

Azərbaycan Respublikası
Təhsil Nazirliyi
The Problems of Credit Management
and Profitability in Banking Industry.
Evidence from Azerbaijan

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ABSTRACT

The biggest goal of the banks is to make as much profit as possible. Today, Major problems of banking industry in Azerbaijan is credit management and increase credit losses. Credit management process covers so many risks such as credit, market, liquidity and so on. This research subject covers so many researchers' opinions, different literatures. While reading dissertation reader will learn what is credit management and what types it has. It is the recommendation of the study that there is the need for a powerful control system to strengthen the loan and profit policy on the management of the banks' credit facility in Azerbaijan banking economy. This involves the need for thorough and strong checking of loan or credit applications (borrower) at various stages of granting loans and progress in the banks and other financial institutions. Moreover, in Azerbaijan banks and other financial institutions must stabilize their liquidity and profitability. Banks should manage credit portfolios and profitability of banks.

Also reader can gain view about the credit management and profitability in Azerbaijan.

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1. INTRODUCTION

1.1 Background of the Study.

In the world economy and Azerbaijani economy, there are facilities for creating, managing and distributing financial assets and liabilities. The financial system constitutes the banking system all over the world. Banks are universal phenomena and universal institution. Generally, bank is a financial institution that converts public deposits and creates credit. Because banks occupy a dominant position in the economy because it is the fulcrum of the money market and the central nervous system of the economy. The banking industry around the world and special banks in Azerbaijan have witnessed many structural changes. These changes are improvements to banks and financial services to improve operators and benefits for customers, shareholders, and the economy as a whole. In Azerbaijan, when Dissolution of the Soviet Union and the development of capitalism contributed to the development of the banking system in Azerbaijan. In general, the banking system is most important element of the Azerbaijani financial system. The Central Bank of the Republic of Azerbaijan (set up on February 11, 1992) is the nation's national bank. At exhibit day created two-ventured bank framework, which depends on advertise standards, works in republic. In the initial step is Banking industry in Azerbaijan, right off the bat have National Bank of the Republic of Azerbaijan, in the second one business banks and other non-bank credit associations. In my nation, in the principal phase of changes, rebuilding and recuperation of state banks were taken and institutional development of private bank framework guaranteed. In this stage Azerbaijan government and The Central Bank of the Republic of Azerbaijan needs low prerequisites concerning capital and extremely liberal terms for entering the bank and monetary framework were resolved and delicate managing instruments were connected to direct the bank and money related movement. Because of these procedures bank framework was create and number of private banks expanded

quickly. Since 2002 important stage of reconstruct of bank system and bank sector started to be carried out.

In Azerbaijan, when passage of enormous oil incomes in the nation, as a consistent consequence of fruitful oil methodology, and in this base, as the banks were prepared to a successful exchange of their money related assets to the vital objectives, improvement procedure was made for 2002-2012.

In Azerbaijan, Bank items are offered to clients through the most recent mechanical means as web bank, versatile bank.

Over the past two decades, especially since 1992, the development of Azerbaijan's economy has had a considerable impact on the operation of banks and other non-financial institutions. This decade has experienced a decline in Azerbaijan's economy, with occasional reductions in oil revenues and the global economic recession. As a subsystem of the national economy, banks have experienced a crisis in the low-income stage.

1.2 Statement of the Problem:

One of the real issues confronting the managing an finance industry is the rising incidence of loan defaults. The result of loan losses is reflected in the bank's profitability. Sequel to increase bad obligations in the Azerbaijan keeping money industry, insider's misuse in financial activity, financial administration's fitness have been called to address. Bad debts arise when credit management in the bank becomes weak and such bad debts reduce the bank's profitability.

In the banking sector, loans and advances accounted for the largest proportion of bank-income-increasing assets, so loan defaults led to bad debts, destroyed the assets and subsequently reduced bank profitability because bad debts or bad debt provisions were included in the income statement accounts. As we all know, in the banking industry, lending is of vital importance to banks and the public because it is the source of income and the basic items that determine bank liquidity and ultimate solvency.

Bank credits as advances and advances are stores that are exchanged to financial shortfall units for speculation purposes. It isn't a mystery that any lessening in bank resources (loans and advances) because of terrible obligations will influence the accessible measure of future advances. Therefore, this will affect the government's production, employment, taxes, and funds and reserves accessible for social administrations, as well as bank growth. In Azerbaijan's banking sector, due to the non-profitability of the banking industry in Azerbaijan and the bank's subsequent bankruptcy/difficulties, the occurrence of huge bad debts not only caught the attention of the currency and government departments but the general public. In Azerbaijan, if the issue is not resolved urgently, people are increasingly worried about bank failures and increased banking crisis. From the recent development of the banking sector, this fear may not be appropriate.

1.3 Objective of the Study

The main purpose of the study was to assess the impact of Azerbaijan's banks on the management of loans and advances in their asset structures and on the management or management of bank earnings. The specific objectives of the study included the following:

- Study the structure established by the Bank of Azerbaijan for the management of loans and advance payments and determine whether it is appropriate.
- The regulatory and institutional framework for the bank's financial intermediary function in Azerbaijan
- Review practices of global and national banks in giving advances and debts and their recovery procedures.
- Review the extent of bank loan losses and the quality of the assets (loans and advances)

- Identify problems that have undermined the effective and efficient management of loans and advances by the National Bank and addressed them.

1.4 Scope of the Study

My diploma in work includes the management of credit facilities (loans and advances), the main cause of credit problems and their impact on the profits of Azerbaijani banks. Banks use selected banks as case studies. These banks include:

“Rabita Bank”, “Xalq Bank”, “ASB Bank”, “Nbc Bank” , “Yapikredi Bank” , “Bank OF Baku”

The study period is last years. This period witnessed the most dramatic changes in the economic landscape of Azerbaijan banks in recent past, occasioned by the downturn in the national economy and prepare new economic financial policies by Azerbaijan government. These changes have had a considerable impact on the operation of Azerbaijan’s financial and banking systems. The period of time chosen by Azerbaijan’s banking industry indicates that during this period, the value of loan management trends will be maintained and it will help predict possible future trends. Understanding the possible trends in the future and the coming years will help bank management to control the future and achieve effective and efficient management of credit portfolios.

1.5 Significance of the Study

My research on this nature has value not only for the management of commercial banks, other banks, shareholders, potential investors and depositors, but also for the entire economy. Credit Management is a key aspect of financial system. The management of credit is very important for all banks (global and national) to improve its profitability. The proper management of credit will help to increase the wealth of the shareholder. In the whole world the proper management of credit will ensure that an

organization can generate sufficient positive credit from both deposit and lending. So the efficient management of credit will solve the problems. In conclusion, so the proper management of credit is a profit determinant of profitability and succeeds of a bank.

2. Definition of Credit Management

Banks around the world are the most important institutions that act as intermediaries in the fund flow within the financial system. One of the most used means of mediating the fund flow of the banks is the loans. The credits are one of the channels of the money transfer mechanism.

The problematic credit is that the repayment agreement between the bank and the borrower delayed collection and the emergence of the possibility of loss. The most important thing that could undermine the stability of the banking industry one of the factors was cash or non-cash use and later became problematic credits.

There are many definitions given for credit management by different scholars. Among these some are here cited as follows:

“Credit management is implementing and maintaining a set of policies and procedures to minimize the amount of capital tied up in debtors and to minimize the exposure of the business to bad debts.” (www.smallbusiness.wa.gov.au, n.d.)

“Credit Management, from a debtor’s point of view, is managing finances especially debts so as not to have a tail of creditors lurking behind your back. Credit management is a responsibility that both the debtor and the creditor should seriously take.” (<http://www.selfgrowth.com/articles/Tabije3.html>), n.d.)

When it works proficiently, acknowledge administration fills in as an amazing instrument for the business to remain monetarily steady.

2.1 Process of Credit Management

In the financial system, the process of credit management must first accurately assess the credibility of the client base and his/her business attainability.

This is especially important if companies choose to provide certain types of credit or on the other hand rotating credit to specific clients. In this way, in banks and other money related establishments, legitimate credit administration is setting particular criteria that a client must meet before getting the proposed credit course of action. In money related framework, as a component of the assessment procedure, credit administration likewise calls for deciding the aggregate credit line that will be stretched out to a given client. A couple of components are utilized as a major aspect of the credit administration procedure to assess and qualify a client for the receipt of some type of business credit in the money related organizations. This includes gathering insights on the potential client's present money related condition, including the present credit track record that reveals the character of a client in meeting commitments and in addition security esteem. Viable credit and advance administration cannot just spare the bank or any money related organization required from conceivable misfortunes and other negative conditions, but also protect every customer and customer from any more debt obligations that cannot be resolved in time.

In financial institutions, when the credit management process works well, everyone benefits from it. The money related establishment, for example, banks has a sensible measure of affirmation that credits allowed to a client will be paid back inside terms, or that normal least installments will be gotten on layaway account adjusts.

2.2 Types of Credit

There are four main types of financial credit. By seeing how every function, monetary establishments (banks and others) will have the capacity to get the most answer for their advance recuperation and abstain from paying pointless charges.

✓ Service credit which is regularly scheduled installments for utilities, for example, phone, gas, power, and water. You frequently need to give a store, and you may reimburse a late charge if your installment isn't on time.

✓ Loans: Advances can be reimbursed in one singular amount or in a couple of customary portion installments until the point when the sum acquired and the back charges are ponied up all required funds. Besides, credits can be secured or unsecured.

✓ Consumer credit is depicted as purchasing on time, financing through the store or the simple reimbursement framework. The borrower takes the products home in return for a guarantee to reimburse later time. Autos, telephones, tablets, PCs, real machines, furniture and a few needs are regularly acquired thusly. You generally sign a plan, make an upfront installment, and consent to pay the adjust with a predefined number of equivalent installments called portions.

✓ Credit cards are issued by singular retail locations, banks, or different organizations. Utilizing Visas can be what might as well be called an intrigue free credit - in the event that you pony up all required funds toward the finish of every period.

2.3 Credit Analysis

Credit analysis is the main method in reducing the credit risk on a loan request. This includes determining the borrower's financial and economic strength, estimating the probability of default and reducing the risk of non-payment to an acceptable level. The main credit assessment is based on subjective assessments (or judgmental assessment techniques) of loan officers. Once a customer requests credit, a bank official, typically analyzed by a bank's credit risk analyst, analyzes all available information to determine whether the loan meets the bank's risk-reward goal. Credit and loan analysis is essentially default risk analysis, in which a loan officer attempts to evaluate a borrower's ability and readiness to repay. In banks and other financial institutions, the objective of credit analysis is to review both borrowers and lending institutions and assign risk ratings. The risk rating is obtained by estimating the default probability of a given confidence level of the customer throughout the life cycle of the facility and by estimating the number of losses the lender will suffer when a default occurs in the financial system. Credit analysis includes various financial analysis and other

techniques, including ratio and trend analysis, as well as detailed analysis of the creation of forecasts and cash flow.

Most banks usually rely on subjective judgments to assess the credit risk of corporate borrowers.

2.4 Credit Information

Sufficient and opportune information that empowers an agreeable evaluation of the financial soundness of borrowers applying for a bank credit is essential for settling on mindful loaning choices. Reasonable loaning choices made based on sufficient data on the reliability of borrowers are one of the important factors in guaranteeing the money related solidness of banks. But, there has been serious difficulty in Azerbaijan financial institutions of getting accurate and well - timed information on prospective borrowers that facilitates the making of such prudent lending decisions.

2.5 Credit Process

In the financial system, the fundamental objective of commercial and customer lending is to make profitable loans with minimal risk. Management should target specific sector or areas in which lending officers have expertise. The credit and advance process depends on each bank's frameworks and controls to permit administration and credit officers to assess hazard and return tradeoffs.

2.6 Business Development and Credit Analysis

Business development is the process of marketing banking and financial services to existing and potential customers. Identify new credit customers by borrowing and soliciting their banking business, and maintain relationships with current customers and cross-selling non-credit services. (Mirach, nd) Every bank worker, from tellers handling drive-up facilities to members of the board of the managers, is responsible for business development. Each employee regularly contacts potential customers and can sell bank services. To encourage marketing, many banks and financial institutions use

cash incentives or other incentive programs to reward employees who successfully cross-sell services or bring new businesses to the bank.

2.7 Credit Execution and Administration

According to the bank's organizational structure, official credit decisions can be made on their own or by committees. This structure varies depending on the size and power of the bank, the number of employees, and the types of loans processed. A bank's Board of Directors regularly has the last say on which advances or credits are affirmed. Generally, every money related establishments each loaning officer has autonomous specialist to affirm credits up to some settled dollar sum.

