ADDIS ABABA UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

MASTER OF BUSINESS ADMNISTRATION (IN FINANCE)

ASSESSMENT OF LOAN RECOVERY PERFORMANCE OF DEVELOPMENT BANK OF ETHIOPIA (DBE)

BY

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MAY, 2020
ADDIS ABABA, ETHIOPIA

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A THESIS SUBMITTED TO ADDIS ABABA UNIVERSITY SCHOOL OF GRADUATE STUDIES IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA-FINANCE)

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MASTER OF BUSINESS ADMNISTRATION IN FINANCE

This is to certify that this Thesis is prepared by Ato. Ermias Mekonnen entitled: Assessment of loan recovery performance of Development Bank of Ethiopia Submitted in Partial Fulfillment of the requirements of degree of Masters of business administration in finance complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

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Declaration

I hereby declare that this thesis is my original work has not been presented for a degree in any other university and all sources of materials used for the thesis has been duly acknowledged.

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Acronyms

ADLI- Agriculture Development Led Industrialization Strategy

CDD-Customer due diligence

DEB-Development Bank of Ethiopia

GDP - Gross Domestic Product

MENA-Middle East and North Africa

NBE - National Bank of Ethiopia

NPL- Non-performing loans

OLS- Ordinary Least Square

ROA-Return on Asset

SMEs- Small and Medium Enterprises

Contents

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ABSTRACT

The study examines the loan recovery performance of DBE. To achieve this objective the research methodology adopted both descriptive and analytical research design. Data was collected from primary and secondary sources. Primary data was collected by using questionnaire. A sample size of 73 respondents were taken from the bank's credit process, project rehabilitation and loan recovery teams by using Simple random sampling method. Secondary data was retrieved from DBE Supervisory reports and also from DBE annual reports, bulletins, manuals, directives and procedures issued by the bank. In the study SPSS were used to analyze the data. The finding from the questionnaire revealed that rate of inflation; Gross Domestic Product and interest rate are the major macro-economic factors that affect the loan recovery performance of the bank. On the other hand malpractice of loan police and procedures, lack of close follow up, lack of skilled man power, and in adequate customer due diligence assessment are the major bank specific factors that lower the loan recovery performance of the bank. The researcher recommends that the bank should provide Loan advisory service before and after the loan, and the Bank should developed strong credit assessment and follow up to reduce the amount of NPL.

***Key Terms**: Nonperforming loan, loan recovery and DBE*

CHAPTER ONE

1. INTRODUCTION

1.1 Background of the study

The banking business, compared to other types of business, is substantially exposed to risks, especially in this ever-changing competitive environment. Banks no longer simply receive deposits and make loans. Instead, they are operating in a rapidly innovative industry with a lot of profit pressure that urges them to create more and more value-added services to offer to and better satisfy the customers. Risks are much more complex now since one single activity can involve several risks (Dam, 2010).

Banks form a crucial part of the financial market and any moves by banks can have immediate impacts on the country's or even the global financial healthiness. The world has been observing a lot of crises stemmed from banking institutions then spread to the whole financial sector, typically of which is the 2008 economic downturn. The issue of a safe and sound banking sector and the importance of a feasible risk management framework in banks are now more alarming than ever (Dam, 2010).

Businesses in general and banks in particular have been aware for many years of hazards and uncertainties arising from information technology (IT) infrastructure, human motivation and fraud, business disruption, legal liability and many similar issues. Developments in modern banking environment, such as increased reliance on sophisticated technology, expanding retail operations, growing e-commerce, outsourcing of functions and activities, and greater use of structured finance (derivative) techniques that claim to reduce credit and market risk have contributed to higher levels of operational risk in banks (Greuning and Bratanovic, 2003).

According to Nazanin and Kateryna (2015), one of the main causes of major failures at banks until now was the lack of attention to risk management in general and to operational risk management in particular. The relevance of this issue has grown in addition to operational risk management challenges concerning risk culture, internal control and risk governance (Schwarts and Garliste, 2013).

In addition to credit, liquidity and market, operational risk is the other significant risk in banks. These risks are all interconnected to each other, but for the purpose of this research the focus is only on operational risks and how they should be managed. Although the recent financial crisis has been generally characterized as a liquidity crisis, operational risk and its factors have played a significant role in crisis length and severity (Jongh and Vuuren, 2013). Therefore, the need to explore the concept of operational risk has increased significantly.

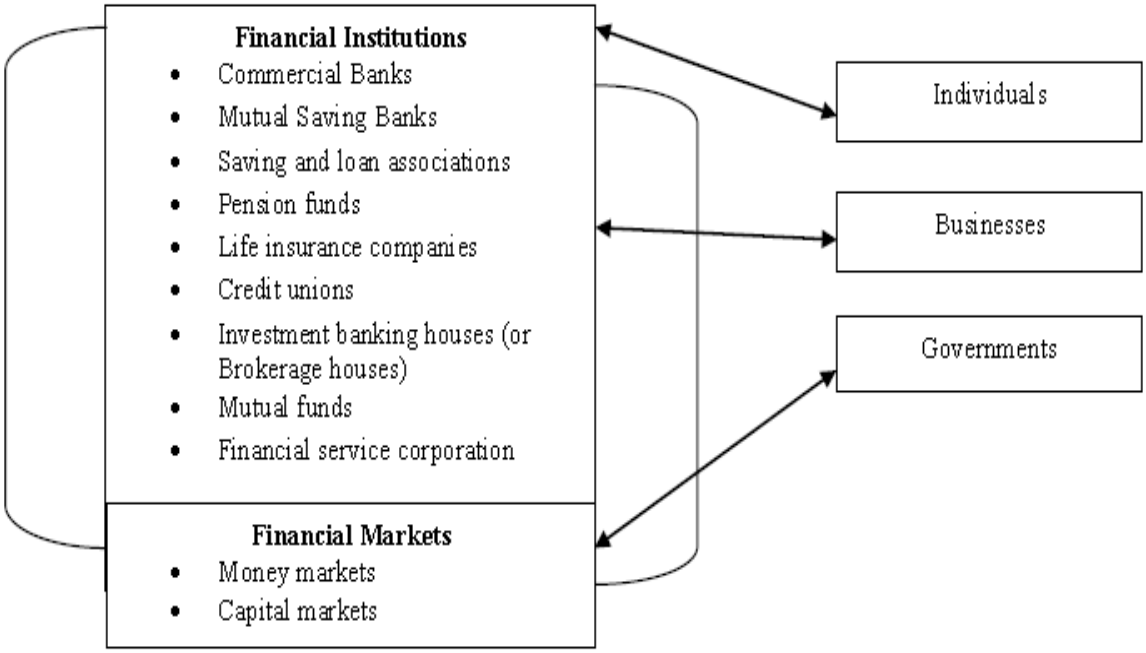
To achieve the objectives of circulating more and more financial resources to meet the increasing demand for credit and to keep the Bank in sound financial position, the loans extended to various sectors of the economy must be recovered in full. Both the principal which is used for re-lending as well as the interest to meet the operating costs must be recovered. However, for the last many years the Bank's loan repayment performance has been very low due to various factors. These factors may explain among others the loan repayment behavior of borrowers and lending behavior of the Bank. This has an impact on the sustainable provision of credit to the potential investors and existence of the bank as a financial institution (DBE Annual Report, 2018). Knowing these factors will assist the Bank in its continuous efforts to recover its existing loans and to set ideals for forthcoming ones. Therefore, loan recovery is considered as a crucial factor affecting the liquidity and profitability of the bank. Thus, the present study will examine factors that affect loan repayment performance of projects financed by Development Bank of Ethiopia.

The researcher strongly believes that identifying the factors affecting loan repayment performance of projects would enable the bank's management to tackle and minimize the problems and consequently will enhance its loan recovery performance.

In light with the above points, the general objective of the study is to assess the loan recovery performance of DBE, by combining both macroeconomic and bank specific factors. The study used ten years audited financial statements of DEB, from 2009/2010 to 2017/18.

1.2. The Role of DBE as a financial Institution

Figure 1: Flow of funds in the economy (Suppliers and Users of Funds)



Source: *Adapted from Shim & Siegel (2007).*

Development finance institution means an institution which is engaged mainly in medium and long term project finance business, with the purpose of promoting development in the industrial, agriculture, construction, services, commercial or other economic sectors (NBE Directive, 2012). Development Banks are state backed financial institutions that are engaged in the provision of long term loans to not only profitable projects but also to socially beneficial ones. The rapid industrialization in many countries in the 19th century was achieved by state provision of long term loans to risky projects via Development banks, (Diamond, 1957; Boskey, 1961). Accordingly, the credit policy of Development Bank of Ethiopia (2009) details the governing operational principles and guidelines of the Bank for achieving its dual objectives of (1) providing customer focused and efficient credit services and (2) maintaining its own financial health and sustainability (DBE Credit Policy, 2009).

A healthy economy depends heavily on efficient transfer of funds from savers to individuals, businesses, and governments who need capital. Most transfers occur through specialized financial institutions, which serve as intermediaries between suppliers and users of funds.
The financial system has diverse and important roles to play. Perhaps the most important is to transfer funds from surplus to deficit economic units in the most efficient way possible (Pilbeam, 2005). People who have the money but who do not have business skill need to save it in a bank rather than putting it at home under their mattresses so as to be safe and not to make their resource sterile as it will generate interest when it is deposited at banks. Inversely, those who have developed entrepreneurial skill but running with a short of finance are ready to take loan. Since it is very difficult for the surplus and deficit units to meet each other due to asymmetric information (more sever in developing countries), there is a need to have an intermediary institution or Bank (Pilbeam, 2005). Therefore, the existence of a development finance institution like Development Bank of Ethiopia (DBE) in the economy is undeniably important.

