

Factors affecting to the Credit Recovery in Sri Lanka: A Review of Literature

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Abstract

One of the most important matters in banking in general and lending in particular is the ability of a lending officer to confidence lend out money and be assured that these funds will be recovered from the borrower without resorting to punitive action. The problem of credit default is a real one that has cost many financial institutions fortunes in bad debts. Because of lack of information on credit defaults many credit officers are likely to still lend out funds that may never be recovered. This study sought to identify factors that lenders could look out for and the foresight they would need to have in order to avoid default of credits. The findings were that the education background of borrowers is a vital factor that they all need to be weary of as they make decision to lend. It also was brought to the fore that it is vital to equip credit officers with sufficient knowledge and skills in the field of lending for them to be better analyst of credit assessment.

Keywords: Credit Recovery, Interest Rate, Project Completion, Customers Dishonestly

Paper Type: Model Development (Literature Review)

Introduction.

Credit is the extension of fund to borrower which he/she pays interest rate for using the money. In finance the term “recovery” refers to collection of amount due. The normally recovery depends on the purpose, time and business running process etc. Normally credit amount will be recovered on installment basis. Recovery is different from one credit to another, as follows: (Saloner, 2007)

- In short term credit is recovery is less than 36 months
- In medium term credit recovery from 36 months to 84 months
- In long term credit normally recovery from 84 months and above.

Most cases some of the money extended as credits are not paid, this do have negative impact on the finance sector and also the money that will be available

to others will not be available. Following factors effecting the credit recovery (Peeters, 2003);

- Poverty among the people.
- Economic recession
- Inflation
- Political instability
- Poor investment
- Staff weak skill and corrupt tendency
- Poor infrastructural provision by government

We selected this topic to our research because of financial sector of Sri Lanka has been face a lot of difficulties and burning issues regarding credit recovery. When we refer central bank reports and other financial source documents, we can perceive that credit recovery rates were decrease in value year by year. Therefore we recognize that it is enormous problem to our country. As examples:

July 14, 2014(LBO) – Sri Lanka’s central bank held policy rates at 6.50 and 8% and urged banks to tighten spreads to lower lending rates as private sector credit demand remained weak.

In May credit to the central government from the banking sector as fallen by 11.5 billion rupees and loans to state enterprise had also fallen marginally.

Credit to private sector had also slowed to 2.2% from a year earlier, indicating that credit volumes had contracted about 6.8 billion rupees during May.

Banks suffering from bad loans have two buffers to cushion their stock. Their capital and interest rate spreads. As a result not all banks are willing to let lending rates fall quickly analysts say. (Pamoja, 2010)

These above issues cause to reduce profit of finance sector. Because of that low profits company cannot works properly. This financial issues create the big financial crisis. This crisis effect to not only finance sector also the economic sector. Then this whole problems badly effect to the business sector of country. Due to this situation collapse the development of the country. (Schreiner, 2003)

Considering above all factors, we think that credit recovery methods are very important determinant to the basis of country. Therefore we give the priority to this topic name as “Factors effecting the credit recovery in Sri Lanka”.

Having mentioned that, the overall objective of this paper is to investigate the factors lead to credit recovery by way of a literature review.

Literature Review

Credit plays a major role in economic transformation and rural development. In Sri Lanka credit risk which mainly depend of quality of longs and credit recovery, rates. Assets quality improved during the year with the gross non-performing loan ratios declaring from 5.6% in 2013 to 4.2% in 2014. This was largely due to the declining in low quality assets such as pawning advances. The construction in pawning advances also led to a decline in provision for bad and doubtful debts. However the provisions coverage ratio increases to 39.7% from 32.5%. (Central bank, 2014).

Historically, the occurrence of banking crises often been associated with a massive accumulation non-performing loans, as examples in Indonesia where over 60 banks collapsed during the crises non-performing loans represented about 7.5% of loan portfolios (Klingebiel, 2002). Banking crises which affected a large number Sub-Saharan African countries in the 1990's also accompanied by a happy accumulation non-performing loans.

