for connected purpose”. The commercial banks in Ghana have grown to about to 28. Ghana’s financial sector is dominated by foreign banks that emerged after the liberalization of the financial market over the last eight years.

2.2 Lender characteristics and Loan characteristics and Issuance of Credit

Creditors sometimes require no other assurance of repayment than the debtor's credit standing, that is, one's record of honesty in fulfilling financial obligations and one's current ability to fulfill similar obligations. Sometimes more tangible security, such as the guarantee of a third party, is required. Also, the debtor may be obliged to assign the rights to some other property, which is at least equal in value to the loan, as collateral security for payment. Bonds placed on sale by a corporation are often secured by a mortgage on the corporation's property or some part of it. Public borrowing, as by the issuance of bonds of a government, is usually unsecured, resting on the purchaser's confidence in the good faith, taxing power, and political stability of the government (Owusu, 2011). When goods are sold on a deferred-payment plan, the seller may either retain legal ownership of the goods or hold a chattel mortgage until the final payment is made. The depositing of funds in a bank for safekeeping may also be regarded as a form of credit to the bank, as such funds are used for loan and investment purposes, and the bank is legally bound to repay them as an ordinary debtor.

The screening effort: The time and effort a bank invests in screening the firm or individuals demanding for bank debt could have an influence on the pledging of collateral. For instance, with regard to SME lending, banks usually have superior expertise in judging the different aspects of project quality in comparison to the often-unrealistic optimistic entrepreneur (Crouhy, & Mark, 2010) [12]. Although the disciplining role of collateral to prevent moral hazard by borrowers is well described in literature, collateral also has a potential drawback. Krahnen, (2009) [24], prove that collateral protection may induce banks to be ‘lazy’ and reduces their screening efforts below socially efficient screening levels. Especially for SMEs, it seems that banks do little screening and particularly rely on collateral or commitments demanded. Hence, collateral and screening could be considered as substitutes. The time to maturity or loan duration has an impact on the incidence of secured debt: long-term bank debt would be more often secured due to several reasons. First of all, long-term loans require a long-term judgment of the creditor on the creditworthiness of the debtor. A company that is creditworthy at the moment of a credit decision cannot assure that it will remain creditworthy in the future. The chance of occurrence of an adverse event becomes larger when the duration of the loan is larger. In this case, collateral has the power to decrease the ex -ante loan assessment of risk. The pledging of collateral is an effective mechanism for the creditor to ascertain him of a certain value in the future: a company may not retain its value on a longer term but collateral does most likely retain its value (Udell, 2008) [34]. From both a theoretical and empirical point of view, loan size would have a positive impact on the provision of collateral by a firm. The advantages of loans backed by collateral (e.g. preventing asset substitution, claim dilution, reducing foreclosure costs), have to be more extensive than the costs that are mainly fixed. For small loans, these benefits cited may not cover the fixed costs including monitoring costs, costs for asset appraisals and administrative expenses. Given these arguments, Yamori, (2012), conclude that larger loans should be more frequently secured. Loan size is also linked to the probability of default, since a firm that receives more debt attains a higher leverage level and so increases the risk of non-payment (Krahnen and Lang, 2005). Empirically, there is no consistency in the relationship between loan size and collateral or commitment protection. The results of studies of (Ivashina, & Scharfstein, 2010; Orgler, 2010) [22, 28]. suggest that loans of a larger size are more often secured. The results in Berlin, & Mester, (2012) [5], suggest the opposite.