2.8 Credit Review

Credit review efforts are aimed at reducing currency risk while dealing with problem loans and clearing the assets of failed borrowers. Effective credit and loan management separate loan review from credit analysis, execution and management. In banks, the survey procedure can be partitioned into two capacities: observing the execution of existing advances and dealing with issue credits. Numerous banks and money related organizations have a formal advance audit panel, free of credit officers, that reports straightforwardly to the CEO and chiefs' advance board of trustees.

Credit audit staff (bank or monetary organization specialist) survey current advance to check that the borrower's budgetary condition is worthy, advance documentation is set up, and set the value meets return destinations.

2.9 Credit Approval and Implementation

The separate steps in the credit approval process and its implementation have a major impact on the risks associated with credit approval. The quality of credit approval processes anticipate two factors, i.e. a transparent and comprehensive presentation of the risks when granting the credit for banks and other lenders on the one hand, and an adequate assessment of these risks on the other. Moreover, the grade of efficiency of the

credit approval processes is an important rating element. Since the nature of the various borrowers and property, and the enormous number of products and their complexities are quite different, a unified process to evaluate credit risk is impossible. The quality of the credit and loan approval process from a risk perspective is determined by the best possible identification and evaluation of the loan risk resulting from a possible exposure.

2.10 Financial Analysis

Review, appraisal and follow-up are three primary factors in credit management and decision-making.

The comment or review is for the past. It should enable bank staff to determine whether it is safe to lend to a particular customer. In order to achieve this judgment, bank staff must agree on their own risks and feasibility. Review the solvency, liquidity, and profitability of any unit shown in its financial statements, i.e., the income statement and the balance sheet. During the bank review process, according to the bank's requirements and analysis of these statements, consult the profit and loss account classification and balance sheet.

2.11 Credit appraisal

Credit evaluation means considering new or improvement suggestions based on future information. In assessing proposals, bankers or bank employees try to find out: the financial needs of customers or customers, the ultimate use of funds, the feasibility of operations, and the financial risks involved. When proposing management capital finance, bank employees can confirm the elements only when the borrower's business plan is supplied for the following period. Banks want business plan form client. The business plan is represented by operating statements, balance sheets, capital and fund flows, and cash flow statements, all based on the forecasted basis.

2.12 Follow-up

Follow-up can be defined as continuing activities aimed at ensuring compliance with regulations prescribed by banks and other financial institutions, statements on customer health status, corrective actions and ongoing activities results. Money related security, require based back and end-utilize are the fundamental suspicions of loaning.

A bank laborer needs different sorts of information and data from the borrowers for assuming the praise resolutions. Such information is typically accessible in different monetary articulations, for example, pay proclamation, asset report, income explanation, stores (cash and capital) stream proclamation, and so on. However, unless bank employees can use these statements, mere collection of these financial data from borrowers is of little use. Please classify as necessary and analyze to obtain meaningful results.

3. Default Problems

Unpaid debit has a few bothersome results. It step by step destabilizes the credit framework. The cost of loan management for loans overdue is high. Defaults push up loan costs without an increase in loans. Defaults diminish the asset base for additionally loaning, debilitate faculty resolve, and impact the borrower's certainty. I distinguished six components which added to defaults:

- a) Variability in salaries caused by random, etesian, or startling components;
- b) Fault and failure in the association dispensing credit;
- c) Uncomfortably terms not helpful for reimbursement;
- d) Misallocation of obtained cash and capital;
- e) Miscellaneous cause, for example, sickness ailment, passing. And so forth.

(Padmanabhan, (1986: 26-31),)

Causes of delinquencies and defaults are classified as relating to three levels: borrower level, financing institution level, and economy level.

A) Reasons at borrower level:

- Borrowers who intentionally occupy credits to superfluous utilization think that it's difficult to meet reimbursement duties on time.

- Investments lose to produce adequate livelihoods because of disgraceful specialized counsel; absence of supporting administrations, unfit advertising, and so on. Budgetary speculations additionally lose because of unexpected causes like surges, dryness, and so forth.

- When borrowers have obligations towards informal banks, they get priority over institutional and budgetary moneylenders.

- Contingency at borrower family like passing, disease, and so forth., influence reimbursement execution and yield.

- Formal monetary establishments and loan bosses which don't broaden utilization and crisis credits are obligated to have higher default proportions.

B) Reasons at financing institution level:

- Incomplete financing appraisal procedures for financing institutions may lead to the financing of poverty projects and result in breach of contract.

- The quality of credit officers, their talent and knowledge in the field, and their ability to judge borrowers and the incentives available to them affect repayment efficiency.

- Fixing an incorrect repayment plan and lack of flexibility usually leads to a breach of contract. At the same time, borrowers tend to delay repayments when the repayment procedures are cumbersome.

- The default has a "propagating effect", especially in marginal situations. When banks and other financial institutions are reluctant to impose sanctions on apparent defaulters, defaults tend to increase through the imitation process.

C) Reasons at economy level:

When general state approaches, especially those identifying with estimating of sources of info and yields, showcasing, and so on., oppress the particular segment.

- Wrong financial and monetary approaches of States could bring about high rate of inflationary conditions. Borrowers keep an eye on impediment reimbursements in such a circumstance to exploit the fall in estimation of cash.

- Interest rate arrangements of government have a staminal part in the advancement of reimbursements. At the point when the genuine rate is over low, acquiring and spending will be significantly more lucrative than sparing and reimbursement.

- High government mediation in the everyday organization of budgetary foundations and banks could bring about terrible advances or credits.

- Disasters like aridness, surge, advertise abundance, and so forth could come about non-performing obligations.

3.1 Common Sources of Major Credit Problems

- In the Azerbaijan banking industry, the most important banking and financial matters have taken over weaknesses of credit management and loan management either explicitly or implicitly. In the experience of supervisors, certain ace issues tend to continue. Serious credit misfortunes in keeping money and monetary frameworks frequently reflect issues that emerge in the meantime in different territories

- Concentration is likely to be the single most important cause of major credit or loan problems. The creditworthiness is deemed to be a potential loss in relation to the bank's financial capital, total assets, or appropriate measures, in relation to the bank's overall risk and level.

- All in all, numerous making directors and counselors ought to have particular controls constraining focuses to one borrower or set of related borrowers, and, actually, ought to likewise anticipate that banks will set much inferior border on

individual-obligor exposure in Azerbaijan economy. Most credit executives in banks and other financial institutions also monitor business industry concentrations. Numerous budgetary organizations and banks are exploring methods to recognize focuses in light of basic hazard components or connections among factors. Albeit little banks may think that its hard to accomplish or approach focus limits, extensive saving money foundations must perceive that because of their substantial capital assets, their risks to single obligors may reach unnecessary levels while still being within regulatory limits.

- In Azerbaijan, many credit issues (bad debts) reveal fundamental weaknesses in the credit and supervision processes. In Azerbaijan keeping money area, while weaknesses in endorsing and administration of market-related credit exposures speak to critical wellsprings of misfortunes at banks, numerous advance or credit administration issues would have been dodged or moderated by an intense inside and outer credit administration process.

- In our country, banks and other financial institutions have suffered credit losses due to the failure to use their discretionary use of certain leveraged credit facilities. As mentioned above, credit defaults to highly leveraged borrowers may have significant losses. In the meantime, utilized structures, for example, some buyout or obligation rebuilding techniques, or structures including customers composed alternatives for the most part bring amassed credit dangers into the banks and monetary establishments' credit portfolio and should just be utilized with fiscally capable customers. regularly , yet, this sort of structures are most speaking to weaker borrowers on the grounds that the financing empowers a significant upside income if all goes well, while the borrower's misfortunes are constrained to its total assets.

- Some budgetary organizations and banks' credit exercises include loaning against non-monetary resources. In suchlike loaning, some money related establishments have neglected to make a sufficient evaluation of the relationship between's the budgetary state of the borrower and the value changes and liquidity of the market for the

security resources in each nation. Particularly in our nation, much resource based business loaning (i.e. business fund, hardware renting, and figuring) and business land loaning seem to include a moderately high relationship between's borrower financial soundness and resource worth. As of not long ago the borrower's income, the fundamental wellspring of reimbursement is typically fixing to the advantages being referred to, breakdown in the borrower's salary stream, if because of segment or neighborhood monetary issues might be joined by decreases in resource esteems for the insurance. In my locale, numerous advantage based customer loaning (i.e. home capital credits, car financing) shows associated, if weaker, connection between the money related soundness of customers and the business sectors for buyer resources.

- A associated issue is that a great deal of monetary organizations don't assess business cycle impacts in loaning. As income likelihood and resource esteems increment in the climbing segment of the area cycle, advance investigation may join excessively idealistic presumptions. Productive pressure testing which assesses division or item cycle impacts is one way to deal with consolidating into credit or advance choices a more full comprehension of a borrower's advance hazard.

- In by and large, some endorsing issues mirror the nonappearance of an astute supposition of drawback situations. In extra to the business cycle, borrowers or debtors may be undefended to changes in risk factors such as certain goods and commodity prices, shifts in the ambitious scene and the vulnerability of achievement in business tactics or management direction. In banks and other financial institutions, many financial lenders fail to “tension test” or examine the credit using enough adverse assumptions and thus fail to detect vulnerabilities.

4. Credit monitoring

Credit monitoring is one of the important processes in banking.

Credit monitoring is a service that warn you whenever modify is made to one of your loan papers. This allows you to quickly affirm the exactness of the supplant and, if essential, begin dealing with any issues previously they truly escape hand. Any suspicious credit-report change can be an indication of misrepresentation, all things considered, and credit paper regularly contain blunders that can cause dismissal by an investor.

Banks develop and implement detailed procedures for the continuous monitoring and analysis of the status of loans and debts in portfolios. These procedures define the criteria for the identification and reporting of potentially problematic loans, which require more stringent monitoring of loans and receivables, classification in a different group, allocation of provisions and / or additional corrective actions.

In banks and other financial institutions, specialist personnel are also allocated for the monitoring of credits. In banks and finance companies, these monitoring activities include the guarantee of guarantees and guarantees. A structure is created that will not allow for potential conflicts of interest when the appointment is made in order to better monitor the credit.

An effective credit monitoring process in all banks;

- Knowledge of the current financial situation of the borrower is one of the most important tasks of each banker,
- The compliance of the loan with the contract conditions is very important for a bank
- It is one of the most important processes of compliance with the approved policies and procedures of the approved credit limits and follow-up credit to the customers,
- The collateral must be adequate for the current financial position of the borrower,

- Timely identification and classification of problem loans is one of the most important elements

Is an important tool of internal rating monitoring and control systems in all financial institutions more frequent customer visits for credit-deteriorating credit customers, and additional monitoring methods such as their activity reports, more frequent monitoring by senior management, and helping banks get rid of harm in the upcoming period.

It is expected that the board and the country will have sufficient knowledge about the risk and portfolio quality of the bank, as well as the portfolio of the management board, including many customers, such as retail loans.

The most important elements to pay attention to all financial institutions are the early warning systems, which can affect the credit repayment of negative developments that may arise in the sectors where the BRI is originated or interacted with by the customers within the scope of the loan monitoring process or which may occur in the economic conjuncture. The results from early warning systems are used effectively in monitoring portfolio quality.

In all banks and financial institutions, the information and analysis of the risk parameters of the customers in the monitoring activities are utilized to the maximum extent from the platforms that are collectively shared.

Developments in lending or customer-focused sectors and regions are closely monitored by bank management and workers.

Large-cap loans are monitored closely by lenders and financial institutions in order to minimize any losses that can be incurred as a result of sudden adverse changes in the financial structure of credit customers. Not only company-specific but sector-based evaluations and trends are also very important for the bank.

Monitoring the high risk project loans on a regular basis, as well as the activities of companies with high credit risk, will lift the risk of encountering the problem in the future.

In the event of early warning of default or breach of contract, the repayment capacity and credit worthiness of the customer will be re-examined carefully by bank workers.

Customer-based delays are set up on each bank, including individual loans, and the relevant units are reported daily.

Banks develop systems to detect overdue loan payments and report on time to the relevant management level, and these reports are presented at the top level. In banks and other financial companies, the task of making this report is not given to those involved in credit approval units.

In the event of a disruption in the interest / profit share or principal payment, each bank worker and senior management should determine what action will be taken at what authority level.

Monitoring controls in the information systems of banks and financial institutions;

- The objectionable and opposite indicators included in the risk center records,
- Unexpected changes in risk center information,
- Legal restrictions such as precautionary seizure by the government concerning the customer and the borrower, bankruptcy delays,
- Objectionable bills and checks and will be designed to give early warning signals in the presence of such states.