The recent focus of the government in relation to the revised credit policy of DBE is to provide medium and long term loans for investment projects in the Government priority areas such as Commercial Agriculture, Agro-processing, Manufacturing Industries, Mining and Extractive Industries preferably, export focused as well as lease financing for Small and Medium Enterprises.

1.2.1. Services

1. 2.1.1. Credit Services

• The Bank extends loan services to applicants after undertaking appraisal studies in reliable methods to ascertain the viability of the proposed projects.
• The Bank provides technical support to new applicants and its clients.

1.2.1.2. Banking services

The Bank provides banking services such as deposit facilities in the form of time deposit and current accounts as well as money transfer services. These services are provided to its clients and

funding institutions. The Bank also gives international banking service and related activities, providing L/C services to its clients to import capital goods and raw materials and to export produces.

1.3. Statement of the Problem

Credit has long been recognized as one of the important tool that supports the success of development project which contributes towards economic development. Similarly DBE provides sustainable credit facility for those engaged in agriculture, industrial and other service sectors which can result in development of the country. So, in order to maintain this objective the bank needs to strengthen its liquidity position by enhancing its loan recovery. However, provision of credit alone does not support the economic development of the country unless it is accompanied by the existence of factors necessary for efficient utilization of the fund in order to repay the loan in accordance with the agreement. Based on strategic objective of the government, term loan projects financed by the bank has long loan repayment period which extends up to twenty years including maximum five years of grace period. Moreover, low interest rate than commercial banks, which is 9.5% for priority area projects and 12% is for non-priority area projects, and suitable rehabilitation mechanism makes the bank different from other lending institutions (DBE Loan Manual, 2018).

The sustainability of the bank depends not only on domestic and foreign source of fund but also on its loan recovery rate too. The loan repayment performance of its clients should be effective so that the bank will be sustainable as a bank and will have a bankable asset quality. One of the measurements by which bank's asset quality can be measured is the nonperforming loan ratio (NPLs ratio). Hence, in order to get soft loan from its lenders, DBE's asset quality has to be regularly monitored and assessed whether it is within the acceptable standard or not that is 15% of the total outstanding loan which is set by Association of African Development Finance Institutions.

The increasing level of Non-performing loans may lead to very serious implications. For instance, it discourages the financial institution to refinance the defaulting client, which put the

defaulters once again into vicious circle of low productivity. Most of the default arose from poor management procedures, loan diversion and unwillingness to repay loans, etc. Because of this, the lenders must give various institutional methods that aimed to reduce the risk of loan default (Ahmmed *et al.*, 2012).

Consequently, to reduce the default rate and to enhance the sustainability of the bank, it is imperative that identifying the various factors which significantly affect the loan repayment performance from internal and external side. Hence, this study was aimed at identifying the factors that affect loan recovery performance of Development Bank of Ethiopia (DBE).

The trends of NPL in DBE had shown a great reduction from 25% in 2009/2010 to 11.67% in 2010/11(DBE annual report 2010/11); however, the NPL of the bank strictly increases from 2013/14 and reached at 34% in 2017/2018 (DBE annual report 2017/18) which is high as compare to the acceptable threshold level in NBE below 5%. This paper is different from other researchers conducted previously such as (Mamuye Abdeta, 2015); it focuses on determinants of nonperforming loan in DBE. The number of studies conducted on loan recovery performance so far is few in number and limited in scope, in which further study is required.

Besides, the researcher find out that most of the researches conducted previously related to determinants of nonperforming loan by only considering bank specific factors, but this paper focus on macroeconomic and bank specific factors that affect loan recovery performance of DBE.

1.4. Research Questions

This study attempts to answer the following questions.

1. What macroeconomic factors affect loan recovery performance?
2. Is there a relation between bank specific factors and loan recovery performance in DBE?
3. What does the bank loan recovery performance looks like?
4. How does the credit policy of DBE'S looks like?

1.5. Objective of the Study

1.5.1. General objective

The general objective of the study is to assess the loan recovery performance of Development Bank of Ethiopia.

1.5.2. Specific Objective of the study

In line with the general objective the study has the following specific objectives:

1. What macroeconomic factors affect loan recovery performance?
2. Is there a relation between bank specific factors and loan recovery performance in DBE?
3. What does the bank loan recovery performance looks like?
4. How does the credit policy of DBE'S looks like?

1.6. Significance of the Study

The effective management of credit risk is a critical component of comprehensive risk management for long-term success of a banking institution. Only those banks that have efficient risk management system will survive in the market in long run. However, there are factors that affect the credit risk management situation. Analyzing such factors and formulating proper solutions are essential to expand the activities of banks in a sustainable manner. As a result, this study aimed to assess factors that contribute loan recovery performance. The results of the study will provide a better understanding and awareness to policy makers, to design an effective and efficient strategy for the improvement of nonperforming loan and get insight on what it takes to improve their loan qualities and the National bank to examine asset quality of banks. In addition, this study will serve for the other researchers as a reference. Finally, the research findings will be used by the bank for its best achievement in relation to risk management.

1.7. Scope of the study

The study was focuses on projects financed by development bank of Ethiopia. Development bank of Ethiopia is selected to other types of local banks for the reason that it is engaged in long term loans which by their nature are risky with regard to getting them paid back. Hence, factors affecting Non-performing loans in all regions of DBE are assumed to be similar. Furthermore, since the Bank under consideration has the same credit policy and loan procedures (from application for loan up to loan collection) throughout its all offices, a study in DBE head office were assumed to be representative. Moreover, the data collection process will be difficult as there was no organized database to collect the data. Thus, this was limited to both macro-economic and bank specific factors affecting loan recovery performance of Development bank of Ethiopia head office.

1.8. Organization of the study

The remaining part of the thesis was organized as follows. The second chapter deals with theoretical and empirical literature review related to the topic. The third chapter of the paper describes the materials and methodology part of the paper. In the fourth chapter deals with empirical results and discussion is presented. Finally, in the last chapter constitutes the summary, conclusion and recommendation part of the thesis.

CHAPTER TWO

2. Review of Related Literature

2.1. Theoretical Review

In the past decades there have been major advances in theoretical understanding on the role of credit markets. These advances have evolved from a paradigm that emphasis the problems of imperfect information and imperfect enforcement (Hoff and Stiglitz, 1990). They pointed out that borrowers and lenders may have differential access to information concerning a projects risk, they may form different appraisal of risk. So what is clearly observed in credit market is asymmetric information, where the borrower knows the expected return and risk of his/her project, whereas the lender knows only the expected return and risk of the average project in the economy.

Four common problems that faced lending institutions such as banks in the course of undertaking credit activities are:

- To find out what kind of risk the potential borrowers have (adverse selection).
- To make sure that borrower will utilize the loan properly once made, so that he/she will be able to repay it (moral hazard).
- To learn how the project really did in case the borrower declares his/her inability to repay and,
- To find methods to force the borrower to repay the loan if the borrower is reluctant to do so (enforcement).

From the above problem imperfect information and enforcement leads to inefficiency of credit market which in turn leads to loan default. Thorough credit assessment that takes into account the borrowers` character, collateral, capacity, capital and condition (what is normally referred to in the banking circles as the 5C`s) should be conducted if they are to minimize credit risk (Ghatak and Guinnane, 1999).

Banks in many developing countries hold a truly an alarming volume in non-performing loan. The differences between promised and actual repayments on loans are the result of uncertainty concerning the borrower's ability or willingness to make the repayments when they are due which creates the risk of borrowers default (Pischke, 1991; Vigano, 1993; Kitchen, 1989). The

inapplicability of the standard demand and supply model for credit market give rise to credit rationing phenomena. Credit rationing as defined by Jaffee (1971) is the difference between the quantity of loans demanded and loans supplied at the ruling interest rate. In this case lending institutions make use of their own screening criteria to identify credit worthy borrowers so as to decrease the probability of default.

The probability of regular repayment depends on objective factors related to the borrower's operating environment, the borrower's personal attitude towards loan obligation, and the bank's ability to evaluate these two aspects through the information it has and to control credit risk specific contractual conditions. The author argues that the failure of lending agencies in playing their roles in loan disbursement and recovery process is a major contribution to loan default. Determining credit worthiness requires investment of time and resources to evaluate firm specific and industry wide variable, structural or cyclical, by analysts with specific professional skills. A mistake on the evaluation of the borrowers' characteristics or the introduction of inappropriate loan conditions may increase the total risk of the transaction (Vigano, 1993).

2.1.1. Nature and Definition of Nonperforming Loan

The principal activity of banks is making loans to its customers. In allocating funds, the primary objective of bank management is to earn income while serving the credit needs of its community. Lending represents the heart in banking industry. Loans are the dominant asset and represent fifty percent to seventy five percent to the total amount of banks assets. In most banks loans generate the largest share of operating income and represent banks greater risk exposure (Mac Donald and Koch, 2006).

Loans and advances are the most profitable of all assets of a bank. These assets constitute the primary source of income by banks. As a business institution, a bank aims at making a giant profit. Since loans and advances are more profitable than any other assets, it is willing to lend as much of its funds as possible. But banks have to be careful about the safety of such advances (M.

Radha and SV. Vasudevan. 1980). from management accounting point of view, bank asset quality and operating performance are positively related. If a bank's asset quality is inadequate (*e.g*. the loan amount becomes the amount to be collected), the bank will have to increase its bad

debt losses as well as spend more resources on the collection of non-performing loans, this increase non-performing loans (Hassan.S.2010).