2.3 Credit Culture

A bank’s credit culture is the unique combination of policies, practices, experiences, and management attitudes which defines the lending environment and determines the lending behavior acceptable to the bank. A credit culture is the glue that holds credit related issues together. More broadly, credit culture is the system of behavior, beliefs, philosophy, thought, style, and expression relating to the management of the credit function. It consists of a policy that guides credit ethic, a practice that drives lending and an audit that protects assets and credit mechanism. Any glitch in one would bring problem to the other (Colquitt 2007) [11]. Banks' hiring practices should ensure personnel are committed to strict professional ethics and comfortable in high ethical standard and behavioral environment. Crouhy, *et al*. (2006), stressed the significance of installing a sound credit culture in order to track banks' lending strategy and objectives. This study found that interactive parts of a credit culture must match with and be built upon proven principles and high standards. On the other hand, it must also be sufficiently flexible to compensate for change. Shanker *et al*., (2008) found that credit culture has emerged as an important determinant of credit quality for all types of lending. Subordinates have to be responsible and professional in order to prevent from being bias when evaluating loan applications. Management must also ensure that the reward system compensates good ethical practices and penalizes unacceptable and flawed procedures.

2.4 Credit Management and Credit Administration and Risk Mitigation and Risk Diversification

Credit Management refers to the efficient blend of the four major credit policy variables to ensure prompt collection of loans granted to customers and at the same time boost their confidence in and loyalty to the bank (Hensman & Sadler-Smith, 2011) [18]. The first variable is the assessment of the quality of the customer account. This examines the ability of the customers to repay on time. The second policy variable is that of setting the credit period. In so doing, the bank ought to give enough time to allow the customers derive the full benefits of the credit. Such period must not be too long to put the bank at a disadvantage. The third variable is the discount or the enticement to credit beneficiaries to repay credit on time. Such enticement must be motivating enough before the aim can be achieved. The last variable considers the expenditure level that could be incurred in the collection exercise. This implies that the bank must not grant credit where the amount to be expended on collecting the debt will likely be greater than the debt itself. To blend these variables into an efficient workable system requires careful planning, controlling and co-ordination of all available human and material resources. According to Asiedu-Mante (2011) [3] credit management involves establishing formal legitimate policies and procedures that will ensure that: the proper authorities grant credit, the credit goes to the right people, the credit is granted for the productive activities or for businesses which are economically and technically viable, the appropriate size of credit is granted, the credit is recoverable and there is adequate flow of management information within the organization to monitor the credit activity. A typical credit administration unit of a financial Institution performs following functions: Documentation, Credit Disbursement, Credit monitoring, Loan Repayment, maintenance of Credit Files, Collateral and security documents.

Risk mitigation encompasses a variety of techniques for loss prevention, loss control, and claims management. A risk mitigation program can prevent losses and reduce the cost of losses while creating a safer environment for businesses. Banks use a number of techniques to mitigate the credit risks to which they are exposed. Exposures may be collaterized by first priority claims with cash or securities. A loan exposure may be guaranteed by a third-party, or a bank may even purchase credit derivatives to offset various forms of credit risk (Ho, & Yusoff, 2009). A study by Wu, & Huang (2007), reckons that loan portfolio risk can be reduced with an effective credit review of applicants and selective asset backing. When creditors have extensive rights to repossess collateral assets, there is stronger possibility that they can reduce their risks of losses on one hand and borrowers will be more responsible to pay when their assets are at stake. More so, Coco (2000) [10], designed a way to measure the risk of securities statistically and thereby construct desired portfolios based on one's overall risk-reward preferences. The statistical approach to plot the risk reward relation is preceded by assigning expected values, standard deviations and correlations to security's single-period returns (no annuities). Later with these statistical measures one can calculate the volatility and the expected return of the portfolio, which are used as measures for risk and reward respectively. With quadratic programming (optimization, minimization of a quadratic function subject to linear constraints) an investor is able to find a few portfolios (out of an almost infinite number of possible weights of the securities) that will give the optimal risk-reward combination the securities making up portfolios. These portfolios make up the efficient frontier. The assumptions behind this quantification is that all market participants have the same expectations, investors are able to invest in a totally riskless assets yielding the risk free rate of interest and the cost of transactions, information and for management is zero on the market. Based on these assumptions, one should be able to construct an optimal portfolio for all investor preferences. Markowitz divided the portfolio selection process into two separate decisions, first off; find the portfolio with the maximum reward for least amount of risk taken, lowest possible standard deviation. Second; decide on how to allocate the funds between the riskless assets and the risky assets. In effect what is happening with diversification, applied on financial markets, is that the risk of individual securities (in the case of banks: the credit risk of an individual firm) is being diversified away. This risk is called unsystematic risk. The risk that cannot be diversified away is called systematic risk, which is sometimes equated with the market risk. Systematic risk could be described as the uncertain tendencies of the market. A well-diversified portfolio will have the same tendencies as the market, in other words nearly perfect correlation with the market. If the market happens to have a negative tendency (graphically the best fitted line is negative), then the loss of the portfolio will be equal to the loss of the market, and vice versa if the tendency is positive (Liem Nguyen, 2015).