Information and other analysis systems of banks and financial institutions are created to monitor credit conditions and ensure compliance with the terms and conditions of use of collateral received from customers and other borrowers.

For effective credit administration, banks and other financial institutions have different types of inspection/ audit

These are:

- RBI inspection
- Regular inspection by controlling office (Head office/ Regional office) (almost every bank used)
- Concurrent audit (is very important for the review of the reports)
- Stock audit
- Legal audit (financial institutions may resort to this requirement when necessary)

And in addition, stress testing and situation investigation, as well as models developed in monitoring and monitoring the risks arising from the loan portfolio in all banks and financial institutions.

Stress tests are used to measure the level of credit exposure exposed in many financial institutions. The stress test measures the level of loss the bank and its financial institution will face in the face of unfavorable credit developments.

The scenarios used in the stress tests take into account such factors as bad and unfavorable developments in the concentrated sectors, shrinking and shrinking of the economy, liquidity tightness in the bank, undesirable developments in the stock markets and such unfavorable developments or the tendency of the central bank's interest rates to move in undesirable direction.

Banks and financial institutions that issue foreign currency denominated or foreign currency denominated loans also include high exchange rate fluctuations in their scenarios to measure the losses that may arise from the weakening of the repayment capacities of customers and others' debts, taking into account their size in their total portfolio and showing due diligence.

The results of the pressure test and situation investigation are examined by senior management of a bank or financial institution and the measures that can be taken against the losses that may be encountered are evaluated. These measures may be in the form of changes in policy or limits, the use of preventative measures, or the use of good methods to reduce risks.

In many financial institutions, stress testing is used in the development of credit risk mitigation techniques.

The results of stress tests or scenario analyzes are also crucial in determining and updating the policies and limits of banks and financial institutions.

Banks with complex activity take into account and use the internal model approach of the stress tests in the calculation of the capital and the money needed due to the risks exposed.

Stress test analyzes are done on the console in some cases. Taking into account the stress test analysis, unexpected situations are set up that determine how a bank and other financial institutions will act in exceptional circumstances by senior management.

4.1 Management of guarantees and collateral in banks

Banks and financial institutions may benefit from collateral and guarantees to reduce the risks they are exposed to, but transactions are made primarily by evaluating and calculating the repayment capacity of the customer.

Financial institutions and banks specify policies and procedures for collateral management in writing. In Azerbaijan banks, taking into consideration the reasons of the collateral requirement, it is considered that the value losses or collateral value decrease that may occur in the collateral in collateralized loan transactions will cause additional collateral requirement. If additional collateral is required, the bank employee will notify the client in writing.

In all banks, are included in the credit files together with the reasons for the collaterals made outside the allocation conditions.

In Azeri banks, Guarantees are regularly assessed by persons of sufficient knowledge and expertise (usually qualified bank workers) by type and measures are taken to ensure that information and data are updated and that compliance with market conditions is maintained.

Collaterals with readily convertible cash (usually bonds, bonds, home) are preferred. In addition, the monetary harmonization of credit and collateral, and the price volatility of the asset (which is very important for a bank and financial institution) are observed.

In all banks, guarantees related to loans are monitored by the units in the credit processes through the system with latest technology.

For the purpose of financing an asset, loan guarantees are determined by not exceeding the legal limits (supervised by this indigenous government) in the credits required to be secured, especially the credits extended under this guarantee. The loan guarantee rate is measured by the bank employee or the banker by proportion of the loan to the value of the loan. At this level, losses arising from the collateralization of the collateral in the banks and risks related to the asset received as collateral are also taken into consideration.

It is checked whether checks and notes received as collateral by the bank employee are related to a commercial business. In the banks, paying attention to the interdependent interdependent of the payment forces and the concentration on the client and transporter.

In Azerbaijan banks, in the case of credits extended to bail, cross-bail is formed when the borrower and the guarantors cross each other on different credits, or cross-bail is issued mutually by giving a reminder. (Such situations are frequently used when borrowing by customers or borrowers. is one of the most important elements that the bank worker should pay attention to when giving credit).

Collateral - credit matching is done for the credits granted in banks. The necessary algorithms for such matching are established in accordance with the relevant legislation, managed with the latest technology and control processes are established.

In order to avoid risk concentration in collaterals, collaterals are limited and monitored in banks by setting limits. Risk concentration is crucial for the credit process and bank workers are very careful in this regard, at least as a guarantee, the asset is monitored and limited at the level of the market for which the asset is related, the issuer of the asset received as collateral and the guarantors.

The collaterals are periodically reported within the framework of the procedures and principles set out in the relevant banking system for the benefit of credit management, which is usually the accounting department of the major companies or the customer itself.

The guarantee is very important for every bank and banker. The proper functioning of the banker and the banking system depends on collateral guarantees. Successful execution of collateral protects the bank against potential future losses.

5. Data Analysis

5.1 Credit problems in countries

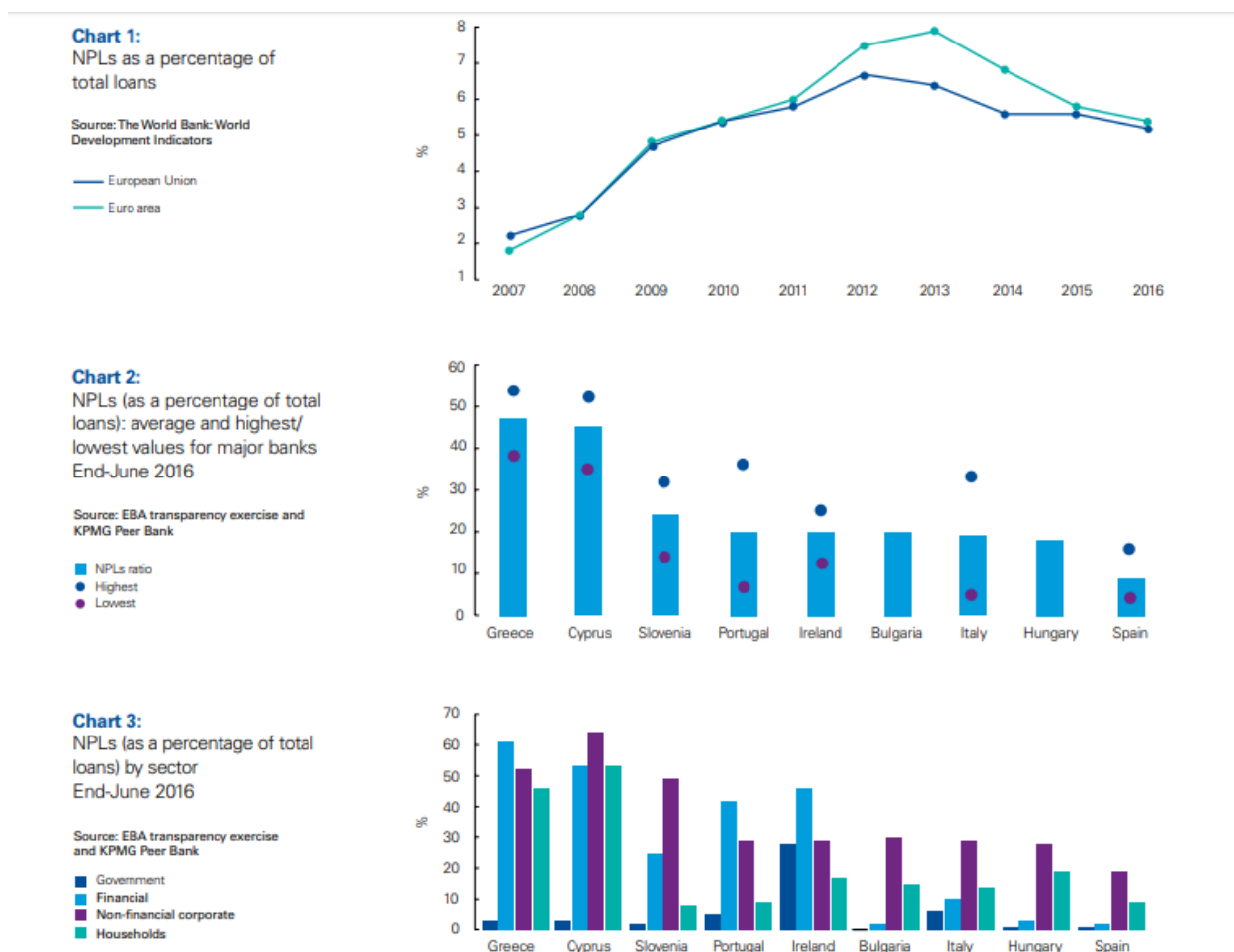
5.1.1 In European union

A major problem

The total amount of non-performing loans of European banks at the end of 2016 was approximately 1 Euro. The corresponding figure for the largest bank in the euro zone is about 880 billion euros, which is nearly 6.2% of the total loan (compared with the 2016 average, the United States is about 1.3% and the United Kingdom is 0.9%).

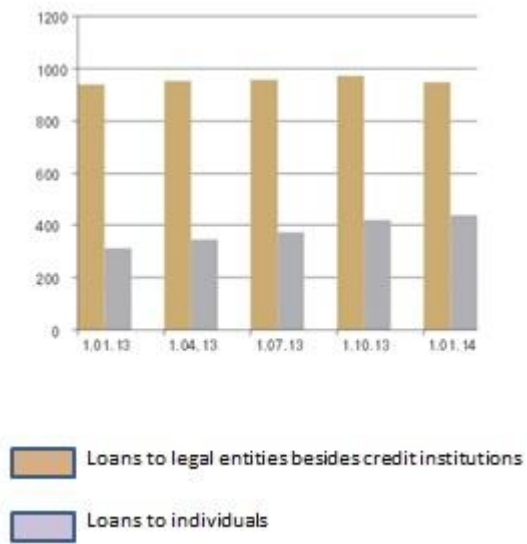
Although the proportion of loans classified as bad business has declined since then (2.5% of total loans in the third quarter of 2017), Europe still has much work to do in this area.