Non-Performing Loan (NPL) is one of the concrete embodiments of credit risk which banks take. The high amount of NPLs represents high credit risk in today banking system and this encounters banks with market risks and liquidity risk. They have greater implication on the function of banks as well as overall financial sector development (Ekrami and Rahnama, 2009). In line with the above idea Daumont .et. al (2004) found the accumulation of nonperforming assets to be attributable to economic downturns and macroeconomic volatility, terms of trade deterioration, high interest rates, excessive reliance on overly high-priced interbank borrowings, insider lending and moral hazard.

Machiraju (no date) sited in Wondimagegnehu N (2011) clearly point out non- performing loans as a leading indicator of credit quality for banks. Bhide, *et.al.* (2003) has noted among various indicators of financial stability, banks' non-performing loan assumes critical importance since it reflects on the asset quality, credit risk and efficiency in resources allocation to productive sectors. Historically, the occurrence of banking crises has often been associated with a massive accumulation of non-performing loans which can account for a sizable share of total assets of insolvent banks and financial institutions, especially during a period of systemic crises.
Nonperforming loans generally refers to loans, which for a relatively long period of time do not generate income; that is the principal and/or interest on these loans has been left unpaid for at least 90 days.

The economic and financial costs of bad loan are significant. Potentially, these loans may negatively affect the level of private investment, increase deposit liabilities and constrain the scope of bank credit to the private sector through a reduction of banks' capital, following falling saving rates as a result of runs on banks, accumulation of losses and correlative increased provisions to compensate for these losses. Impaired loans also have potential for reducing private consumption, and in the absence of deposit guarantee mechanisms to protect small depositors can be a source of economic contraction, especially when coupled with declining gross capital

formation in the context of a credit crunch caused by erosion of banks' equity and asset (Fofack, 2005).

When lending funds are lend their money to the borrowers who are willing to pay higher rates to earn large amount of profit increases the risk exposure of banks, which can be considered negligence on the part of mangers, because they prefer the short term profits and ignore the future loan defaults (Ahmad F and Bashir T 2013. p.1221). Criterion for identifying non-performing loans varies throughout the world even between African countries. Some countries use quantitative criteria to distinguish between "good" and "bad" loans (e.g., number of days of overdue schedule payments), while others rely on qualitative standards (such as the availability of information about the client's financial status, and perspectives about future payments). However, the Basel II Commission emphasizes the need to evolve toward a standardized and internal rating-based approach (Fofack, 2005). Accordingly, the Basel committee puts non-performing loans as loans left unpaid for a period of 90 days.

The definition of NLP varies across countries; there is no global standard to define nonperforming loans at practical level. Saba I**,** et al. (2012:127) argues that non-performing loan (NPL) is a sum of borrowed money upon which the debtor has not made his or her scheduled payments for at least 90 days. Nonperforming loan is either in default or close to being in default. Once a loan is nonperforming, the loans that it will be repaid in full are considered to be substantially lower. If the debtor starts making payments again on a nonperforming loan, it becomes a re-performing loan, even if the debtor has not caught up on all the missed payments. This is why most countries provide their own rules regarding NPLs. performing loans are further defined as loans whose cash flows stream is so uncertain that the bank does not recognize income until cash is received, and loans those whose interest rate has been lowered on the maturity increase because of problem with the borrower.

Caprio and Klingebiel (1996), cited in Fofack (2005), who define non-performing loans as those loans which for a relatively long period of time do not generate income that is, the principal and or interest on these loans have been left unpaid for at least ninety days. The authors further supported that non-performing loans are the loans which are not generating income. Nonperforming loans are also commonly described as loans in arrears for at least ninety days and

non-performing loans have been widely used as a measure of asset quality among lending institutions and often associated with failures and financial crises in both developed and developing world (Guy, 2011).

The term "bad loans" as described by Basu (1998) is used interchangeably with non- performing and impaired loans. Despite ongoing efforts to control bank lending activities, non-performing loans are still a major concern for both international and local regulators (Boudriga et al, 2009). Greenidge and Grosvenor (2010), again argue that the magnitude of non-performing loans is a key element in the initiation and progression of financial and banking crises. In consistence with the above authors, Reinhart and Rogoff (2010) as cited in Louzis et al (2011) pointed out that, non- performing loans can be used to mark the onset of a banking crisis. According to Berger and De Young (1997) sited in Joseph M, et al., (2012), non-performing loans could be harmful to the financial performance of banking institutions.

Nonperforming loan is also defined from institutional point of view. According to the IMF, a non-performing loan is any loan in which interest and principal payments are more than 90 days overdue; or more than 90 days' worth of interest has been refinanced, capitalized, or delayed by agreement; or payments are less than 90 days overdue, but no longer anticipated. Another definition of a non-performing loan is one in which the maturity date has passed but at least part of the loan is still outstanding. The specific definition is depending upon the loan's particular terms. Non -performing loans can also be defined as defaulted loans, which banks are unable to profit from it. Usually loans fall due if no interest has been paid in 90 days, but this may vary between different countries and actors. Defaulted loans force banks to take certain measures in order to recover and securitize them in the best way.

Under the Ethiopian banking business directive, non-performing loans are defined as "loans or advances whose credit quality has deteriorated such that full collection of principal and/or interest in accordance with the contractual repayment terms of the loan or advances in question" (NBE, 2018). It further provides that:

…, loans or advances with pre-established repayment programs are nonperforming when principal and/ or interest is due and uncollected for 90 (ninety) consecutive days or more beyond the scheduled payment date or maturity.

Therefore, loans become nonperforming when it cannot be recovered within certain stipulated period of time that is governed by some respective laws.

Generally, from the above definition NPL is:

i. A loan that is not earning income;

ii. Full payment of principal and interest is no longer anticipated;

iii. Principal or interest is 90 days or more delinquent or;

iv. The maturity date has passed and payment in full has not been made.

In Ethiopia the criteria of NPL is in accordance with the Basel rules. If a loan is past due 90 consecutive days, it will be regarded as non- performing. The criteria used in Ethiopian banking business to identify non-performing loan is a quantitative criteria based on the number of days passed from loan being due.

2.1.2. Classifications of Loans and Advances

Loan can be classified as performing and non-performing. Performing loan is loan that Payments of both principal and interest charges are up to date as agreed between the creditor and debtor. Generally, loans those are outstanding in both principal and interest for a long time contrary to the terms and conditions contained in the loan contract are considered as NPLs.

To identify the loans which are non- performing and to calculate and determine the amount of provisions according to loans directive number SBB/69/2018 loans are classified into five class.

1. Pass: Loans or advances that are fully protected by the current financial and the paying capacity of borrower and are not subject to criticism. In other word passed means loans paid back.

2. Special Mention: Past due for more than 30 days but less than 90 days. Special mention class of loans implies Loans to incorporations, which may get some trouble in the repayment due to business cycle losses.

3. Substandard: Past due for more than 90 days but less than 180 days. Substandard signify Loans whose interest or principal payments are longer than three months in arrears of lending conditions are eased.

4. Doubtful: Past due for more than 180 days but less than 360 days. Doubtful indicate that full liquidation of outstanding debts appears doubtful and the accounts suggest that there will be a loss.

5. Loss: Past due over 360 days, in other word loss imply that outstanding debts are regarded as not collectable.

Non-performing loans comprise the loans in the last three categories (Substandard, Doubtful and Loss), and are further differentiated according to the degree of collection difficulties. As per the directive No. SBB/69/2018 Minimum provision percentage against outstanding principal amount of each loan or advance classified in accordance with the criteria for the classification of loan or advance on the above. Below the table show that the minimum percent of provision for NPLs.

Classification category	Minimum provision
Pass	1%
Special mention	3%
Substandard	20%
Doubtful	50%
Loss	100%

Source: Directive No. SBB/69/2018

2.1.3. Theories on Bank Loan

2.1.3.1. Loan Pricing Theory

Banks cannot always set high interest rates, e.g. trying to earn maximum interest income. Banks should consider the problems of adverse selection and moral hazard since it is very difficult to forecast the borrower type at the start of the banking relationship (Stiglitz and Weiss, 1981). If banks set interest rates too high, they may induce adverse selection problems because high-risk borrowers are willing to accept these high rates. Once these borrowers receive the loans, they may develop moral hazard behavior or so called borrower moral hazard since they are likely to take on highly risky projects or investments (Chodecai, 2004). According to loan pricing theory

setting too high interest rate increase the chance of loan default, consequently it boosts the rate of nonperforming loan. According to loan pricing theory interest rate have a positive and significant impact on the rate of NPL.

2.1.3.2. Credit Market Theory

The theory postulates that if collateral and other pertinent restrictions remain given, then it is only the lending rate that determines the amount of credit that is dispensed by the banking sector. Therefore, with an increasing demand for credit and a fixed supply of the same, interest rates will have to rise. Any additional risk to a project being funded by the bank should be reflected through a risk premium that is added to lending rate to match the increasing risk of default. Subsequently, there exist a positive relationship between the default probability of a borrower and the interest rate charged on the advance. It is thus believed that the higher the failure risks of the borrower, the higher the interest premium (Ewert et al, 2000). Credit market theory is directly support the idea of loan pricing theory.