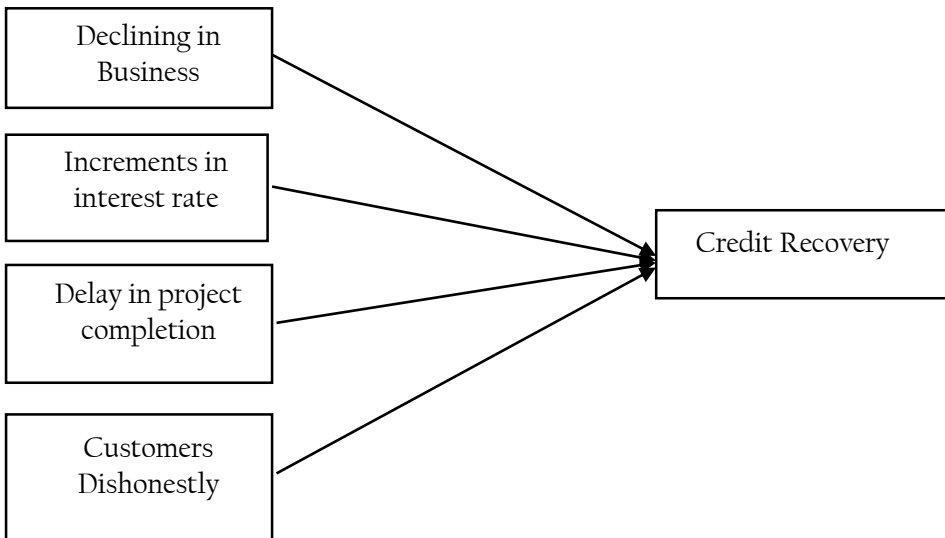
This section provides a critical review of issues that have been exploiting and studied both theoretical and empirically in the existing literature on credit recovery. Credit recovery can be explained to recovery concept measure by Richered 1986. According to him, monitoring credit recovery is much like tracking blood pressure poor credit recovery can lead to serious problem while a sudden deterioration can be fatal. Credit recovery is an extremely basis issue for the effective performance of financial institution, but frequently is surprisingly, complicated and confused (Richered, 2014 & 1986). The problem of credit recovery has been addressed by researchers from different perspective. Often times it has been attributed to the idea the credits are risky and some borrowers are too poor to re pay (Donald, 1994). Some analysis have argued that low recovery rates are due to lending policies, credit targeting lender unwillingness to recover credits and management ability of bank employees (Gregoy, 1995).

But frequently over looked problem is that borrowers are discouraged to repay and / or lenders cannot recover credits because of the political intervention in rural financial market (kere, 1994) . This MC Naughton defines a credit policy as a set of guidelines design to minimize costs associated with credit while maximizing the benefit from it (Naughton, 1996). The inherent characteristics of borrowers and their business, characteristics of the lending institution and suitable of the loan product to the borrower and systematic risk from the external factors like the economic, political and business environment in which borrower operates (Derbun, 2005). Evidence from many years such as that collateral value and recovery rates on corporate default can be volatile and moreover that they tend to go down just when the number of default goes up in economic downturn. Individual lending is defined as the provision of credit to individuals who are not members of a group that is jointly responsible for credit

repayment. It requires frequent and close contacts with the individual client. It is most successful larger, urban base, production oriented business and for those who have some form of collateral or are willing consigner or with small scale farmers in rural areas, normally clients are those who required working capital or fined assets (Frankel, 2000). We identified that following factors affected to the credit recovery through some Articles.

- 1) Declining in businesses: Business dynamism is the process by which firms continuously born, fail expand and contract as some jobs are created others are destroyed. When declining the business, businessmen are avoiding repaying loan installments. Economic and political factors mainly affect to the business decline (Turner, 1996).
- 2) Increase the interest rate: When interest rate increases day by day, borrowers have to face many hardships. Inflation is basically influence to the high interest rate. Because of that borrowers cannot their credit installments properly (UMOA, 2001).
- 3) Delay in project completion: Financial institutions grant many loans for the contractors for their projects. Due to some bad effects, projects are delayed. Therefore contractors cannot complete their credit repayments (Maria, 2000).
- 4) Customers dishonestly: Some customers do not be honest to the financial institutions, when loan repayment. They try to do many frauds to avoiding loan installments (Patrick, 1994).

Factors of credit recovery



Summary

According to our identification credit plays a major role in economic transformation and rural development. In Sri Lanka credit risk which mainly depend of quality of loans and credit recovery, rates. We identified that some factors affecting to the credit recovery through some articles. Those are; declining in businesses, increase the interest rates, delaying project completion and customers dishonestly. Banks have to increase loan recovery rates in order to profit maximization. Financial institutions should be improve the quality of project appraised reports and to provide sufficient technical instances of borrowers, the bank should allocate sufficient budget or find funds to upgrade the knowledge and skill of its staff. The financial institutes should revised and update the loan processing parameters and formats that are used by lending department so as to be clearly understand able to the clients. The bank should set conditions that enforced clients, especially clients with big project, to present project execution contact document and recent managerial and technical staff or their project.

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