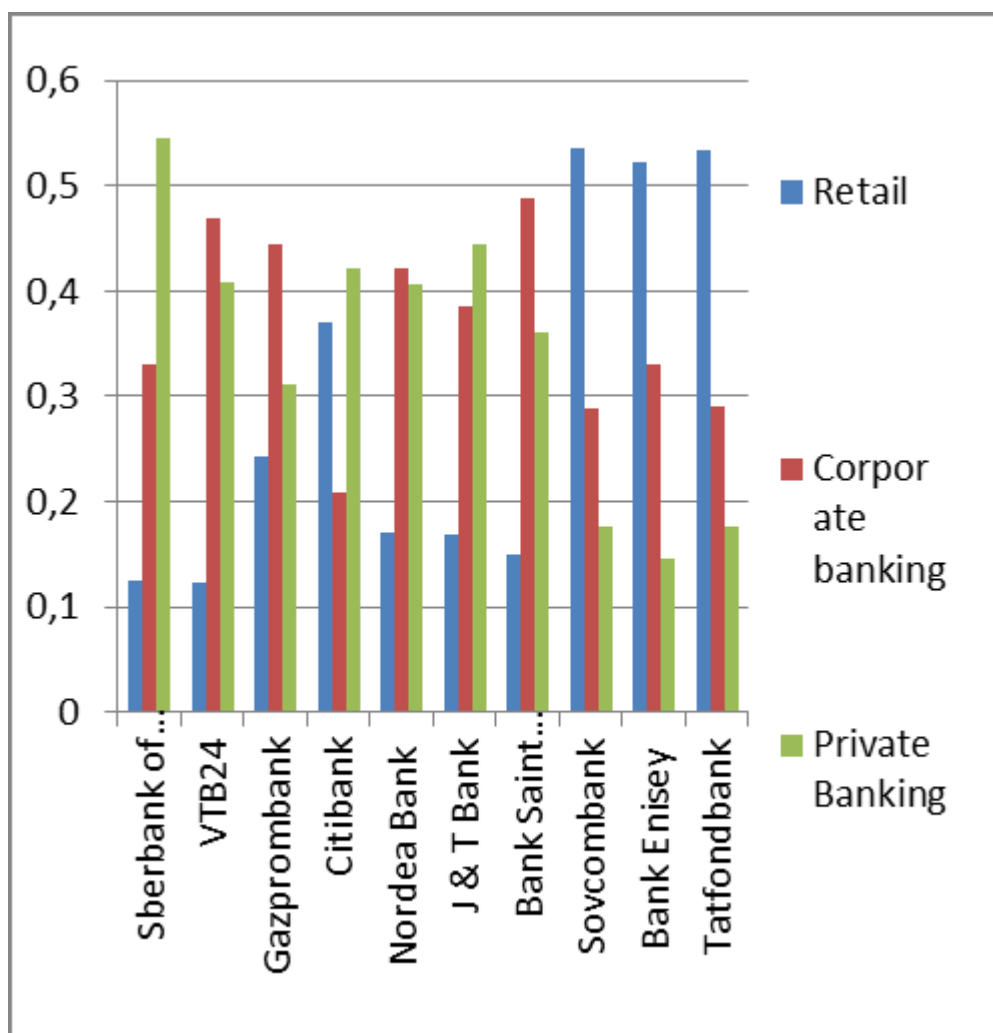
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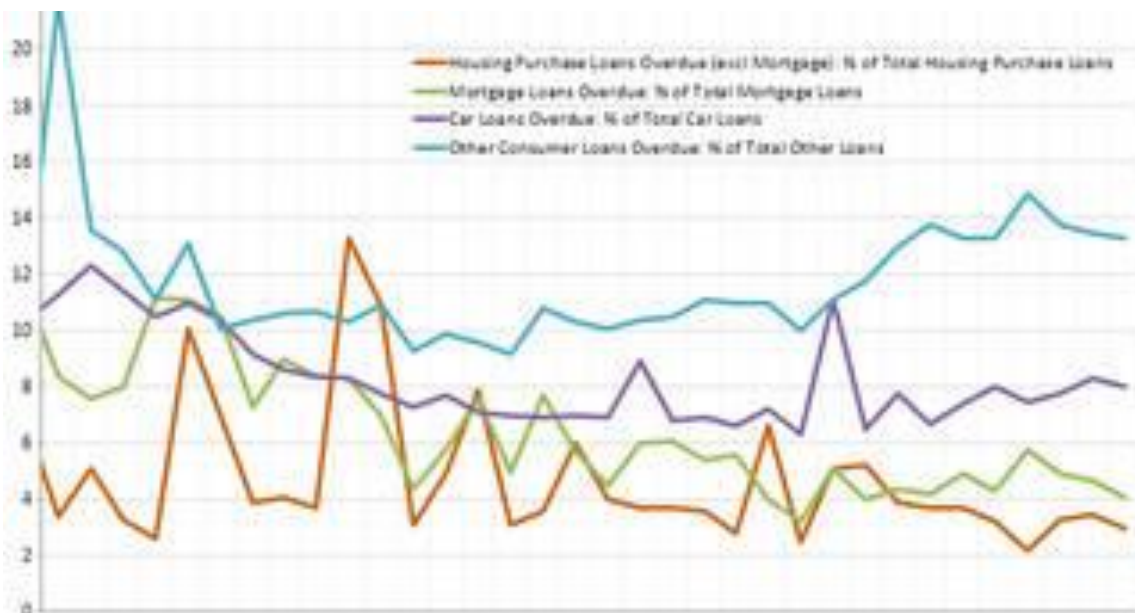
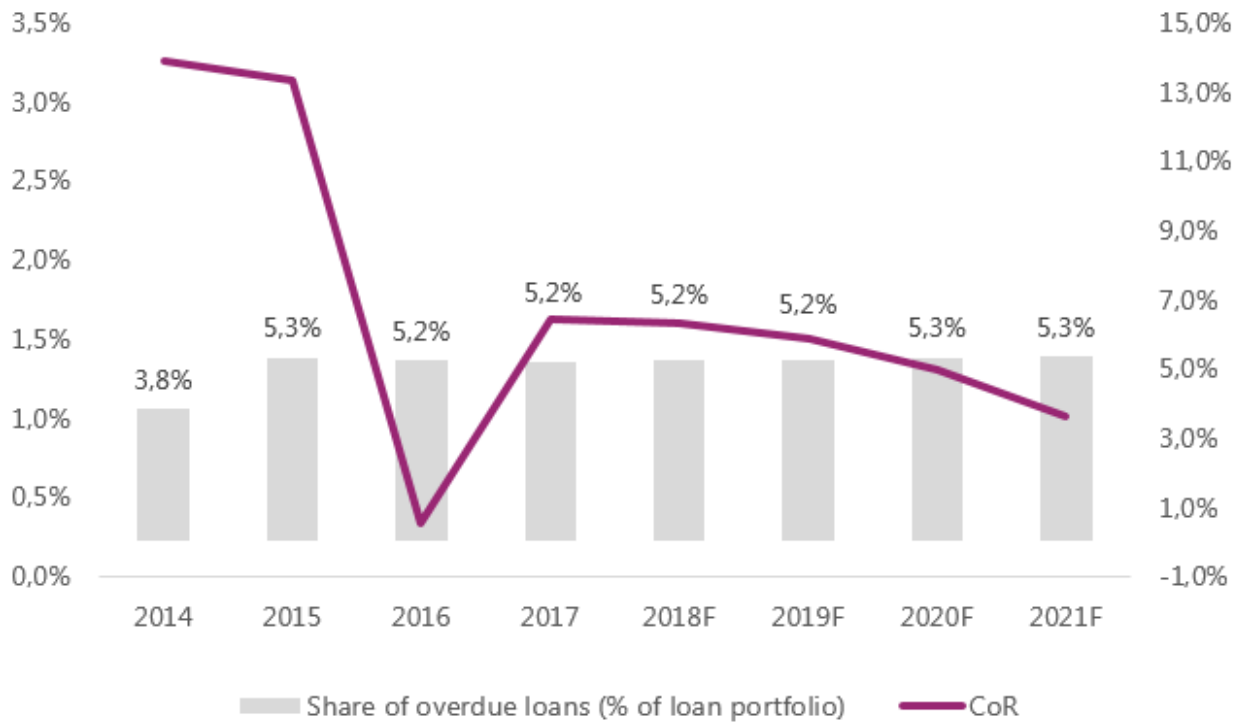


(<https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2017/05/non-performing-loans-in-europe.pdf>)

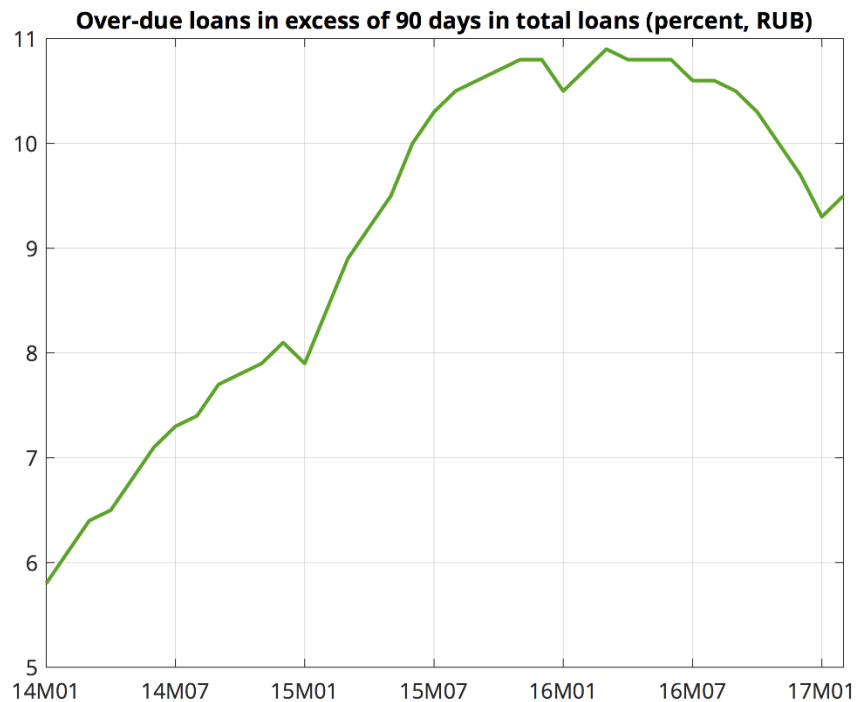
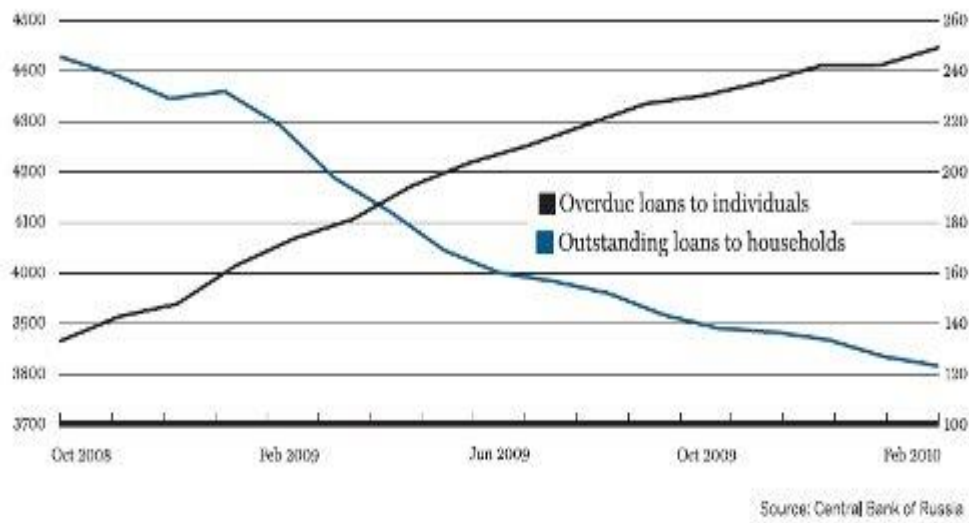
In Russia







Russia retail banking statistics (Rbs bn)

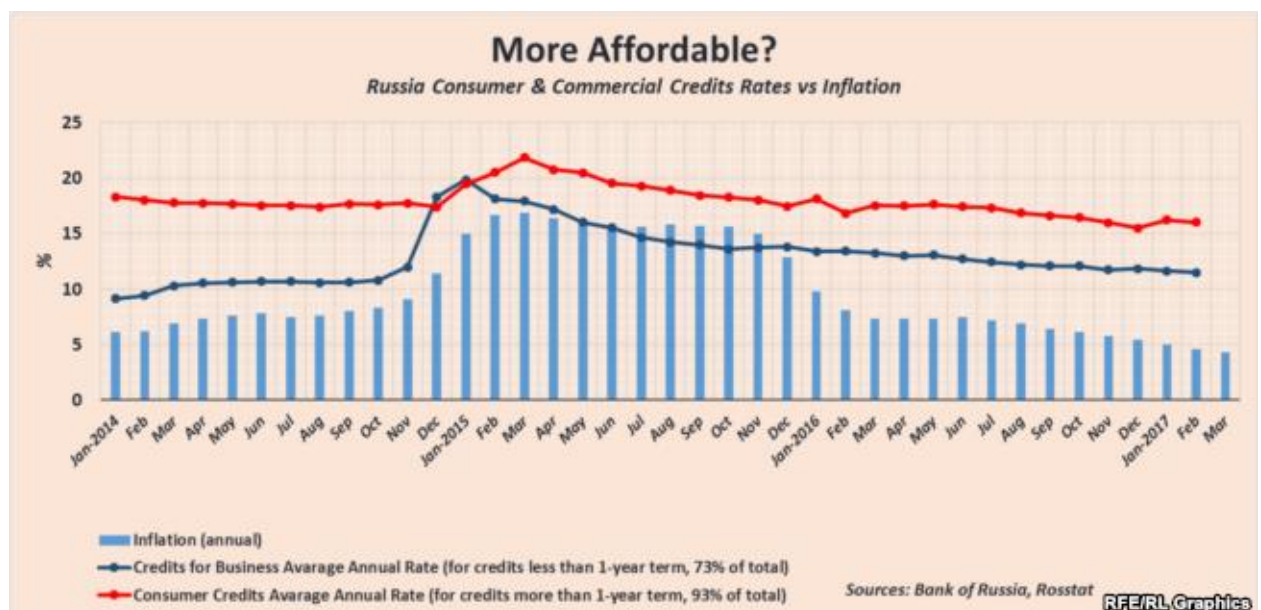
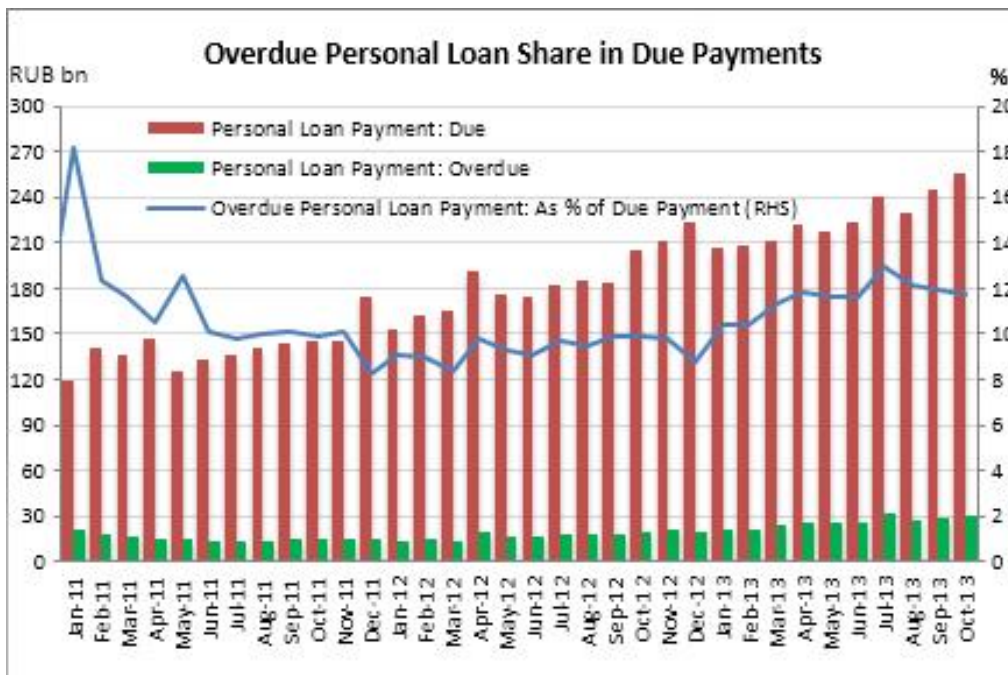


