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   RESULTS & DISCUSSION

   FINDINGS

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DELINQUENCY MANAGEMENT: SPECIAL REFERENCE OF BANK OF CEYLON NORTHERN PROVINCE

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ABSTRACT
*This study offers exploratory insights into the level of loan delinquency on Bank of Ceylon in Northern Province. The results were based on the analysis of data from 2005 to 2009 with the loans from the banks. Findings revealed that several factors were responsible for banks' altitude of expanding loan portfolio, principal of which are good credit worthiness, good management and loan recovery policies, and the proper evaluation of loan proposals by the loan officers. The research showed that loans delinquency rate was low at 10.28 per cent of total loan obligations in Bank of Ceylon Northern Province. The correlation(r) value between repayment rate and on-time collection rate is 0.978** which is significant at 0.01 level, there is strong negative relationship between arrears rate and repayment rate, the r value between repayment rate and arrears rate is -0.977** which is significant at 0.01 level, the r value between arrears rate and loss provision rate is 0.768, there is no significant relationship between the arrears and loss provision. In view of the findings of this study, some uncontrollable factors specially ethnic war & people internal displacements are influencing in loan default of 2009. Particularly Mullaitivu, Kilinochchi and Mankulam branches are facing this severe problem; their delinquency rate is 88.60%, 85.44% and 93.59% respectively.*

KEYWORDS
delinquency, loan portfolio, recovery policies and repayment rate.

INTRODUCTION
In the last decade, there have been strong macroeconomic improvements in emerging countries and their financial markets have expanded rapidly by financial liberalization and technological developments. These developments increased the accuracy of pricing and the creation of new financial instruments, thus, provided the basis for efficient financial markets (Kyuyung, 2005). The creation of new instruments has significant advantages: provide a flexible financial system to meet different needs, open the door to new investment opportunities for existing market participants, and encourage the entry of new institutions (Gjedrem, 2005). Increase of participants in the financial markets is crucial to create liquidity, that way; the system can absorb the effects of fluctuations in the financial asset prices.

Financial stability can be described as efficiency of financial system performing its resource allocation function and spreading risk function efficiently in a stressed situation. So the delinquency management is most important to maintain the financial stability of Micro finance Institution.

Credit risk refers to the loss because of the debtor's non-payment of loans or other forms of credit. Credit risks are faced by lenders to consumers, lenders to business, businesses and even individuals. Credit risks, nevertheless, are most encountered in the financial sector particularly by the institutions such as banks. Credit risk management therefore is both a solution and a necessity in the banking setting. The global financial crisis also requires the banks to regain enough confidence by the public not only for the financial institutions but also the financial system in general and to not just rely on the financial aid by the governments and central banks. It is critical for the banks to engage in better credit risk management practices.

While financial institutions have faced difficulties over the years for a multitude of reasons, the major cause of serious banking problems continues to be directly related to lax credit standards for borrowers and counterparties, poor portfolio risk management, or a lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of a bank's counterparties.

Early stage delinquency management is an important part of the customer management lifecycle. If accounts can be cured quickly and with little impact on customer service, organizations can salvage important customer relationships and turn a potential negative situation into a positive experience for everyone. The decision to outsource these activities is also critical to the success of any early stage delinquency program. With Delinquencies Rising, a Leading Technology Solutions Provider Turned to Diners Club for Guidance in Identifying the Cause and Finding the Cure.

Risk is an integral part of financial services. When financial institutions issue loans, there is a risk of borrower default. When banks collect deposits and on-lend them to other clients (i.e. conduct financial intermediation), they put clients' savings at risk. Any institution that conducts cash transactions or makes investments risks the loss of those funds. Development finance institutions should neither avoid risk (thus limiting their scope and impact) nor ignore risk (at their folly). Like all financial institutions, microfinance institutions (MFIs) face risks that they must manage efficiently and effectively to be successful. If the MFI does not manage its risks well, it will likely fail to meet its social and financial objectives. When poorly managed risks begin to result in financial losses, donors, investors, lenders, borrowers and savers tend to lose confidence in the organization and funds begin to dry up. When funds dry up, an MFI is not able to meet its social objective of providing services to the poor and quickly goes out of business.