2.1.4. Factors affecting loan recovery performance

2.1.4.1. Macroeconomic factors that affect loan recovery performance

Despite the fact that loan is major source of banks income and constitutes their major assets, it is risky area of the industry. That is also why credit risk management is one of the most critical risk management activities carried out by firms in the financial services industry. In fact, from all risks banks face, credit risk is considered as the most dangerous as bad debts would impair banks profit. It has to be noted that credit risk arises from uncertainty in a given counterparty's ability to meet its obligations. The solidity of bank's portfolio depends on the health of its borrowers. In many countries, failed business enterprises bring down the banking system (Alemu, 2001, sited in W. N. Geletta, 2011). A sound financial system, among other things, requires maintenance of a low level of non- performing loans which in turn facilitates the economic development of a country.

The literature identifies two sets of factors to explain the evolution of NPLs over time. One group focuses on external events such as the overall macroeconomic conditions, which are likely

to affect the borrowers' capacity to repay their loans, while the second group, which looks more at the variability of NPLs across banks, attributes the level of non-performing loans to bank-level factors.

During intensive competition banks offers a competitive deposit rates to attract funds and charge marginal costs to the borrowers. Banks offering higher deposits rates have greater share of deposits and lower interest rate spreads, whereas banks offering lower deposits rates have small share of deposits and higher interest rate spread. Thus it can be concluded that market concentration is significantly positively associated with interest rate spread. The banks with lower capitalization and high risk increases their customers by offering higher competitive rates and have lower interest rate spread (Berger, A.N., R et al. 2004). Uhde and Heimeshoff (2009) argued that short term increases in interest rates to deposit rates increase the banks costs of funds, resulting in the higher interest demand on loans. The growth in lending rates is positively correlated with loan defaults, thus results in growth of banks NPLs.

2.1.4.1.1. Interest Rate

Lending interest rate as a price of money reflects market information regarding expected change in the purchasing power of money or future inflation (Ngugi, 2001). Monetary contraction and interest rate increase reduce spending directly; both also reduce spending indirectly by shrinking bank loan supply (Bernanke and Blinder, 1988). Many of the bad debts were attributable to moral hazard: the adverse incentives on bank owners to adopt imprudent lending strategies, in particular insider lending and lending at high interest rates to borrowers in the most risky segments of credit markets. Bank lending rates are mostly seen as being rigid for the reason that they do not move in tandem with the markets.

A number of explanations have been suggested to account for the rigidity in bank lending rates. In the case of loans, the rigidity has been as a result of the rationing of credit to borrowers owing to the fact that there are problems of asymmetric information (Blinder and Stiglitz, 1983). Indeed, financial markets are not perfect; in the presence of adverse selection and moral hazard issues, banks are more likely to opt for credit rationing than to adjust their lending rates in a

situation where there has been an upward adjustment of interest rates by the central bank. It may also be possible that when large banks capture large market share, the impact of tight monetary policy on bank lending will be minimal.

Bloem and Gorter (2001) agreed that "bad loans" may considerably rise due to abrupt changes in interest rates. They discussed various international standards and practices on recognizing, valuing and subsequent treatment of non-performing loans to address the issue from view point of controlling, management and reduction measures. A study conducted by Espinoza and Prasad (2010) focused on macroeconomic and bank specific factors influencing non-performing loans and their effects in GCC Banking System. After a comprehensive analysis, they found that higher interest rates increase non-performing loans but the relationship was not statistically significant.

The interest rate affects the difficulty in servicing debt, in the case of floating rate loans. This implies that the effect of the interest rate should be positive, and as a result the increasing debt burden caused from rising interest rate payments should lead to a higher number of NPLs.

2.1.4.1.2. Gross Domestic Product

The performance of any types of loans is highly related to country's economic condition. Keeton and Morris (1987), who investigated the fundamental drivers of loan losses for a sample of nearly 2,500 US commercial banks for the period 1979 to 1985 using simple linear regressions, had already demonstrated that local economic conditions explained the variation in loan losses recorded by banks. To support the above empirical study, Sinkey and Greenwalt (1991) by employing a simple log-linear regression model and data of large commercial banks in the United States from 1984 to 1987. Report that depressed regional economic conditions also explain the loss-rate (defined as net loan charge offs plus NPLs divided by total loans plus net charge-offs) of the commercial banks. Carey (1998) sited in Joseph, Mabvure T et al,(2012.p.474) also report similar results and suggests that the state of the economy is the single most important systematic factor influencing diversified debt portfolio loss rates. A strong economic condition measured by GDP, as motivating factor to banks has statistically significant impact on issuance of more private credit to businesses. A strong economic condition creates more demand for goods and services which lead to more investment in different sectors hence

increase the per capita income as well as the savings, collectively these factors convince to banks to issue more private credit (kashif and Mohammed, undated).

2.1.4.1.3. Deposit Rate

During intensive competition banks offers a competitive deposit rates to attract funds and charge marginal costs to the borrowers. Banks offering higher deposits rates have greater share of deposits and lower interest rate spreads, whereas banks offering lower deposits rates have small share of deposits and higher interest rate spread. Thus it can be concluded that market concentration is significantly positively associated with interest rate spread. The banks with lower capitalization and high risk increases their customers by offering higher competitive rates and have lower interest rate spread (Berger, A.N., R et al. 2004). Uhde and Heimeshoff (2009) argued that short term increases in interest rates to deposit rates increase the banks costs of funds, resulting in the higher interest demand on loans. The growth in lending rates is positively correlated with loan defaults, thus results in growth of banks NPLs.

2.1.4.1.4. Rate of Inflation

Macroeconomic instability which is mostly manifested by high inflation rate also makes loan appraisal more difficult for the bank, because the viability of potential borrowers depends upon unpredictable development in the overall rate of inflation. Moreover, asset prices are also likely to be highly volatile under such conditions. Hence, the future real value of loan security is also very uncertain that banks do poorly both when product and asset price prudential policy, inflation accelerates unexpectedly, unemployment increases, and/or aggregate output and income decline unexpectedly. Unexpected accelerations in inflation adversely affect banks performance, by increasing the rate of loan default and decreasing banks profit (Martin Brownbrigde, 1998, sited in W. N. Geletta, 2011).

A growing theoretical literature describes mechanisms whereby even predictable increases in the rate of inflation interfere with the ability of the financial sector to allocate resources effectively. More specifically, recent theories emphasize the importance of informational asymmetries in

credit markets and demonstrate how increases in the rate of inflation adversely affect credit market frictions with negative repercussions for financial sector (both banks and equity market) performance and therefore long-run real activity (Huybens and Smith 1998, 1999). The common feature of these theories is that there is an informational friction whose severity is endogenous. Given this feature, an increase in the rate of inflation drives down the real rate of return not just on money, but on assets in general. The implied reduction in real returns exacerbates credit market frictions. Since these market frictions lead to the rationing of credit, credit rationing becomes more severe as inflation rises. As a result, the financial sector makes fewer loans because their loan is not secure, resource allocation is less efficient, and intermediary activity diminishes with adverse implications for capital/long term investment. Hence, there is a positive relationship between increase in inflation rate and nonperforming loan.

Causes of nonperforming loan extends from borrowers specific act to bank's weak regulatory mechanism in advancing loans and monitoring procedures. Credit/loan contracts specify the amount borrowed, the interest and non-price terms like collaterals, which constrain the borrower in order to reduce default. As the terms of contract change the behavior of the borrower is likely to change (Stiglitz 1990). From the above theories information asymmetry have a lion share for banks loan default. The problem of asymmetric information between lenders and borrowers further complicates the matter. Besides that, the management might not be efficient in managing loan portfolios. Consequently, this leads to lower credit ratings for the approved loans and high probability of default resulting in higher non-performing loans.

The authors like Gehrig and Stenbacka, (2007) stated that information sharing reduces adverse selection problems and thereby promotes financial stability; it serves as a borrower disciplining device and it reduces the informational rents that banks can extract within the framework of their established customer relationships. In addition, Barth, Lin, Lin & Song (2008) show that information exchange will help in minimizing lending corruption in banks by reducing information gap between consumers and lenders, improving the bribery control methods and reducing informational rent, and hence the bargaining power of lenders. Furthermore, Jentzsch (2008) clarify that sharing credit information between lenders increases competition and enhance access to finance. Credit information also acts as a borrower disciplining device, by cutting

insolvent debtors off from credit and eliminates or reduces the borrower's incentive to become over-indebted by drawing credit simultaneously from many banks without any of them realizing it.

Generally, in developing and underdeveloped countries, the reasons for default have a multidimensional aspect. Various researchers have concluded various s reasons for loan default.

2.1.4.2. Bank Specific Factors affecting loan recovery performance

Macroeconomic factors which are viewed as exogenous forces influencing the banking industry should not be sought exclusively in determining NPLs. In contrast, the typical nature of the banking sector along with the specific policy choices of a particular bank with regard to its efforts to maximize efficiency and improve in its risk management are expected to exert a vital influence on the evolution of NPLs. A few literatures have examined the connection between bank-specific factors and NPLs. Literature on bank specific determinants of nonperforming loans are reviewed in the section that follows.

2.1.4.2.1. Rapid Loan Growth

Studies indicate that loan delinquencies are associated with rapid credit growth. Keeton (1999) who used data from commercial banks in the United States (from 1982 to 1996) and a vector auto regression model indicate this association between loan and rapid credit growth. Sinkey and Greenwalt (1991) who have also studied large commercial banks in the US and found out that excessive lending explain loan –loss rate. Salas and Saurina (2002) who studied Spanish banks found out that credit growth is associated with non-performing loans. Besides, study by Bercoff, Giovanni and Grimard (2002) shows that asset growth explains NPLs.