Otkritie, one of ten „systematically imperative" banks, had been minimized by ACRA (Analytical Credit Rating Agency, a rating organization set up by the Russian

government in 2016) to BBB-in July. The rating obliged state-claimed firms to pull back all stores (~Rbs100bn), which incited a bank keep running in August. On August 29, the CBR ventured in, taking a 75% stake in the bank. After fourteen days, B&N, the twelfth biggest moneylender, spoke to the controller after a portion of the banks it procured since 2014 ended up being in a more terrible shape than it had anticipated. Also, the CBR pulled back the permit of Yugra, the nation's 33rd biggest bank, toward the finish of July. In spite of the fact that savers were repaid by the CBR, advertise worries on managing an account segment's steadiness have expanded both home and abroad. The feelings of dread are not without a reason: non-official sources demonstrate the offer of hazardous credits in the segment may be in the scope of 12-18%, the most elevated amount since 2010. In that light, official information proposing that NPLs achieved a level at 11% in the primary quarter of 2016 appear to think little of the genuine size of inconvenience.

Simultaneously with more tightly directions, the national bank means to present a two-layer managing an account framework to stay away from excessively numerous little banks to be constrained bankrupt. Banks will get either "all inclusive" or "fundamental" licenses. The fundamental permit will enable the bank to acknowledge stores from residential people and organizations, open financial balances, profit exchanges, trade monetary forms, issue bank certifications and advances to organizations if the most extreme hazard does not surpass 20% of the bank's capital. For a bank holding an all inclusive permit, a more extensive scope of tasks is permitted. Such banks will have the capacity to acknowledge stores from outside organizations and natives, issue bank assurances to them, and so forth. The change time frame will last until the finish of 2018. Keeps money with essential licenses are required to speak to under 2% of area resources, consequently restricting foundational dangers coming from lighter directions. The fundamental permit likewise confines worldwide tasks, which

will help keeping capital flight from the nation. Regardless of recompenses for "essential banks", the solidification procedure could include encourage bailouts as expanded rivalry could prompt a flight to quality favoring solid, state-possessed banks. Moreover, issues of 'take banks' are presumably not over either until the point when their portfolios are cleaned legitimately.



5.1.2 In Turkey

Problem loans in Turkish Banking System (Million TL)

<http://ogresearch.com/news/is-the-russian-banking-sector-in-crisis???history=0&pfid=1&sample=5&ref=0>

Loan Consumption and Problematic Loans in Turkish Banking System

Years / Indicators	2008	2009	2010	2011	2012
Total Loans	256.036	271.796	361.009	461.100	555.877
Non- Performing Loans	13.216	13.216	13.216	13.216	13.216

In turkey bank industry, when Table-1 is examined, it is seen that credit volume has increased continuously since 2008. The loan volume, which was TL 256,036 million in 2008, increased approximately 118% in 2012 to TL 555,877 million in Turkey. In turkish bank sector, In 2009, there was an increase of about 56% compared to the previous year.

((Optimum Journal of Economics and Management Sciences))

Table-2: Change in Profitability Ratios of Turkish Banking Sector.

Yıllar	Net Dönem Karı/Toplam Aktifler	Net Dönem Karı/Özkaynaklar	Net Dönem Karı/Ödenmiş Sermaye
1998	2,7	44,9	59,6
1999	-0,6	-14,9	-12,7
2000	-3,6	-89,8	-71,9
2001	-3,8	-69,9	-63,4
2002	1,4	11,2	24,0
2005	1,4	10,6	28,5
2006	2,3	18,9	43,4
2007	2,6	19,5	47,0
2008	1,8	15,4	34,6
2009	2,4	18,3	48,9
2010	2,2	16,5	47,6
2011	1,6	13,8	40,3
2012	1,7	13,0	45,1

(TBB)

When we look at table 2, this table show that profitability ratios are negative in the period of 1999 and 2001 crises. The highest profitability ratios are seen in 1998 in Republic of Turkey. In 2011, the return on assets was 1.6% and the return on equity was 13.8%. Both are in a downward trend compared to the previous year in turkish bank sector . In Turkish bank industry, asset profitability is 1.7% in 2012 and return on equity is 13%. Return on equity tends to decline compared to the previous year.

The Banking Sector has achieved an average profit of 14.7% with an equity of 359 billion TL in 2017. Credits: Total loans grew by 21 percent and fixed prices by 8 percent to TL 2.1 trillion (\$ 560 billion). TL loans increased by TL 283 billion in 2017.

(https://www.tbb.org.tr/Content/Upload/Dokuman/7502/TBB_BN_Aralik_080218.pdf)

5.1.3 In Azerbaijan

The amount of overdue loans has increased in Azerbaijan in recent years. the biggest reason is fall of manat. Another reason is that banks have poor credit management.

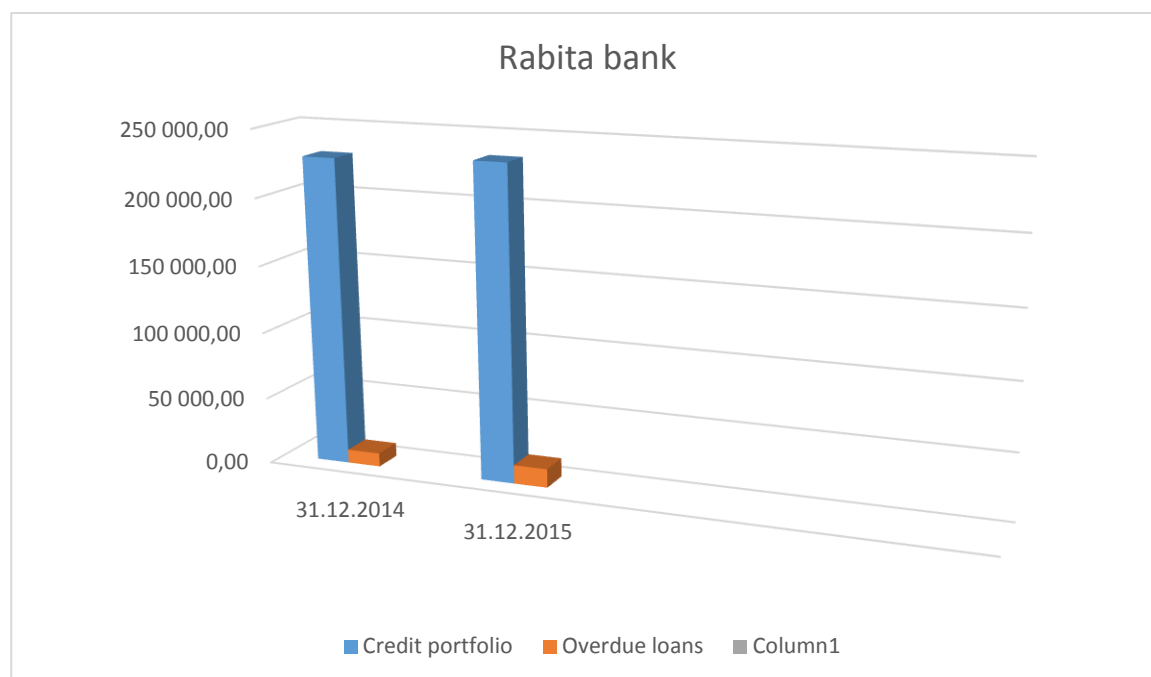
If we look at the many banks' balance sheet, we show many bank's have overdue loans.

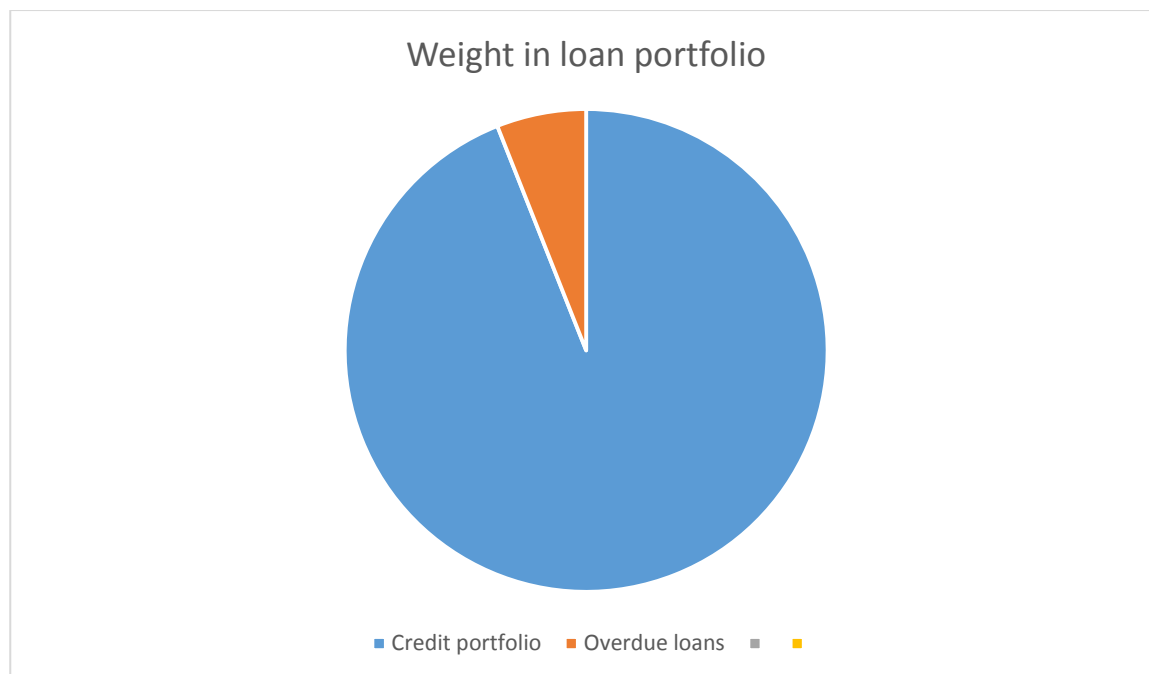
In Rabita bank

Rabita bank is small bank in Azeribaijan. This bank established in 1993. Yasamal branch is first branch of bank. At the same time, Rabita bank have 2 Nakhchivan branch. Rabita bank is one of the member SWIFT.

If we look at Rabita bank's balance sheet, we show:

In 31.12.2015, Rabita bank's Credit portfolio is 233457 Azn. At the same time Rabita bank's overdue loan is 13933.





Xalq Bank

Xalq bank is one of the Azerbaijani banks. This bank established in December 2004. Xalq bank's have big portfolio. Xalq bank is one of the major bank in Azerbaijan bank industry.