This new direction in delinquency management led to excellent results, with a tremendous 90 percent reduction in write-offs. By implementing new policies consistently, constantly and fairly the company reaped tremendous rewards. The changes extended beyond the reduction in write-offs. Automating expense reporting, paying Diners Club directly for approved charges to the card and using electronic funds transfer have reduced the portion of expense reports paid with a reimbursement check from 100 percent to 20 percent. This has significantly slashed processing costs and freed up employee time for more customer-serving activities. The culture within the company has undergone a change as well. The communication program has fostered a greater sense of accountability among all employees, opened company-wide dialogue and encouraged the company's finance group and its business managers to work together to enforce policies. Making greater use of the reports within Global Vision is raising the value that the company places on using information to manage more proactively. With this insight into expense activity, the company is also able to reduce its exposure to financial risk and focus on being the best service company possible.

The MFIs are the key all over the world to facilitate the financial services among the poorest to alleviate the poverty. The poverty alleviation is the most important fact to reach the economic development of each county. So the micro finance institutions should be sustainable to protect the society and give the credit facilities. This sustainability is mostly depending on the recovery percentage of granted credit facilities.

In Sri Lanka, Central Bank pay a special attention to alleviate the poverty percentage in Northern Province within 2012. In this way, the banking industries turned in the way of implementing the microfinance system in order to strengthen the development of the country through alleviate the poverty. In this connection the Bank of Ceylon is also functioning as the primary micro finance institution in Sri Lanka. This study is intended to evaluate the delinquency management of the Bank of Ceylon in Northern Province.

PROBLEM STATEMENT

An excessive increase in repayment delinquencies may cause lenders with low capital adequacy ratios to become insolvent, resulting in widespread failures (Crook & Banasik, 2005). Because it is impossible to know who will fail to make repayments with certainty, lending institutions strive to manage consumer credit risk by estimating the scale and probability of economic losses for each portfolio.
According to the Central Bank of Sri Lanka (2008) the global financial environment was marked by intensifying turbulence, particularly since mid-September 2008. As the effects of US Sub-Prime mortgage market Crisis spread to other parts of the world, the result was a worldwide credit crunch. The drying up of liquidity in financial markets the world-over had ripple effects on real variables as well.
Central Bank of Sri Lanka (2008) declares that Sri Lanka's financial sector faced the spin-off effects of the turbulence in the international financial markets commendably well. While banks operating locally did not have direct exposures to US mortgage linked securities or to the financial institutions that failed elsewhere, the partial closure of Sri Lanka's capital account as well as the sound regulatory framework in place, safeguarded the domestic financial system. In addition, since January 2008, licensed banks. Which account for the greater part of financial intermediation in the country, have been migrating to the Basel II Capital Adequacy framework, which encompasses credit, market and operational risk aspects, and this has helped further strengthen the domestic financial system. The domestic financial system also came under stress due to liquidity problems faced by one commercial bank and failure of some unauthorized finance business during 2008. However, the central bank came to the rescue of the troubled commercial bank in a timely manner and systematic risks stemming from the undesirable external or domestic developments taking effect. Hence, Sri Lanka's financial system remains sound and continues to support economic activity.
Therefore the present study intends to identify whether the BOC follow the effective delinquency management? Why there are differences on delinquency management among the branches of Bank of Ceylon?