Similarly Weinberg (1995) uses data on the growth rate of total loans and loan charge-offs in the United States from 1950 to 1992 to show a pattern of increases in lending preceding increases in loan losses .Weinberg (1995) hypothesizes that risk-neutral lenders increase lending during periods of economic expansion because the expected returns from investment projects improve, and therefore, the expected returns from all loan customers rise.

Supply-side explanations of the expansion of bank loans frequently suggest a relaxation of underwriting standards, whereas loan contractions are said to suggest a tightening of standards. So with growth of loan size becomes poor loan performance ascribing to the relaxed underwriting standard.

2.1.4.2.2 High Interest Rate

Banks that charge high interest rate would comparatively face a higher default rate or non-performing loans. Study by Sinkey and Greenwalt (1991) on large commercial Banks in US depict that a high interest rate charged by banks is associated with loan defaults. Rajan and Dhal (2003) who used a panel regression analysis indicates that financial factors like cost of credit has got significant impact on NPLs. Study by Waweru and Kalini (2009) on the commercial banks in Kenya using statistical analysis indicates that high interest rate charged by the banks is one of the internal factors that leads to incidence non-performing loans. Besides, studies by Berger and DeYoung, 1997, for the US; Jimenez and Saurina, 2006, for Spain; Quagliariello, 2007, for Italy; Pain, 2003, for the UK; and Bikker and Hu, 2002,(for 29 OECD countries) banks profit margin exhibited by high interest rate affects occurrence of NPLs.

2.1.4.2.3. Lenient Credit Terms

Credit sanctioning that has not duly considered the credit terms would potentially lead to occurrence of poor loan performance. Jimenez and Saurina (2005) in their study conducted on the Spanish banking sector from 1984 to 2003 evidence that NPLs are determined by lenient credit terms. Cause for the lenience is attributed to disaster myopia, herd behavior, moral hazard and agency problems that may entice bank managers to take risk and lend excessively during boom periods as per this study. Rajan and Dhal (2003) who studied the Indian commercial banks also found out terms of credit determines occurrence of Nonperforming loans.

Rajan (1994) hypothesizes that bank managers have short-term decision horizons because their reputations are strongly influenced by public perceptions of their performance, as evidenced by short-term earnings. Managers' reputations suffer if they fail to expand credit when the economy

is expanding and bank earnings are improving. This herd behavior will result in some loans going to customers with higher default risk than would occur otherwise.

Weinberg (1995) also suggests that bank managers adjust lending standards as market conditions change, seeking to smooth overall lending risk. The Office of the Comptroller of the Currency (OCC, 1988) concludes that the dominant reason for bank failure in the early 1980s was poor bank management, which encompasses lax lending standards. An FDIC study of the causes of the banking crises of the 1980s and early 1990s (FDIC, 1997) finds that a combination of factors – economic, legislative, managerial, and regulatory – led to the banking crises.

Importantly, the FDIC study finds that bank managers adjusted lending practices as economic conditions changed, increasing lending into economic and sectorial booms and reducing lending during economic contractions. In addition, the FDIC study suggests that bank managers reacted to competition from other bankers and that this competition might have encouraged a weaker lending standard that leads to loan defaults.

Besides study by Waweru and Kalini (2009) indicates lack of proper skill amongst loan officials, speedy process of evaluating loans mainly due to external pressure, are among the factors that lead to huge concentration non-performing loans. Commercial banks and other financial institutions experienced an increase in competition in the United States during 1980 and early 1990. This resulted in a change in lending practices.

Due to the competition and the pressure to deliver increasing returns, banks increased the granting of credit facilities to marginal borrowers. These facilities were aggressively priced to compensate for the increase in risk. Although the strategy delivered short-term results, credit losses followed and in many cases caused banks to fail (Koch & MacDonald, 2003). The failure of banks can therefore, not only be linked to unfavorable economic environments, but also to the nature of the credit policies they employ.

2.1.4.2.4. Credit Orientation

Financial sector development goes hand in hand with orientation of the public. Study conducted by Rajan and Dhal (2003) indicate that credit orientation significantly affects loan default rate as per their panel regression analysis conducted on commercial banks on India.

2.1.4.2.5 Bank Size

Study by Cole et al. (2004) used data obtained from the 1993 Federal Reserve National Survey of Small Business Finance and bank financial reports, suggest that smaller banks adopt small business loan underwriting practices that are riskier than those of larger banks, riskier in that small banks prefer to lend to small firms that lack hard financial data to support the lending decision and riskier to the extent that the failure rates of small businesses are higher than those of larger, established firms.

In their study of commercial banks in India, by use of panel regression analysis Rajan and Dhal (2003) indicates that, banks size have significance on occurrence of NPLs. Salas and Saurina (2002) indicated that bank size, is among the factors that explained variations in NPLs for Spanish banks. Studies by Berger and DeYoung, 1997, for the US; Jimenez and Saurina, 2006, for Spain; Quagliariello, 2007, for Italy; Pain, 2003, for the UK; and Bikker and Hu, 2002, for 29 OECD countries) also shows that Bank size is significantly related rate of occurrence of loan default.

2.1.4.2.6. Cost Efficiency

Hughes et al. (1995) link risk taking to banks' operating efficiency. The argument is that risk-averse managers are willing to trade off reduced earnings for reduced risk, especially when their wealth depends on the performance of the bank. In order to improve loan quality, they will increase monitoring and incur higher costs, affecting the measure of operating efficiency. Therefore, a less efficient bank may in fact hold a low risk portfolio. Bercoff, Giovanni and Grimard (2002) also showed that operating efficiency helped explain NPLs.

2.1.4.2.7. Ownership structure

Hu et al (2006) analyzed the relationship between NPLs and ownership structure of commercial banks in Taiwan with a panel dataset covering the period 1996-1999. The study shows that banks with higher government ownership recorded lower non-performing loans. Walter and Werlang (1995) found that state-owned financial institutions underperform the market, because their portfolios concentrate on the non-performing loans indebted by the state. Jang and Chou (1998) adopt the ratio of non-performing loans to total loan as the measure of risk by using 1986-1994 data of 13 Taiwanese banks for empirical study. The average risk-adjusted cost efficiency of the four provincial government-owned banks was the lowest among the sample banks.

2.1.4.2.8. Poor Loan Follow-up (Monitoring)

Regular monitoring of loan quality, possibly with an early warning system capable of alerting regulatory authorities of potential bank stress, is essential to ensure a sound financial system and prevent systemic crises. (Agresti et al., 2008). The need to give due attention to borrower thus need not be overemphasized in order to ensure loan performance. There is a tendency by borrowers to give better attention to their loans when they perceive they got better attention .Some of the loans defaults ascribe to lower level of attention given to borrowers. It is advised that banks keep up with their loans timely (Mayers, undated).

Banks rarely lose money solely because the initial decision to lend was wrong. Even where there are greater risks that the banks recognize, they only cause a loss after giving a warning sign (Machiraju). More banks lose money because they do not monitor their borrower's property, and fail to recognize warning signs early enough. When banks fail to give due attention to the borrowers and what they are doing with the money, then they will fail to see the risk of loss. The objective of supervising a loan is to verify whether the basis on which the lending decision was taken continues to hold good and to ascertain the loan funds are being properly utilized for the purpose they were granted.

In order to meet these objectives banks need to see whether the character of the borrower, its capacity to repay the loan, capital contribution, prevailing market conditions and the value of the

collateral that was taken during loan approval time continues to remain the same (George G, 2004).

It is clear that effective credit monitoring involves looking into various operations of the company including operations of the loan, checking whether the company is properly managed, and the environment in which the company is carrying out its business is satisfactory.

Constant monitoring increases the chance that the company will respond to a bank's concern and provide information more willingly. A bank which always closely follows a company's standing can often point out danger or opportunities to the company, as well as quick agreement to request for credit. It thus establishes that monitoring is basically constructive, and not a panic reaction and carries more weight when it expresses concern (Donaldson, undated).

A bank should have clearly defined continuous procedures for identifying potential bad and doubtful loans. These procedures should include regular independent reviews of the loan portfolio. Within this system, there should be formal procedures for the continuous review of all large loans and all areas of lending concentration. These reviews should place particular emphasis upon the borrower's continuing ability to service the loan. Failure to do these continuous reviews and monitoring will lead to loss to banks or increases the risk of such losses.

From the regulatory point of view, Ethiopian banks are required to make continuous review of their loan and submit reports to the central bank. This function of banks has a legal as well as contractual base. But the detail as to the frequency of visiting the borrower's premises, verifying the use of the loan and other related circumstances is left to the discretion of individual banks. The legal base for banks to do the review is provided under Article 5 of Directive No.SBB/43/2008.

2.1.4.2.9. Poor Risk Assessment

Risk, and the ways, in which it can be identified, quantified and minimized, is key concerns for a bank's management and its auditors when they are considering the need to provide for bad and doubtful loans. No loan is entirely without risk. Every loan, no matter how well it is secured, and

no matter who is the borrower, has the potential to generate loss for the lender. It is the degree of risk to which a loan is susceptible and the probability of loss that vary; these should normally be reflected in the interest margin and other terms set at the inception of the loan (Brown, 1993).

A bank, in considering whether to lend or not, takes into account the quality of a borrower which is reflected in, inter alia, its past and projected profit performance, the strength of its balance sheet (for example, capital and liquidity) the nature of and market for its product, economic and political conditions in the country in which it is based, the quality and stability of its management and its general reputation and standing. It is important for the bank to know the purpose of the loan, to assess its validity and to determine how the funds required for the payment of interest and the repayment of capital will be regenerated.