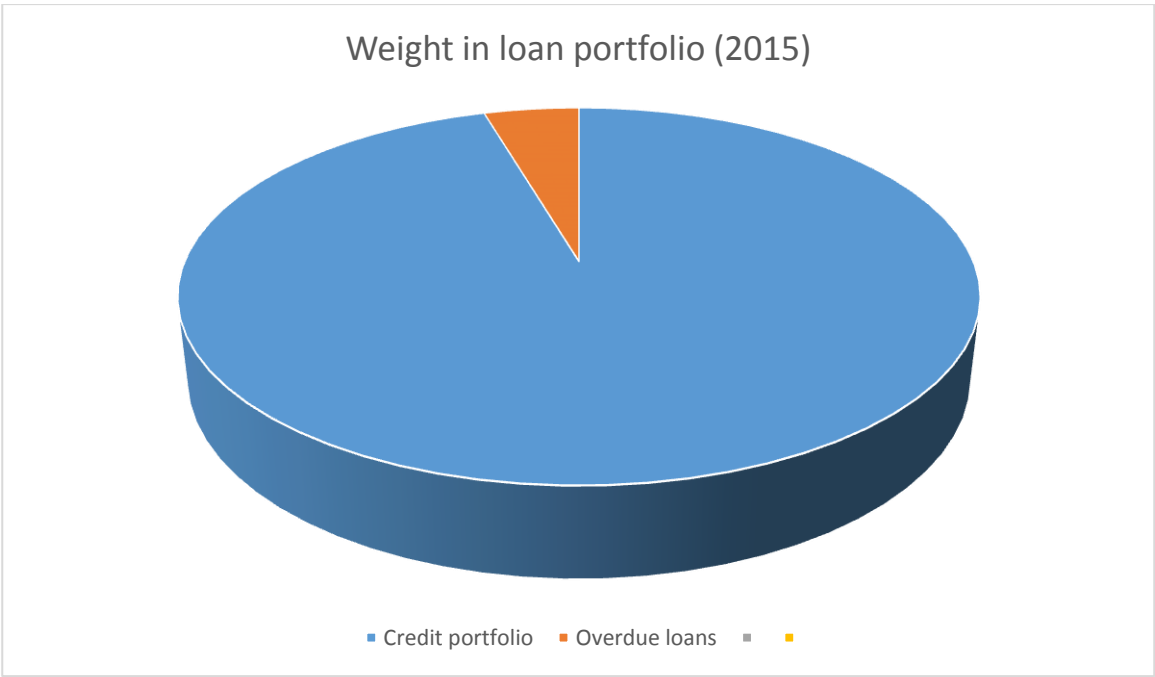
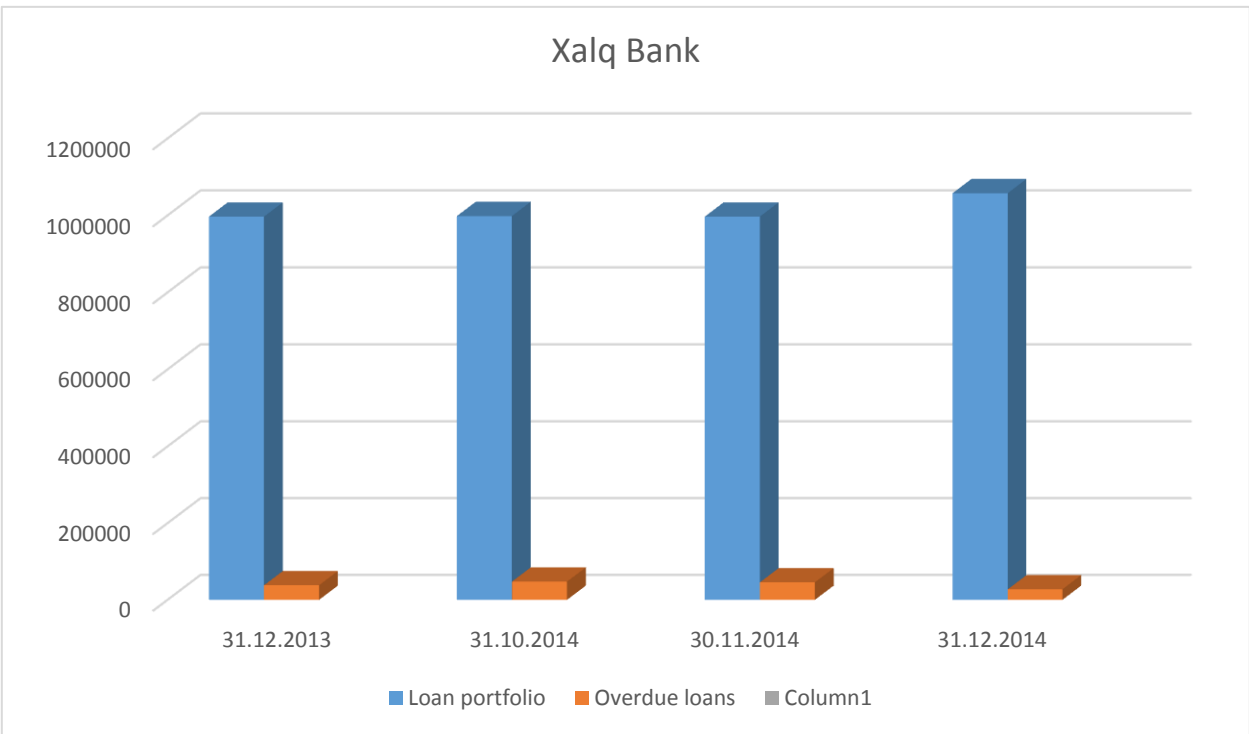
In June 2004, Xalq bank become member of SWIFT. At the same time, Xalq bank one of the Azerbaijan-Russia business chamber.

In July 2007, Xalq Bank became a member of the Azerbaijan Deposit Insurance Fund.

In 2007, "Kapital bank" bought 20% of Xalq bank's shares.

In 2009, this bank celebrate fifth anniversary. At same year Xalq bank moved new head office.

Xalq bank won many international awards. For example, Xalq Bank which is the most important role in Azerbaijan bank industry awarded Best banks of GUAM – 2010 and "European Quality" Award and so on.



Bank of Baku

Bank of Baku founded in 1994, nowadays, «Bank of Baku» is Open Joint Stock Company. First name is “Tuqay kommersiya bankı”. In 1998, Bank of Baku was member of SWIFT. In 2014, Internet banking was activated. In 2014, the number of Bolkart holders exceeded 200000.

Bank of Baku ranks first in the nomination of the Central Bank of the Republic of Azerbaijan for non-cash payments that will most important role in finance industry in future. According to the calculated amount, the most cash converted transactions according to the number of plastic cards were realized in POS terminals and ATMs of Baku Bank.

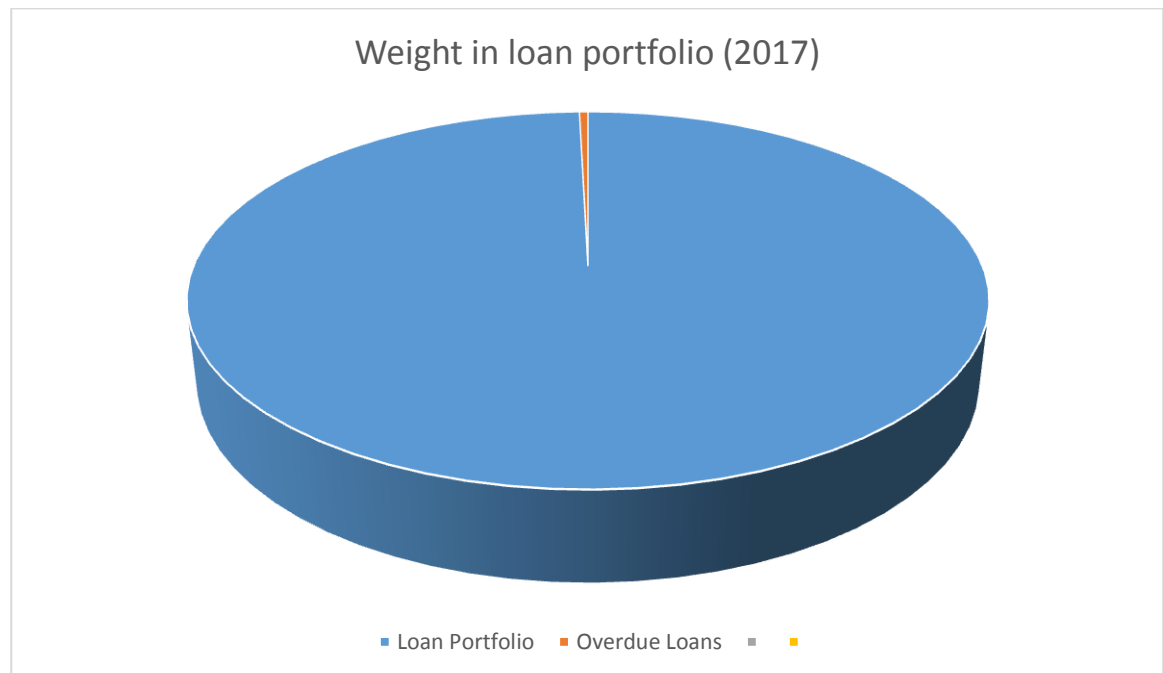
“Bank of baku” partnership with:

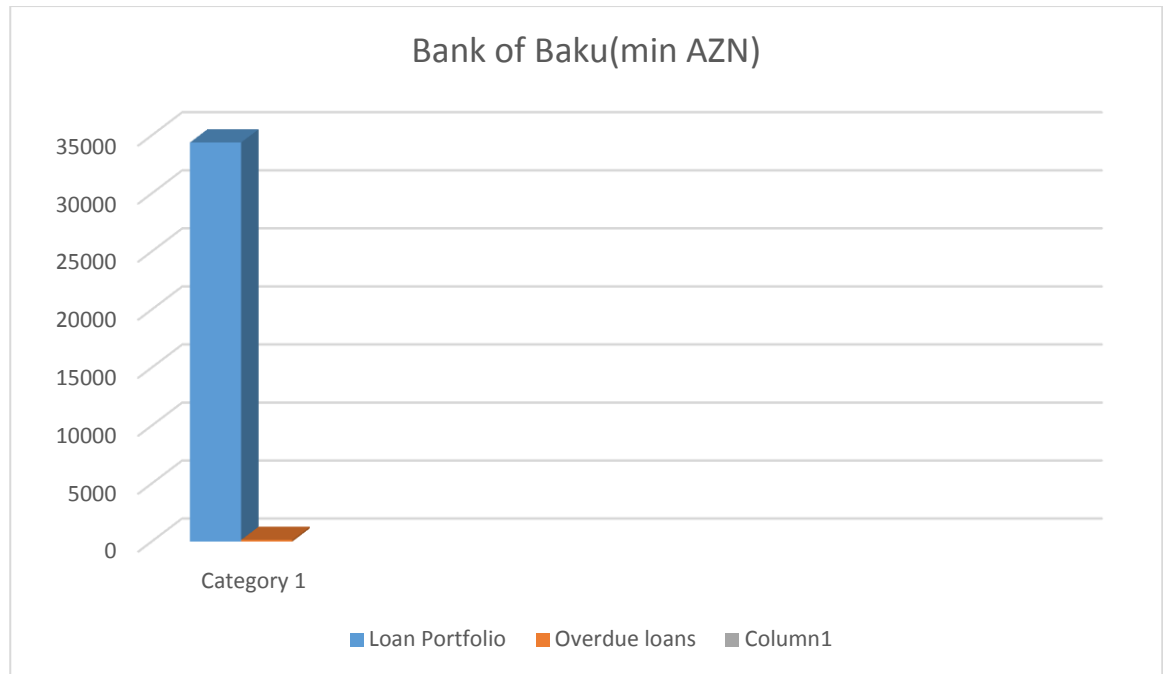
Visa

Mastercard

European bank

Bank of Georgia

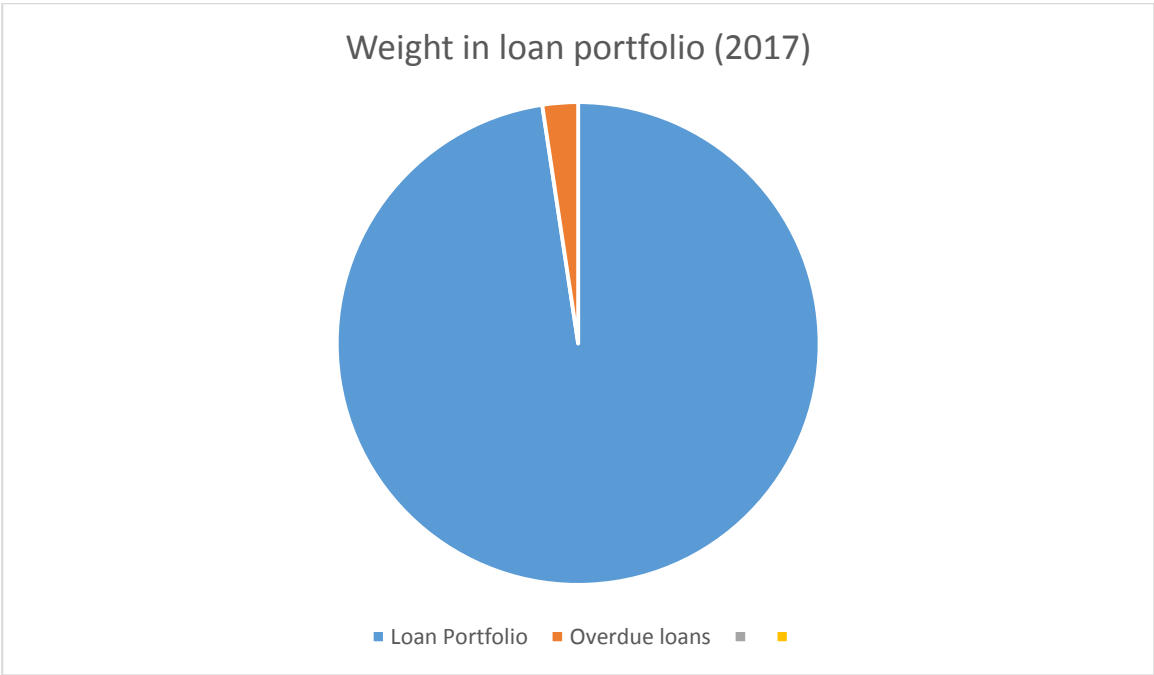
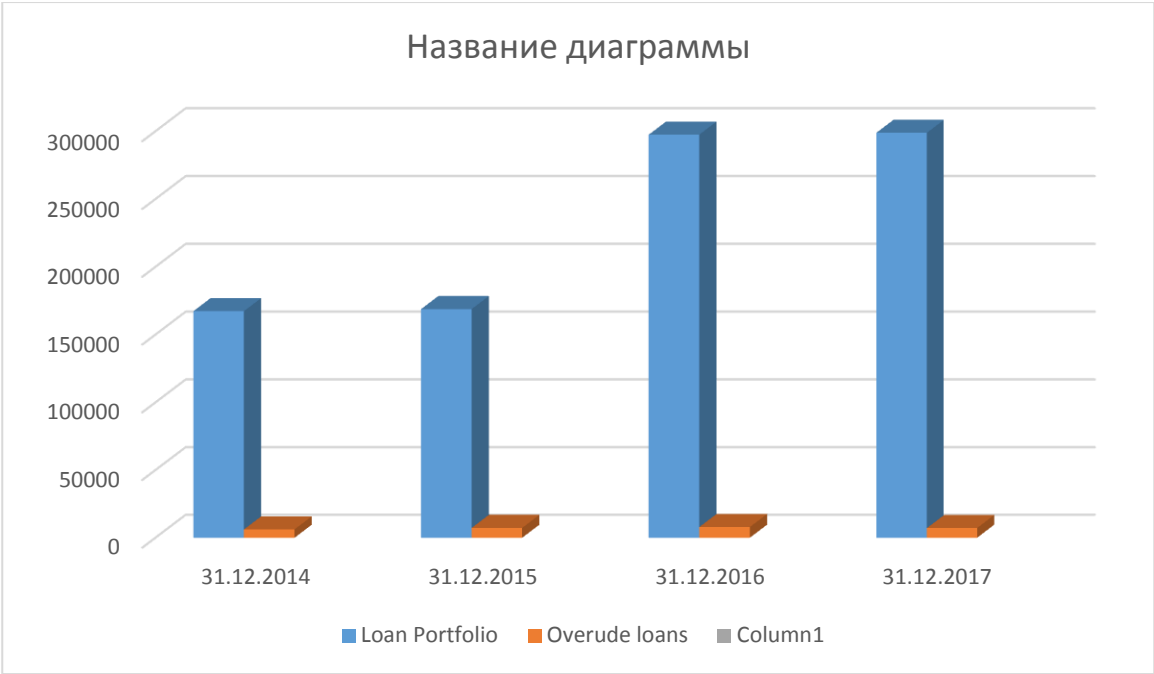




Azərbaycan Sənaye bankı (ASB)

ASB founded in 1996. In 1997, Became a member of Baku Interbank Currency Exchange (BICE).

In 2000, partook in the foundation of Baku Stock Exchange. At same year, Became an individual from Azerbaijan Banks Association (ABA).

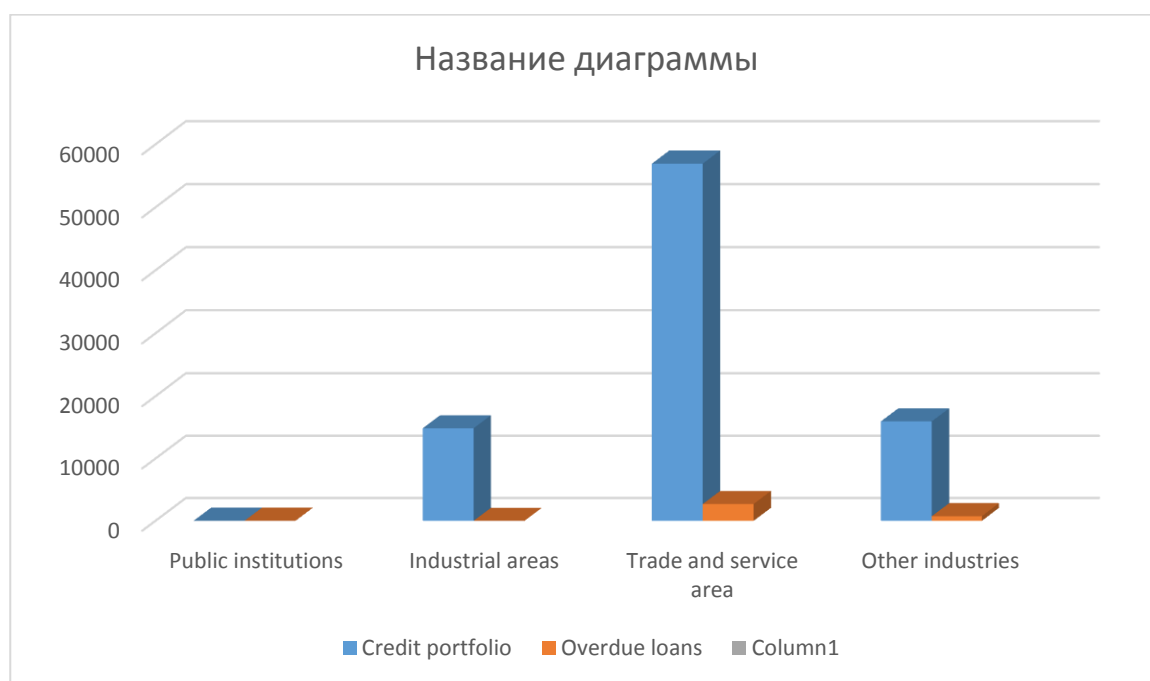


NBCBank

NBCBank registered at the National Bank of Azerbaijan in 1992. NBCBank was renamed to “NBCBank” in 2002. NBCBank is open stock company(2005).

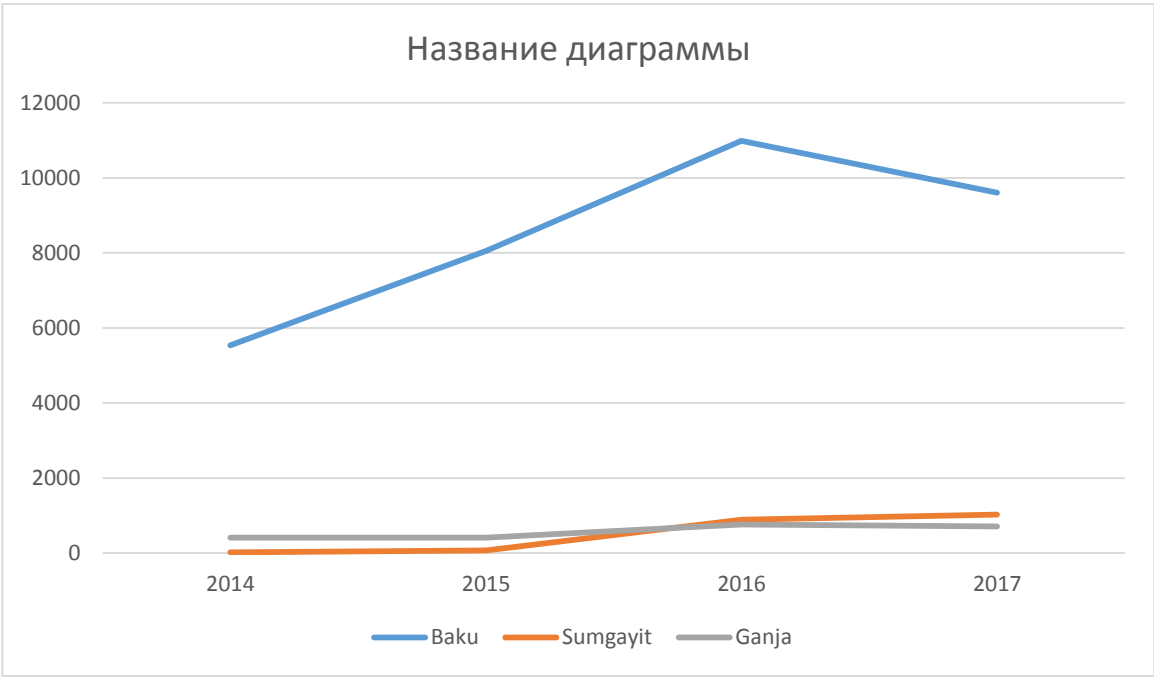
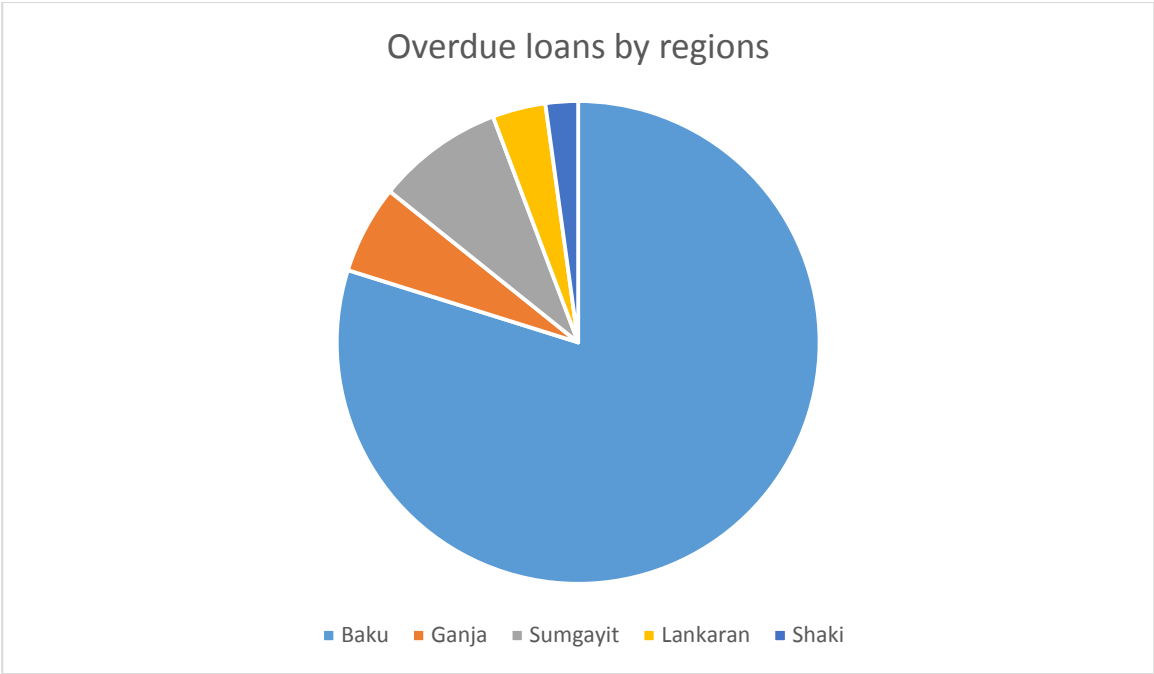
NBCBank has 11 branches (7 branch in Baku, 4 branch in regions). NBCBank” OSC has 17 ATMs in Azerbaijan. NBCBank has many awards.