REVIEW OF LITERATURE

This review of the existing literature covers studies relevant to the research topic. Areas reviewed include the role of microcredit, default in repayment and its effect on microcredit programs, and challenges facing the microcredit subsector. Literature on strategies applied to minimize default is also discussed here.
Amaro and Armando (2008) have conducted this qualitative case study which was to examine the loan default prevention and management practices in Florida's 28 community colleges by conducting telephone interviews. Results revealed that the community colleges used minimal default prevention practices and there was a lack of standardization in the areas of default prevention and aversion. The study recommends that financial and personnel are taught the default prevention guidelines and proposes default prevention.
Boshoff and Staude (2003), in their study of customer recovery satisfaction among the bank employee in South Africa. They identified three main factors *i.e*. procedural justice, interactional justice and distributive justice oriented recovery strategies (JORS). Distributive justice focused on the specific outcome of the firm's recovery effort. Did this outcome (output) offset the costs (inputs) of the service failure? Example of distributive outcomes include compensation such as gratis, discount, coupons, free upgrade, free ancillary services, repair, replace, re-perform and apologies. Distributive justice focused on the actual objective outcome of the service recovery such as financial compensation (i.e. refund and discount). An offer was perceived to be more or less favourable if it was left without explanation for the failure as supported by Spark and Callan, (1996). The distributive justice was based on equity theory which stated that an outcome would be evaluated in terms of its perceived equity. Adam (1965) argued that a person would evaluate the outcome based upon a ratio of inputs to outputs. It was possible that an outcome might even be perceived as too high or too different from that other received and resulting inequality. Thus in this study the relationship between service recovery strategies i.e. justice or fairness of the recovery strategies and customer retention were examined.
The previous research found that procedural justice functioned differently from interactional and distributive justice. It was found that insignificant in Blodgett, *et al.*, (1997), but was operationalised through implicit no-voice or voice in Van den Bos, *et al.*, (1999). There was no one best method for recovering from service failure (Hoffman, 2000). Previous research on service recovery had indicated that not all approaches to service recoveries were the same and not all were equally effective in recovering service failure in different situation and they offered mixed result (Tax, *et al.*, 1998). Normally businesses lose 15 to 20% of their customers. Inadequate company responses to service failure witnessed a significant increase in the firm's defection rate. Furthermore it was reported that 75% of restaurants customers shared their experiences through word-of-mouth. Hence, effective service recovery was directly linked to the firm's profitability (Hoffman, 2000).
Sparks and McKoll-Keneddy (2001), found that respondents were more satisfied with partial refund when service provider adhere to company's policy, but respondents were more dissatisfied if service provider gave away token as special favour. The purpose of the research was to investigate the levels of satisfaction associated with various combination of procedural, interactional and distributive justice related to service recovery strategies. Collie, *et al.*, (2002), revisited the fair process of distributive and interactional justice and found that the analysis provided evidence of fair process across all levels of distributive justice for outcome fairness and satisfaction but only in relation to the effects of the interactional justice. The method used was scenarios based experiment and respondents were undergraduates' business students. Instead of using students as respondents and scenario experiments, Maxham III and Netemeyer (2002), broke the tradition of service recovery research. They conducted a research using self-administered survey questionnaires on bank customers and home buyers. They found a detailed result such as procedure and interactional justices were more influential in overall satisfaction than distributive justice. They further found that satisfaction with recovery more likely to spread positive word-ofmouth, purchase intent than overall firm satisfaction. Furthermore, satisfaction partially mediated word-of-mouth purchase intent.
Previous researchers also found that dimensions such as tangibles (Foster & Cardogan, 2000), firm climate (Clark, 2002; Davidson, 2003), service guarantee (Liden and Skalen, 2003), customer relationship (Boles *et al,* 1997), customer compatibility (Grove and Fisk,1997, Hartline , 2001) , empowerment (Yavas *et al*, 2003, Hocutt & Stone, 1998) , communication (Sparks *et al*, 1997), feedback (Hoffman and Bateson, 1997), explanation (Conlon and Murray, 1996), speed of recovery (Bitner *et al*, 1990; Boshoff,1999), economical and psychological atonement (Webster *et al* , 2000; Levelsque & McDougall, 1996) were correlated to customer retention and service recovery satisfaction (Boshoff & Staude, 2003).
Moreover, some of the previous studies used bank managers (Engku Ngah, *et al.,* 1998; Rohaya & Nor Hayati, 2004; Ramayah & Koay, 2000), bank employees (Clark, 2002; Boshoff & Allen, 2000), and undergraduates students as respondents (Matilla, *et al.,* 2000; Smith, *et al.,* 1999; Smith & Bolton, 1998; Ching Liu, *et al.*, 2000).
However previous researches methods and results were varied and mixed, none of the previous researchers used Bank of Ceylon and neither have they related Delinquency Management in Northern Province of Sri Lanka. Therefore it is now clear that there are gaps in the relevant theories, practical aspects and empirical evidences, concerning the issue of Delinquency Management of Bank of Ceylon in Northern Province of Sri Lanka. Thus the present study is initiated on "A case study analysis on delinquency management of Bank of Ceylon in Northern Province".