The borrower's ability to repay a loan is of paramount importance. Ideally, the loan will be self-financing in that it will be repaid from the cash flow that the borrower is able to generate from employing the proceeds of the loan. A bank will often require security for a loan in the form, say, of a guarantee or mortgage, in which case it will be concerned about the value and title of that security. The decision to grant loan, however, should be based on the prospects and solvency of the borrower and a careful analysis of how the funds to repay the loan will be generated.

In general, banks lack effective measures to identify, quantify and control the regional and industrial risk, constrained by obtaining historical data, decentralized information systems and immature portfolio management skills. So they have to make judgment mainly based on personal experience and consequently have weak management measures on concentrated and systemic risk (Ning, 2007).

Basically, the non- performing loans are a result of the compromise of the objectivity of credit appraisal and assessment. The problem is aggravated by the weakness in the accounting, disclosure and grant of additional loans. In the assessment of the status of current loans, the borrower's credit worthiness and the market value of collateral are not taken into account thereby

rendering it difficult to spot bad loans (Patersson, 2004). Compromise in quality of risk assessment thus leads to occurrence of nonperforming loans.

2.1.4.2.10. Lack of Strict Admittance Exit Policies

Under the influence of idea of pursuing market share excessively, banks do not establish detailed and strict market admittance policies, which undermine the first risk to prevent gate and weaken the orientation effect of admittance policies to market (Shofiqul Islam, 2005). During pre-loan investigation, bank officers put little emphasis on authenticity and integrality review on related materials. They don't clarify the true intended usage of the loan (especially when extending short-termed credit) and the review is too optimistic, which does not analyze the potential influence of changes in related factors. There is also no deep review on the market, no enough understanding on enterprises' operation management situation, no thorough risk revaluation; inaccurate assessment, the risk of loans is not fully covered and the risk on group customers and affiliated enterprises are not identified effectively. The factors above damage the loans at the early stage (Brownbrige, 1998).

Furthermore, some banks neglect the fact that the loan procedures are not completed or detailed and the review materials are not enough; some operate in different procedures than the review materials, for instance, signing loan contract before approval of the loan, issuing letter of credit or bank acceptance before approval; consolidated credit is not fully realized, and credit to some group members is not included in the consolidated credit management. Some extend credit against the rules, i.e. exceeding authority to offer loans, splitting one big number into several small pieces to avoid the authority constraint, issuing bank acceptance to fund enterprises on a rolling basis, or discount without actual trade background.

Most problems in this case relates with accepting guaranty from unqualified institutions, high loan-to-value ratio, providing loans without property registration and transfer of collateral, guaranty for each other between enterprises and legally flawed credit procedures etc. And there are also problems in which that the conditions of the loans are not satisfied and the contracts of loans are not completed.

Though the primary role lies on banks to evaluate their admittance and exit policies, they are subjected to the general laws of a country on banking business. In the Ethiopian Banking context banks are also required to submit reports to NBE on their loan disbursement as well as their outstanding and collected loans showing whether their lending procedure is according to the regulatory guidelines and laws Thus failure to include strict admittance and exit policies and thereby provisions for accountability in the credit manual of banks would create a loop hole that would eventually lead to occurrence of loan default.

The heart of any successful commercial lending function is credit discipline written in loan policy, structured loan approval process and strong loan administration function (Barrickman, 1990). As discussed above, efficient banks and financial markets promote macro development. This development leads to growth in overall economy and most countries work towards ensuring that development. Accordingly, ensuring sound financial system and creating efficient banks by reducing non- performing loans becomes important. Usually giving solutions to non- performing loans arises from identifying the probable causes for its creation.

Regular monitoring of loan quality, possibly with an early warning system capable of alerting regulatory authorities of potential bank stress, is thus essential to ensure a sound financial system and prevent systemic crises. In this regard, the analytical tools currently under scrutiny in the context of macro-prudential regulation do in fact assign great emphasis to indicators of asset quality (Agresti et al. (2008).

2.3. Policies that would help improve the loan recovery status of banks

2.3.1. Credit Management Policies

In the past decades there have been major advances in theoretical understanding of the workings of credit markets. These advances have evolved from a paradigm that emphasis the problems of imperfect information and imperfect enforcement. Borrowers and lenders may have differential access to information concerning a projects risk, they may form different appraisal of the risk. What is clearly observed in credit market is asymmetric information where the borrower knows

the expected return and risk of his project, whereas the lender knows only the expected return and risk of the average project in the economy

In the course of undertaking credit activity lending institutions are confronted with four major problems: (i) to determine what kind of risk the potential borrower is (adverse selection), (ii) to make sure the borrower will utilize the loan properly once made, so that s/he will be able to repay it (moral hazard), (iii) to determine or know how the project really did in case the borrower declares his inability to repay, and (iv) to find methods to force the borrower to repay the loan if the borrower is reluctant to do so (enforcement). These problems of imperfect information and enforcement lead to inefficiency of credit market which in turn leads to default. Deep credit assessment that consider the borrowers` character, collateral, capacity, capital and condition (what is normally referred to in the banking circles as the 5C`s) should be undertaken if they are to minimize credit risk (Kapoor *et al.*, 2007).

The significance of credit management has been highlighted by Mensha (1999) as follows: "credit management process deserves special emphasis since appropriate credit management greatly influences the success or failure of financial institutions". Knowledge of a bank's credit risk management process offers a key indicator of the quality of a bank's loan portfolio. The crucial elements of successful credit management therefore are well developed credit policies and procedures; strong portfolio management; effective credit controls and the most central of all a well-qualified staff capable of implementing the system. In order to operate efficiently and make credit available to investors, financial institutions must maintain basic credit standards. These standards include a thorough understanding of the borrowers' business by the officer in charge; reasonable debt equity ratio; marketability and viability of the investment project and other technical capabilities. Credit analysis, in general, is essential for the officer to judge about the credit worthiness of the borrower as well as the project to which the loan is injected.

2.3.2. Credit Risk Management policies

According to Eastern Caribbean Central Bank (2009), credit risk management is the process of controlling the impact of credit risk-related events on the financial institution and involves the identification, understanding, and quantification of the degree of potential loss and the

consequential implementation of appropriate measures to minimize the risk of loss to the financial institution. In order to maintain successful credit risk management, the lending institution should develop and implement all-inclusive credit risk management in line with its credit risk strategy. The credit risk strategy should reflect the institution's tolerance for risk and the desired level of profitability for incurring various credit risks.

A successful credit risk management encompasses the implementation of clearly defined credit policy and processes to facilitate the identification and quantification of risks inherent in an institution's lending and investment activities. The firm's credit policy should be officially established in writing and approved by the board of directors, and should clearly set out the parameters under which credit risk is to be controlled.

The aim of credit risk management is to capitalize on a bank's risk-adjusted rate of return by retaining credit risk exposure within acceptable limits. Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Banks should also consider the relationships between credit risk and other risks. The successful management of credit risk is a crucial element of a holistic approach to risk management and essential to the long-term success of any bank. In general, loans represent the largest and most apparent source of credit risk for most of the banks (Basel Committee, 1999).
For Vigano (1993), credit risk appraisal is a complex process, which requires a careful examination of information regarding the borrower in order to estimate the probability that the loan will be regularly repaid. The probability of regular repayment depends on certain objective factors related to the borrower's operating environment, the borrower's personal attitude towards loan obligation, and the bank's ability to appraise these two issues through the information it has and to control credit risk specific contractual conditions. Accordingly, the key factors that influence credit risk are summarized by Vigano (1993) as follows: the borrower's ability and willingness to pay, existence of positive external conditions, quality of information and the lender's capacity to ensure the borrowers willingness to pay.

2.3.3. The five C's of credit evaluation

According to Elliott, B. and Elliott, J. (2012), the **5 C's of credit** are character, capacity, capital, conditions, and collateral. Together, these serve as a way for lenders to evaluate the creditworthiness of potential borrowers. ... Both personal and business **credit** scores often play an **important** role in a lender's evaluation of overall creditworthiness.

Character

When lenders evaluate character, they look at stability — for example, how long you've lived at your current address, how long you've been in your current job, and whether you have a good record of paying your bills on time and in full. If you want a loan for your business, the lender may consider your experience and track record in your business and industry to evaluate how trustworthy you are to repay.

Capacity

Capacity refers to considering your other debts and expenses when determining your ability to repay the loan. Creditors evaluate your debt-to-income ratio, that is, how much you owe compared to how much you earn. The lower your ratio, the more confident creditors will be in your capacity to repay the money you borrow.

Capital

Capital refers to your net worth — the value of your assets minus your liabilities. In simple terms, how much you own (for example, car, real estate, cash, and investments) minus how much you owe.

Collateral

Collateral refers to any asset of a borrower (for example, a home) that a lender has a right to take ownership of and use to pay the debt if the borrower is unable to make the loan payments as agreed.

Some lenders may require a guarantee in addition to collateral. A guarantee means that another person signs a document promising to repay the loan if you can't.

Conditions

Lenders consider a number of outside circumstances that may affect the borrower's financial situation and ability to repay, for example what's happening in the local economy. If the

borrower is a business, the lender may evaluate the financial health of the borrower's industry, their local market, and competition.

2.4. Empirical Evidence

This section will present evidence which identify the major factors of nonperforming loans. Many researchers have conducted a lot of study on determinants of nonperforming loans (NPLs), due to its significance for the bank's failure. Accordingly, the first subsection, presents factors affecting nonperforming loans in other countries. The second subsection discusses review of prior studies on factors of non-performing loans in Ethiopia and highlights the knowledge gap emerged from survey of empirical literature.