Overdue loans in the fields of economy (NBCBank report min manat) - 2017

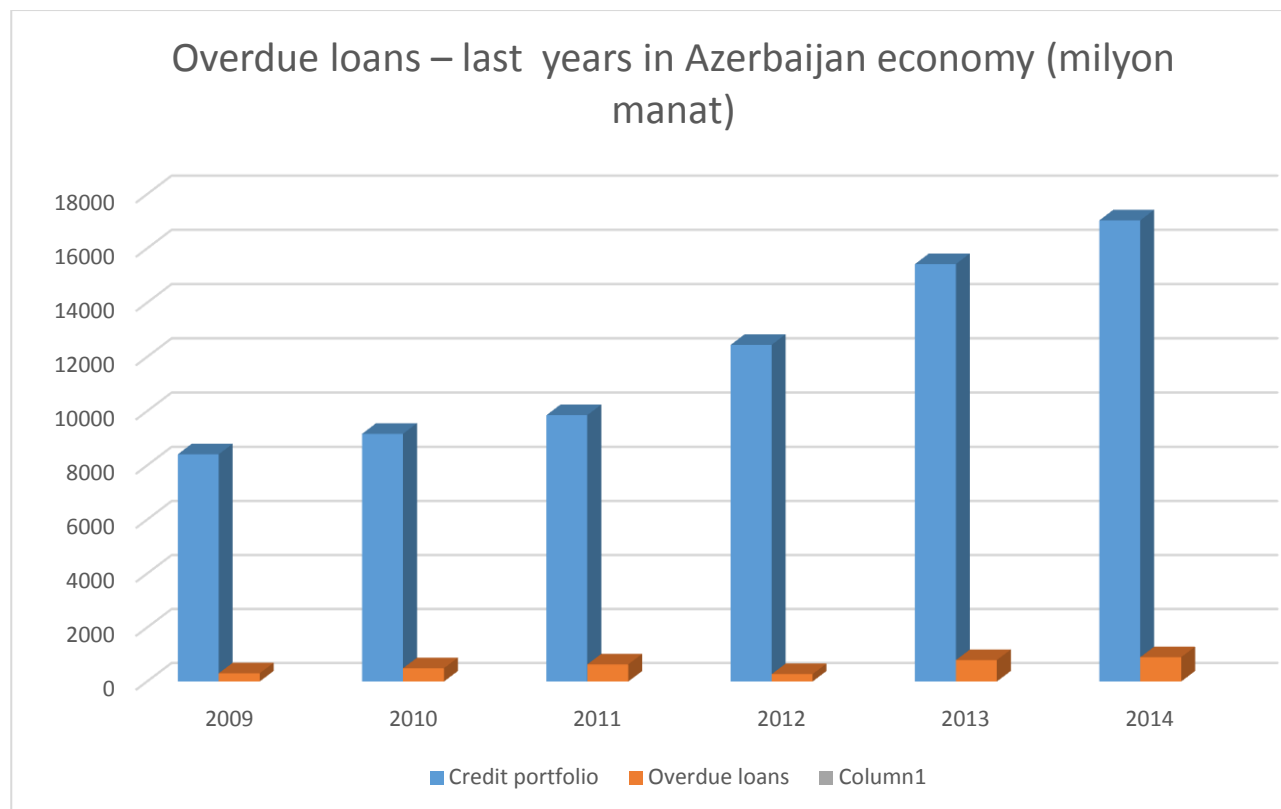


Overdue loans by regions - 2017

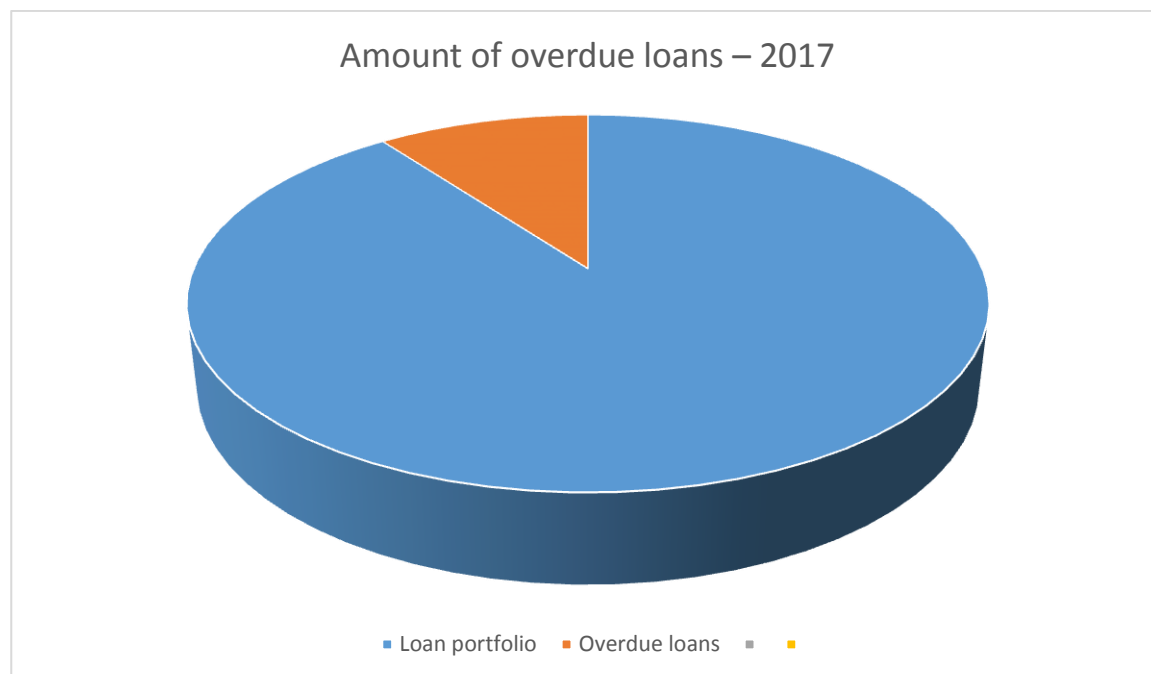
As can be seen from the pie chart, most of the part problem loans have to the city of Baku. The biggest reason for this is that the majority of the population is here and it is the main shopping center. Many banks' headquartered is located in Baku. This reason show that why problem loans is center in Baku. At the same time, Sumgayit is one of the city in Absheron region. And Sumgayit is second city which overdue loans by regions.



Overdue loans – last years in Azerbaijan economy (milyon manat)



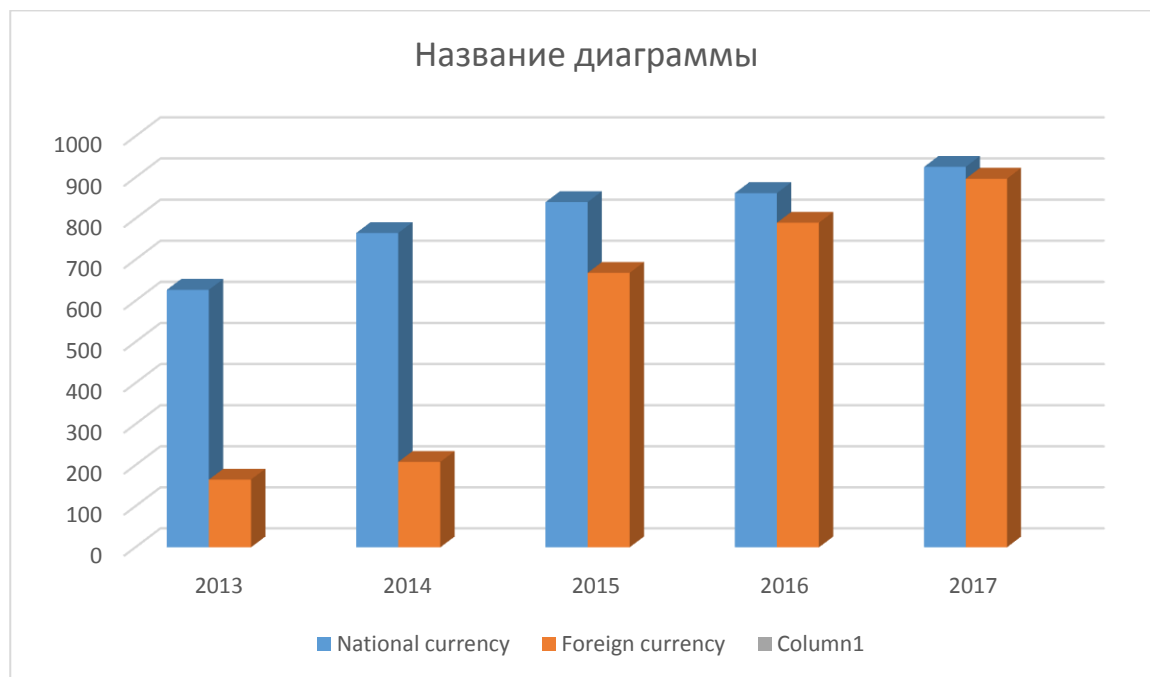
Amount of overdue loans – 2017



Consumer credits is most part of the problem loans in Azerbaijan bank industry. In last years, Central bank of Azerbaijan made a serious decision in overdue loans but

nevertheless problem loans increase in Azerbaijan. In Azerbaijan bank industry, Loan portfolio decreased by 21.1 percent compared to April 1, 2016. Central bank of Azerbaijan restricted banks about loans. But this decision don't show positive results. In last five years, overdue loans rise approximately 600 million manat. This means about three times the increase over the last five years in Azerbaijan banking industry.

Overdue loans by national and foreign currency (million manat)



	De c-2013	De c-2014	De c-2015	De c-2016	Au g-2017
Nat ional currency	627	765	840	682	926
For eign currency	165	208	266	279	289

This column show that, Total overdue loans increase 87 percent since December 2014. Overdue loans increase 21 percent in national currency at same time, overdue

loans increase 330 percent in foreign currency. The biggest reason is the devaluation in 2015.

6. Solutions

Everyone says that the biggest cause of these problems is the central bank or the other banks. I do not agree with that. People who take credit they are biggest reason loan problems. Citizens take credit more than their repayment ability. At the same time, Azeri people take new credit for repayment past credit. This situation is the biggest credit management problems in Azerbaijan banking industry.

Solution:

Central bank and commercial banks should be making more stringent demands in the loan process. And Commercial bank should be good credit analysis when in the loan process.

In Azerbaijan, There is a need to toughen legislation against borrowers who delay the loan. Because borrowers who delay to loan misuse suitable poor legislation.

In this area in general, the legislation is very limited. If you look at the experience of USA, France, Germany, Turkey, Norway and Sweden there are legislative acts and ethical codes in bank industry. In France, Germany, Turkey, Norway, Sweden and other European countries, even if a civilian does not pay off the debts, the utility costs (for example, Gas, electric, phone) first paid to its debt to the banks. The remaining amount is credited to its utility debts. These issues are not regulated in the legislation at present in our country.

The main problems is connection with unsecured loans, which there is no guarantee these loans. At the same time, Banks may be able to reduce the problem portfolio by selling troubled assets. It is good solution and It is widely using in world practice. Many European countries and USA use this practice.

One of the biggest problems is the credit rules which people don't know. People should be read credit rules before take credit.

In Azerbaijan, there is a need to develop a special program that envisages systematic activities of banks. American and european experience shows that with such a program it is possible to solve problems of banks as well as problems of problem loans. Financial Market Supervisory Authority (FIMSA) should be create new rules about credit process and credit problems.

6.1 Prevention of holding banking

In Azerbaijan, many holdings have bank company. These types of banks help holding activities. Sometimes come up financial problems in these types of banks. Financial Market Supervisory Authority (FIMSA) should be regulate these banks and monitoring Holding activities.

Banks should be good carry out credit policy and credit risk management.

These activities is most important part of credit management and need good bank manager and employees in banks.

Azerbaijan banks give credit with high interest rate. Our banks should comply with world practice. It is important part of integration to globalism and global economy.

7. Conclusion

Bank system is most important part of Azerbaijan Economy.

Any problem that may arise in the banks can lead to a crises for the country's economy. Banks should closely follow the customers both when giving credit and when after giving credit.

The banking system's wrong operation will damage the country's economy after a while. So the banks need to be supervised by the government.

Proper implementation of banks' risk policies is crucial both for the banking system and for the future of the country's economy.

both the borrowers and bank workers must be well educated about credit risk and credit repayment.

With the advancement of technology, the banking system will have an important place in everyone's life. So the banking system must be in good condition.

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