METHODOLOGY

Micro Soft Excel 2007 And SPSS (Statistical Package for Social Science) was used to analyze the data and test the Hypothesis. The following tools were used to test the hypotheses and find the reliability.

RATIO ANALYSIS

Reliability measure was used to test the Variation in the level of average delinquency rates for loan is formulated as a function of the following ratios.

Repayment rate = $\frac{Amount\ Received}{Amount\ Otstanding}$

On-time collection Rate = $\frac{Amount\ Received\ on\ time}{Amount\ due\ for\ the\ first\ time}$

Portfolio at risk (PAR) = $\frac{Outstanding\ amount\ of\ past\ due\ loan}{Total\ outstanding\ portpolio}$

Arrears Rate = $\frac{Amount\ past\ due}{Total\ outstanding\ portfolio}$

Loan loss provision rate = $\frac{Loan\ loss\ provision}{Total\ outstanding\ portfolio}$

CORRELATION ANALYSIS

Correlation test are applied to a random sample of values for the continuous variables. In this case of the person correlation co-efficient. This is a parametric test because it is assumed that the distribution of response is normal for each independent variable value. If a change in the value of another variable, the two variables are said to be correlated. This examines that, whether two variables are perfectly correlated or partially correlated.

HYPOTHESIS OF THE STUDY

The following hypotheses are formulated for the present Study.
H1: Repayment rate & On-time collection rate are positively correlated
H2: Repayment rate and Arrears rate are negatively correlated
H3: Arrears rate (Portfolio at Risk) and loss provision rate are positively correlated

RESULTS AND DISCUSSION

ANALYSIS OF DELINQUENCY MANAGEMENT

Repayment rate, On-time collection Rate, Arrears Rate (Portfolio at risk -PAR), Loan loss provision rate are used to analyze the data collected from the Bank of Ceylon to prove position of delinquency management and to test the hypotheses.

TABLE 01: LOAN REPAYMENT RATE OF BANK OF CEYLON BY YEARS 2005 TO 2009

Years	2005	2006	2007	2008	2009	Average
	(%)	(%)	(%)	(%)	(%)	(%)
Northern Province	94.89	91.17	87.70	89.87	89.46	90.62

Repayment of the loan by installments, made up of an amount of capital borrowed and an amount for the interest charged. Depending on the type of mortgage, these installments can be fixed for the life of the loan or vary with interest rate changes. Measures the amount of payments received with respect to the amount due. This rate reflects the percentage of recovery on disbursed loan.

Average Northern Province's repayment rate is 90.62% and it was 94.89%, 91.17%, 87.70%, 89.87% & 89.46% in 2005, 2006, 2007, 2008 & 2009 respectively. Repayment rate of Northern Province is very high in 2005 as 94.89%, it was low as 87.70% in 2007, in this period Mannar, Mankulam, Kilinochchi and Point Pedro branches are influenced in this reduction of repayment rate of Northern Province. Their repayment rates were 74.01%, 66.91%, 81.51% and 61.60% respectively.