Credit approving that has not properly considered the credit terms would potentially lead to occurrence of loan default. As per the study by Jimenez & Saurina (2005) on the Spanish banking sector from 1984 to 2003 NPLs are determined by lenient credit terms. The authors indicated that the causes for the leniency were attributed to disaster myopia, herd behavior, moral hazard and agency problems that may entice bank managers to take risk and lend excessively during boom periods. This has been supported by Rajiv & Dhal (2003) who found that terms of credit determines occurrence of non-performing loans.

On the other hand, banks that charge high interest rate would relatively incur a higher default rate or non-performing loans. In this regard, a study by Sinkey & Greenwalt (1991) on large commercial Banks in US revealed that a high interest rate charged by banks is associated with loan defaults. Rajiv & Dhal (2003) who used a panel regression analysis indicated that financial factors like cost of credit have got significant impact on NPLs. Bloem and Gorter (2001) also indicated that "bad loans" may substantially rise due to abrupt changes in interest rates. The authors discussed various international standards and practices on recognizing, valuing and subsequent treatment of non-performing loans to address the issue from view point of controlling, management and reduction measures. Similarly, a study by Espinoza and Prasad (2010) focused on macroeconomic and bank specific factors influencing NPLs and their effects in GCC Banking System found that higher interest rates increase non-performing loans but the relationship was not statistically significant.

Other studies such as Sinkey & Greenwalt (1991) indicated that loan delinquencies are associated with rapid credit growth. The authors found that excessive lending explain loan loss rate. This was confirmed later by Keeton (1999) who used data from commercial banks in the United States (from 1982 to 1996) using a vector auto regression model showed that there was association between default and rapid credit growth. Likewise, Salas and Saurina (2002) in their study on Spanish banks also revealed that credit growth is associated with non-performing loans. Also, study by Bercoff *et al*. (2002) confirmed that asset growth explains NPLs.

Skarica (2013) also conducted a study on the determinants of NPLs in Central and Eastern European countries. By employing the Fixed Effect Model and seven Central and Eastern European countries for 2007-2012 periods, the study revealed that loan growth, real GDP growth rate, market interest rate, unemployment and inflation rate as determinants of NPLs. The results show that GDP growth rate and unemployment rate have statistically significant negative association with NPLs with justification of rising recession and falling during expansions and growth has impact on the levels of NPLs. This implies that economic developments have a strong impact on the financial stability. The result also discovered that inflation has positive impact on NPLs with a justification that inflation might affect borrowers' debt servicing capacities. Similarly, Jimenez and Saurina (2005) provide evidence that non-performing loans are determined by GDP growth, high real interest rates and lenient credit terms. Meanwhile, Rajiv & Dhal (2003) utilize panel regression analysis and reported that favorable macroeconomic conditions and financial factors such as maturity, cost and terms of credit, banks size, and credit orientation impact significantly on the non-performing loans of commercial banks in India. Likewise, Keeton (1999) revealed evidence of a strong relationship between credit growth and impaired loans. Specifically, Keeton (1999) showed that rapid credit growth, which was associated with lower credit standards, contributed to higher loan losses in certain states in the US.

Boudriga *et al.* (2009) studied on the lender specific factors and the role of the business and the institutional environment on loan default in the MENA countries for 2002-2006 periods using random-effects panel regression model for 46 countries. The variables included were credit growth rate, capital adequacy ratio, real GDP growth rate, ROA, the loan loss reserve to total

loan ratio, diversification, private monitoring and independence of supervision authority on nonperforming loans. They reported that credit growth rate was negatively related to nonperforming loans. Capital adequacy ratio was positively and significantly affecting loan default implying that highly capitalized banks are not under regulatory pressures to reduce their credit risk and take more risks. In the contrary, their findings reported that ROA has negative and statistically significant influence on NPLs.

2.4.1. Empirical Studies in Ethiopia

Wondimagegnehu (2012) in his study "determinants of NPLs on commercial banks of Ethiopia" revealed that underdeveloped credit culture, poor credit assessment, aggressive lending, botched loan monitoring, lenient credit terms and conditions, compromised integrity, weak institutional capacity, unfair competition among banks, willful defaults by borrowers and their knowledge limitation, fund diversion for unexpected purposes and overdue financing has significant effect on NPLs. Conversely, the study indicated that interest rate has no significant impact on the level of commercial banks loan delinquencies in Ethiopia.

Similarly, Mitiku (2014) studied the "Determinants of Commercial Banks Lending: Evidence from Ethiopian Commercial Banks using panel data of eight commercial banks in the period from 2005 to 2011 with the objective of assessing the relationship between commercial bank lending and its determinants (bank size, credit risk, GDP, investment, deposit, interest rate, liquidity ratio and cash required reserve). Based on seven years financial statement data of eight purposively selected commercial banks and using Ordinary Least Square (OLS) technique, the study found that there was significant relationship between commercial bank lending and its size, credit risk, gross domestic product and liquidity ratio. While interest rate, deposit, investment, and cash reserve required do not affect Ethiopian commercial bank lending.

In view of the above discussions, numerous studies were conducted on the determinants of Non-performing loans. Most of these studies focused on Bank specific and Macro-economic determinates of NPL. However, in the previous empirical analysis no study has been conducted on customer-specific factors influencing non-performing loans. Besides, most of the empirical studies reviewed and discussed in the above paragraphs were made in other countries; and

studies in Ethiopian commercial banking sector are scant. Moreover, despite a single study by Wondimagegnehu (2012) on the determinants of NPLs of commercial banks in Ethiopia, no further research has been conducted in the banking sector in general and on Development Bank of Ethiopia (DBE) in particular. Therefore, this study is expected to fill the gap by assessing the association between bank-and customer-specific factors and level of nonperforming loans (NPLs).

CHAPTER THREE

3. Research Design and Methodology

3.1 Methodology

Under this section research design, the sources of data, method of data collection and analysis were discussed, which helps the researcher to answer research questions and met research objectives.

3.2 Research Design

To achieve the objective of the study, the researcher used qualitative research design to identify the major factors that affect loan recovery performance of Development Bank of Ethiopia.

3.3 Research Methodology

The methodology adopted in the study were contains diverse methods and tools that are relevant to achieve the desired research outcome. Accordingly, the research strategies employed in this study were both quantitative and qualitative (mixed methods) approach. The use of quantitative strategy of inquiry is necessary when the researcher want to deeply investigate and analyze an event, program and problem very well (Creswell, 2003). The purpose of the quantitative aspect of this study is to seek information that can be generalized about the association between macroeconomic and bank-specific factors and loan recovery performance at DBE head office. The study was based on survey design with a semi-structured self-administered questionnaire and document analysis. On the other hand, the purpose of the qualitative strategy is to search for data that can supplement the gap that might not be captured by the quantitative survey and to obtain deeper understanding of the bank specific-and macro-economic factors that affect loan recovery performance.

3.4 Nature of Data and Instruments of Data Collection

The data employed in this study were both primary and secondary. In the context of DBE, a loan is said to be NPL when it fails to meet its debt obligations and past due over 365 days Based on NBE directive, the status of arrears loan can be classified into five ageing categories. Namely, *Pass, Special mention, Substandard, Doubtful* and *Loss*. The first two are categorized under *performing loan* and the rest three are categorized under *non-performing loan*. Accordingly, the data for the study were collected only from projects that are under the categories of non-performing that includes *substandard*, *doubtful* and *loss* ageing categories.

In order to collect primary data, the researcher used questionnaire. Questionnaire was dispatched to the staffs of the bank to identify the major factors that affect loan recovery performance. As far as the secondary data is concerned, DBE working documents and individual files of different projects were reviewed and the annual reports of the bank, bulletins, manuals, directives and procedures were employed in the study.

3.5 Population and Sample Selection

The participants (subjects) of the study were DBE head office staffs and its nonperforming loans. Sample selection was based on simple random sampling. Considering the total population of the study, the sample size of the study was determined using mathematical formula. Borrowers sample size will be taken only from default loans (Non-performing loans) which are under loan classification of *substandard*, *doubtful* and *loss*. Based on NBE directive of loan classification, non-default loans are under *pass* and *special mention* loan classification while default projects are under *substandard, doubtful* and *loss* loan classification. Thus the sample size was taken only from default loans which are under loan classification of *substandard*, *doubtful* and *loss*. However, the samples for staff respondents were taken from the bank's credit process, project rehabilitation and loan recovery teams. The mathematical formula used in sample size determination is given below at 5% precision level (Israel, 2009).

$$n = \frac{N}{1 + N(e)2}$$

Where,

N = Total Population

e = Precision level

n = sample size

Population					
No	Stratum	N	%	Selected Samples	
				N	%
1	Employees in credit and Rehabilitation process of head office	90	100	73	100
Total		90	100	73	100

3.6 Method of Data Analysis

Both qualitative and quantitative analyses methods were used to investigate and describe the factors affecting loan recovery performance. The analyses were performed using IBM SPSS Statistics Version 20.0. Besides, frequency and percentage were used to analyze the data gathered through the questionnaire. The interview was analyzed qualitatively. Finally, the results were presented using tables and graphs.

CHAPTER FOUR

4. DATA PRESENTATION, ANALYSIS AND INTERPRETATION

The previous chapters presented the introduction, literature review and the research methodology. This chapter presents results relating to the bank-specific and macroeconomic factors affecting the Non-Performing Loans. This chapter tries to show the results of the survey conducted in Development Bank of Ethiopia.