2.5 Credit Scoring Models

The Judgmental approach used by most banks and financial institution are based on 3c's, 4c's or 5C's which are character (reputation), capital (leverage), collateral, capacity (volatility of earnings) and condition. Credit scoring models are very useful for many practical applications especially in banks and financial institution. Credit Scoring was used for other purposes such as aiding decision in approving personal applications. In recent years, credit scoring has been used for home loans, small business loans and insurance applications and renewals (Blanchflower, Levine, & Zimmerman, 2003) [8]. Hsieh (2005), in their submission came with a proposed method or model which demonstrates two real world credit data sets. They also proposed the hybrid mining approach which is used to build effective credit scoring models. A credit scoring model provides an estimate of a borrower‘s credit risk, i.e. the likelihood that the borrower will repay the loan as promised, based on a number of quantifiable borrower characteristics (Dinh and Kleimeier, 2007) [13]. Menkhoff, Neuberger, & Suwanaporn, (2010) [26], wrote an article which describes the internal rating systems presently in use at the 50 largest US banking organizations: since internal credit risk rating systems are becoming an increasingly important element of large commercial bank‘s measurement and management of the credit risk of both individual exposures and portfolios. They used the diversity of current practice to illuminate the relationships between uses of ratings, different options for rating system design, and the effectiveness of internal rating systems. They concluded that Growing stresses on rating systems make an understanding of such relationships important for both banks and regulators. Sharpe, (2009) [30], model postulates the asset risk premium which was a stochastic process with a negative correlation. They concluded based on the empirical finding that risk premiums of a security tend to move reversely against the returns of stock index in it. Frydman and Schuermann (2008) [16] discovered two kinds of databases used in building and checking credit risk model. They categorized them as, Standard and Poor Credit-Pro database and Moody‘s KMV Credit Monitor database. These databases have long time series (S and P‘s built from the year 1981 and Moody‘s from the early 1990s) and large number of observations. Their conclusion was that the data used was associated with North American banking system and the loan concerned was for large companies.

3. Methodology

A case study design was used where qualitative data was collected to discover the lending process. The design process includes ascertaining variables that were needed to be examined to achieve research objectives, sampled organizations for the study; the data was analyzed using suitable methods of analyses in order to attain research objectives, analysis of research findings and research conclusions and recommendations. Primary and secondary data was used in this study. The primary data were collected from employees of the banks through in-depth interviews. Secondary data was collected from books, articles, journal publications and the internet sources of related materials. The study population comprised employees of Barclays bank Ghana Ltd, head office. The head office was chosen because the operations of the banks are been undertaken there and because of convenience in terms of data accessibility to the researcher.