ON-TIME COLLECTION RATE

Repayment of the loan by installments, made up of an amount of capital borrowed and an amount for the interest charged. Measures the amount of payments received with respect to the amount on outstanding without any delay. This rate reflects the percentage of on-time recovery of total outstanding loan.

This on-time collection rate clearly describes the delinquency management of branches. If the bank has over 95% of on-time collection rate, the bank maintain proper management on recovery and disburse loan with perfect evaluation.

TABLE 02: ON-TIME COLLECTION RATE OF BANK OF CEYLON BY YEARS 2005 TO 2009

Years	2005	2006	2007	2008	2009	Average
	(%)	(%)	(%)	(%)	(%)	(%)
Northern Province	94.18	90.69	87.33	88.05	88.36	89.72

Northern Province's average on-time collection rate of last 5 years as 89.72%, it was 94.18%, 90.69%, 87.33%, 88.05% & 88.36% in 2005, 2006, 2007, 2008 & 2009 respectively. From these figures, we can come to the conclusion that the on-time collection rate of Northern Province is in declining range, Mankulam, Mullaitivu, Kilinochchi & Mannar branches are highly influenced in this effect of Northern Province's on-time collection rate of disbursed loans.

ARREARS RATE

Failure to pay an obligation when due. Loans with more than two missing payments (over 90 days past due) are regarded as seriously delinquent and debt collection efforts are initiated to recover the amount due. In a monetary context, something that has been made payable and is overdue and unpaid. These overdue (above 90 days past due) amount on percentage of total loan outstanding is called as arrears rate.

Table 03 describes the percentage of arrears loan on total loan of each branch and districts for last five years. Northern Province's average arrears rate of last 5 years as 10.28%, it was 5.82%, 9.31%, 12.67%, 11.95% & 11.64% in 2005, 2006, 2007, 2008 & 2009 respectively. The arrears rate of Northern Province is very high in 2007 as 12.67%, very low in 2005 as 5.82%. Point Pedro, Mankulam, Mullaitivu, Kilinochchi & Mannar branches are highly influenced in this increase of arrears rate in Northern Province. Mullaitivu, Mankulam, Kilinochchi, Mannar and Point Pedro branches' arrears rate is 88.60%, 93.59%, 85.44%, 26.18 & 21.07 respectively.

TABLE 03: LOAN ARREARS (DEFAULT) RATE OF BANK OF CEYLON BY YEARS 2005 TO 2009

Years	2005	2006	2007	2008	2009	Average
	(%)	(%)	(%)	(%)	(%)	(%)
Northern Province	5.82	9.31	12.67	11.95	11.64	10.28

TABLE 04: LOAN LOSS PROVISION RATE OF BANK OF CEYLON BY YEARS 2005 TO 2009

Years	2005	2006	2007	2008	2009	Average
	(%)	(%)	(%)	(%)	(%)	(%)
Northern Province	6.55	6.13	34.43	16.30	34.25	19.53

LOAN LOSS PROVISION RATE

The amount outstanding as due or default for a specific period of time, the bank can't assure that the full default amount could be recovered in future, some risk is there, so the bank needs to make provision amount on behalf of the non-performing loan outstanding. This amount of provision on total non-performing loan outstanding declares the percentage of provision rate made by the bank on total non-performing loan outstanding amount.

A non-cash expense for banks to account for future losses on loan defaults. Banks assume that a certain percentage of loans will default or become slow-paying. Banks enter a percentage as an expense when calculating their pre-tax incomes. This guarantees a bank's solvency and capitalization if and when the defaults occur. The loan loss provision allocated each year increases with the riskiness of the loans a given bank makes. A bank making a small number of risky loans will have a low loan loss provision compared to a bank taking higher risks.

Table 04 describes the Rate of Provision on Total Non-performing Loans by branches and districts basis in Northern Province of Bank of Ceylon.

Average Northern Province's loan loss provision rate is 19.53%, it means 19.53% of non-performing loan is expected by the bank that could not be recovered in future. It was as 34.25% in 2009 and 34.43% in 2007. So Northern Province branches have faced difficulties in 2007 and 2009 by big percentage. It is risk to the bank's financial stability.

CORRELATION ANALYSIS

Correlation analysis is a statistical analysis which statistically measures the extent and nature of the relationship between two intervals or variables. The co efficient of correlation is calculated to identify relationship between the following ratios.

The value of correlation between the Repayment rate and On-time collection rate of Bank of Ceylon Northern Province is 0.978** which is significant at 0.01 level, which represents there is strong positive relationship between the Repayment rate and On-time collection rate of Bank of Ceylon Northern Province. Therefore when repayment rate increases, On-time collection rate will also increase of Bank of Ceylon in Northern Province.

TABLE 05: CORRELATION BETWEEN REPAYMENT RATE AND ON-TIME COLLECTION RATE

Northern Province		Repayment Rate	On-Time Collection Rate
Repayment Rate	Pearson Correlation	1	.978**
	Sig. (2-tailed)		.004
	N	5	5
On-Time Collection Rate	Pearson Correlation	.978**	1
	Sig. (2-tailed)	.004	
	N	5	5

**. Correlation is significant at the 0.01 level (2-tailed).

TABLE 06 : CORRELATION BETWEEN ARREARS RATE AND LOSS PROVISION RATE

Northern Province		Arrears Rate	Loss Provision
Arrears Rate	Pearson Correlation	1	.768
	Sig. (2-tailed)		.129
	N	5	5
Loss Provision	Pearson Correlation	.768	1
	Sig. (2-tailed)	.129	
	N	5	5

TABLE 07: CORRELATION BETWEEN REPAYMENT RATE AND ARREARS RATE

Northern Province		Arrears Rate	Repayment Rate
Arrears Rate	Pearson Correlation	1	-.978**
	Sig. (2-tailed)		.004
	N	5	5
Repayment Rate	Pearson Correlation	-.978**	1
	Sig. (2-tailed)	.004	
	N	5	5

**. Correlation is significant at the 0.01 level (2-tailed).

The value of correlation between the Arrears rate (Portfolio at risk) and Loss Provision rate of Bank of Ceylon Northern Province is 0.768 which is not significant, which represents there is no relationship between the Arrears rate and Loss Provision rate of Bank of Ceylon Northern Province.

The value of correlation between the Arrears rate (Portfolio at risk) and Repayment rate of Bank of Ceylon Northern Province is -0.978** which is significant at 0.01 level, which represents there is strong negative relationship between the Repayment rate and Arrears rate of Bank of Ceylon Northern Province. Therefore when arrears rate increases, repayment rate will also increase of Bank of Ceylon in Northern Province.

FINDINGS AND CONCLUSION

This study offers exploratory insights into the level of loan delinquency of Bank of Ceylon in Northern Province, and the lending practices of the country's bankers towards the Micro credit. The results were based on the analysis of data collected for five years from in 2005 to 2009 with the Northern Province of BOC. Findings reveal that several factors were responsible for banks' altitude of not expanding loan portfolio, principal of which are poor credit worthiness, lack of collateral security and the constraint imposed by regulation, based on capital adequacy.

The study shows that loans delinquency rate was low at 5.82 per cent of total loan obligations among Bank of Ceylon in Northern Province in 2005, contrary to the situation in some parts of Sri Lanka, loans delinquency rate was high at 11.64 percent of total loan obligations in 2009. In view of the findings of this study, some uncontrollable factors specially ethnic war & people internal displacements are influencing in loan default of 2009. Particularly Mullaitivu, Kilinochchi and Mankulam branches are facing this savior problem; their delinquency rate is 88.60%, 85.44% and 93.59% respectively. And given the implications of loan default on the financial sector of a country, the government should collate and analyze information on, so that an informed decision could always be made on the full understanding of the problems of the sector.

However, the measures suggested in this study are of importance to policy planners, not only in Sri Lanka, but in other developing countries in their similar situations of delinquency process.

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