4. Data Analysis and Discussion

Credit evaluation alludes to the procedure through which clients are screened before given them an advance. Respondents views were solicited on the kind of documentations Barclays Bank Ghana Ltd require and were find out that the bank encourages credit evaluation. From the reactions, number documentations were required to evaluate client advances and subsequently figured out if the credit get endorsed or not. The respondents consistently demonstrated that credit evaluation procedure is the initial step embraced amid the credit organization. The respondents affirmed that credit evaluation is the essential stage in the loaning process Aranha *et al*, (2011) [40] portrays it as the "heart" of an amazing portfolio. This includes assembling, handling and examining of value data as method for recognizing the customer's financial soundness and lessening the impetus issues between the loan specialists as principals and the borrowers as operators. According to Hossain, (2010) [21], the bank's credit arrangement, methodology and orders manage the credit evaluation process. Banks ought to construct their acknowledge examination for respect to the fundamental standards of loaning which are Character, Capacity, Capital, Collateral and Conditions. It is intended to guarantee loan specialists take activities which encourage settlement or lessen settlement possible problems. This data about the peril of the borrower makes the monetary foundation to take therapeutic activities like requesting insurance, shorter length of time of installment, high loan fees and other type of installment.

Upon the objectives of the study, the researcher asked the respondents on the some of the strategies used by the bank to reduce loan default. The options that were available for selections are expert system, credit scoring, financial ration, and among others. From the respondents the strategies to reduce loan default are expert system, credit scoring, financial ratio, relationship banking and others. The respondents cited credit scoring. This supports the findings of Tsai, (2009) [33]. He stated that in recent years, credit scoring has been used for home loans, small business loans and insurance applications and renewals. A credit scoring model provides an estimate of a borrower‘s credit risk, i.e. the likelihood that the borrower will repay the loan as promised, based on a number of quantifiable borrower characteristics (Voordeckers, & Steijvers, 2010) [35]. When applying for credit, lenders will check your credit score to see how good it is. But what exactly is a credit score; how is it calculated; and why is this number so darned important? A credit score is a number that strongly indicates to lenders and creditors how likely you are to pay back the debt you owe, based on your past borrowing behavior. The higher your score, the more likely you are, in their eyes that you will pay back the money you borrow. Wette, (2010) [36], indicates that risk management is more important in the financial sector than in other parts of the economy. The purpose of financial institutions is to maximize revenues and offer the most value to shareholders by offering a variety of financial services and especially by administering risks. Subjective decision making by management happens especially when the borrower appears to have met the credit approval criteria. However, subjective underwriting without proper consideration on supporting data can lead to credit risk. Credit approval over the limit or overriding the policy is another factor contributing to credit risk.

5. Conclusion

Commercial lending is the least automated aspects of banking. Many reasons have been given for this, ranging from how complex commercial deals are to the number of exceptions that seem to permeate them. A number of studies have documented the positive association between the length of a banking relationship and the availability of credit to a relationship borrower (Degryse and Van Cayseele 2000). This study's main objective was to examine the lending process used by Barclays Bank Ghana. The studies revealed that credit appraisal, collateral, credit scoring, credit-evaluation; credit documentation and disbursement were among the lending processes that are followed at the bank. From these determinants factors the respondents consistently demonstrated that credit evaluation procedure is the initial step embraced amid the credit organization. The respondents stated that credit evaluation is the essential stage in the loaning process. The findings of this study are not different from that of Aranha *et al*, (2011) [40] thereby portraying it as the "heart" the loaning process. Other factors were also given place in the lending process are security documentation, disbursement and credit scoring. According to Asiedu-Mante (2011) [3] credit management involves establishing formal legitimate policies and procedures that will ensure that: the proper authorities grant credit, the credit goes to the right people, the credit is granted for the productive activities or for businesses which are economically and technically viable, the appropriate size of credit is granted, the credit is recoverable and there is adequate flow of management information within the organization to monitor the credit activity. A typical credit administration unit of a financial Institution performs functions such as documentation, credit disbursement, credit monitoring, loan repayment, maintenance of credit files, collateral and security documents. It can therefore be conclude that Barclays bank Ghana has a due process they follow in granting loan to its customers. However, aside these processes which are in place to monitor loan disbursement procedure, the lending units are faced with a loan of challenges which the bank needs to address. The study also revealed some of the challenged faced by the loan department and the responses were that lending in excess, self-dealing, technical incompetency and subjective decisions are among the challenges faced by the loan department.

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