4.1. Survey Results

The questionnaire was distributed in Development Bank of Ethiopia which related to the credit process including loan officers, appraisal officer, rehabilitation officers, credit principals, credit managers, credit directors of the Bank. The questionnaire was physically distributed to 48 employees who related with credit process. Out of 73 questionnaires 73 were completed and returned. So the overall response was 100 % which is impressive if we see it in the context of the research culture in developing country.

Table 1: Survey Response Rate

Sample Size	73
Completed and returned questionnaires	73
Response rate	100%

Source: Survey outcome and own computation

4.1.1. Descriptive Results

i) Respondents Job position

Table2.Respondants current position in the Bank

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Loan Officer	26	35.6	35.6	35.6
	Credit analyst	23	31.5	31.5	67.1
	Credit Director	10	13.7	13.7	80.8
	Relationship manager	7	9.6	9.6	90.4
	Recovery/ monitoring officer	7	9.6	9.6	100.0
	Total	73	100.0	100.0	

Source: Survey outcome and own computation

The survey respondents included 35.6% loan officers, 31.5 % Credit analyst, 13.7% credit directors, 9.6 % relationship managers and 9.6 % recovery/monitoring officers.

Table3. Respondants working experience in credit process

ii) Working experience in credit process

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Less than 1	4	5.5	5.5	5.5
	1-5 years	30	41.1	41.1	46.6
	6-10 years	12	16.4	16.4	63.0
	11-15 yea	13	17.8	17.8	80.8
	Above 15 year	14	19.2	19.2	100.0
	Total	73	100.0	100.0	

Source: Survey outcome and own computation

The survey indicated that by means of experience 41.1 % of the respondents had 1 to 5 years of experience in credit process. The second larger number of respondents belonged to the category above 15 years' experience as their percentage was 19.2%. 17.8% of the respondents belonged to

the category of 11-15 years of experience which was the third larger While 16.4% of the respondents have an experience of 6-10 years of experience in credit process. The last 5.5 % of the respondents have an experience of less than 1 year. This shows that respondents had a good experience in the Banking sector specifically in credit process which increased the quality of the survey.

Table 4; Rank of macroeconomic factors affecting loan recovery performance in DBE

Macroeconomic factors affecting loan recovery performance	1st %	2nd %	3rd %
Interest Rate	9.76	23.17	67.07
Rate of Inflation	19.25	42.95	37.80
Gross Domestic Product	17.08	26.73	56.19

Source: Survey outcome and own computation

The above table shows rank of macroeconomic factors that affect loan recovery performance in Development Bank of Ethiopia in order of importance (from one to three). The results in this regard indicated that 19.25 percent of respondents ranked rate of inflation as the top ranking factor causing occurrences of nonperforming loans followed by Gross Domestic Product 17.08% as second factor while interest rate is ranked at third factor by 9.76 percent of the respondents.

Table 5; Factors indicating credit monitoring and loan default

	Strongly Agree (%)	Agree (%)	Neutral (%)	Disagree (%)	Strongly Disagree (%)
Strict monitoring ensures loan performance	51.22	46.34	2.44	0	0
Poorly assessed and advanced loans may perform well if properly monitored	3.66	41.46	19.51	35.37	0
Loan follow up is directly related to occurrence of nonperforming loans	10.98	52.44	10.98	23.17	2.44
Banks with higher budget for loan monitoring have lower non-performing loans	7.32	51.22	24.39	15.85	1.22

Source: Survey outcome and own computation

Strict loan monitoring is believed to ensure loan performance by 97.56 percent of the respondents. On the other hand 35.37 percent of the respondents disagree with the assertion that loan might perform well if properly monitored despite poor assessment during sanctioning. This indicates that loan follow-up can never substitute proper credit assessment.

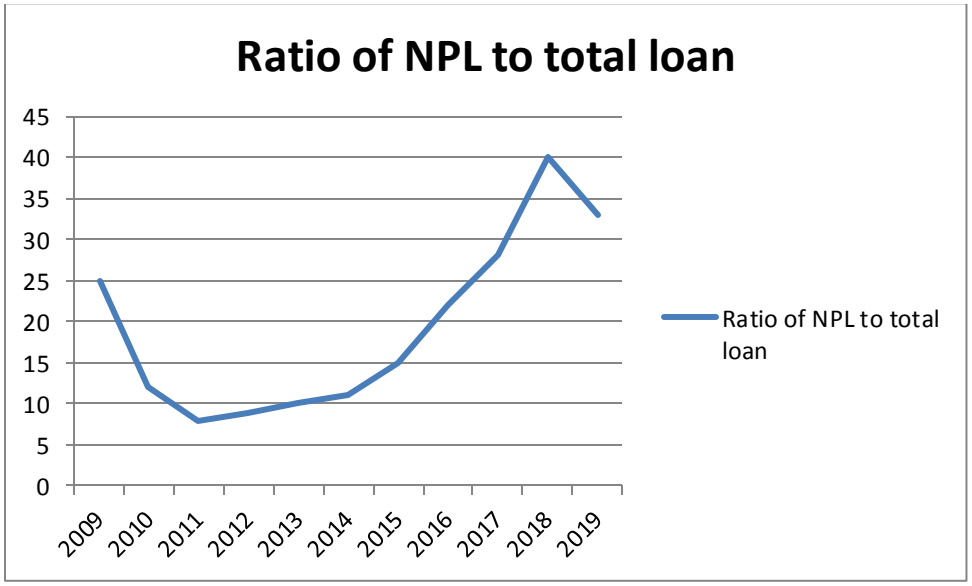
However, 63.42 percent of the respondents agree that occurrence of nonperforming loan is directly related loan follow up. On the other hand only 57.54 percent of the respondents agree that banks with higher budget for loan monitoring have lower nonperforming loans, while 24.39 percent of the respondents neutral about the relationship between higher budget for loan monitoring and lower nonperforming loans.

From the foregoing discussion it can be concluded that credit monitoring is directly related to loan performance. Despite this the respondents didn't support the argument that loan would perform well only by proper monitoring if proper assessment is not carried out while advancing the credit. Thus, in general we conclude that focusing on monitoring and follow up would reduce non-performing loan of the bank.

4.1.2. Secondary data analysis

4.1.2.1. Trend of non-performing loans

Figure 4; Trend of NPL in DBE (2009 to 2019)



Source: Source: Data from credit process in DBE

The above figure shows the trend of non-performing loans ratios for the past ten year's period under review. As it is stated in the literature Non-performing loans ratio refers to the total amount of bad loans expressed as a percentage of the total loan portfolio during the period. The ratios of non-performing loans for the year 2018 was the highest rate registered in the bank during the last ten years while the year 2011/12 shows the lowest NPL ratio which is 7.5%. The trend of NPL ratio declines from 33.5% in 2008/09 to 7.5% in 2011/12 and increases from 7.5% to 40% in 2017/2018 shows a smooth increment after the year 2012 and decreases to 34% in 2018/19 the main reason for the decrease in the ratio is that the bank takes measure and strengthen its loan follow up by tracing each and every loan .The trend shows a significant increase in NPL ratio, the rate were still much greater than 5% level which is high according to NBE guideline 2018.Generally the trend shows low loan recovery performance of the bank.

4.1.2.2 Analysis of interview

In order to get deep understanding about the factors affecting nonperforming loans, in-depth interview was conducted with senior bank officials. All of the interviewees have had over 10 years credit experience in addition to their several years of banking experience. In terms of profile, credit vice presidents, credit process manger and senior credit analysis members participated. The respondents have a lot in common as to what they believed cause occurrence of nonperforming loans. According to the interviewer's response the five Cs of credit character, capacity, capital, conditions, and collateral. Together, these serve as a way for lenders to evaluate the creditworthiness of potential borrowers. Both personal and business credit worthiness. According to the respondent's response in DBE the five Cs are not properly considered when loans are given to borrowers in addition to this malpractice of loan policy and procedures, lack of close follow up, inadequate customer due diligence assessment, lack of skilled and efficient Management for the project and poor infrastructure in the project area plays a great contribution in lowering loan recovery performance in DBE.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1. Introduction

This Chapter presents summary, conclusion and recommendations of the major finding of the study's and provide recommendation and areas of further study and revelation of both theoretical and empirical issues that underline the Loan Recovery performance and trend in DBE.

5.2. Summary of Major Findings

The study which was conducted to assess the Loan Recovery Performance of DBE shows that there are internal and external factors contributing to NPLs. From those internal factors malpractice of loan police and procedures, lack of close follow up, lack of skilled man power, and in adequate customer due diligence assessment has negative influence on the Loan recovery performance of the Bank. From the study it was discovered that; rate of inflation, Gross Domestic Product and interest rate are the major macro-economic factors that affect the loan recovery performance of the bank. This therefore lead the Bank to problem of cash flow which increased provision held. This also reduced the profitability of the Bank. Moreover, it affected the capital adequacy and liquidity which could lead to situation where the Bank would not be in a position of granting of new facility, and also increasing of non-recovery of Loans that incur other costs of the Bank that are associated with debit Recovery.

5.3. Conclusion

The process of loan from application to approval is the normal and routine activity of the bank. But DBE process of loan needs improvement because credit is the core activity of the bank.

The result of present study indicated that the major causes of repayment failures are internal (bank specific) and external (macroeconomic).The bank specific factors are malpractice of loan police and procedures, lack of close follow up, lack of skilled man power, and in adequate customer due diligence assessment and the macroeconomic factors are rate of inflation, Gross Domestic Product and interest rate.

The study shows that the five C's are not properly used for the selection of borrowers in order to give loan.

Now day's modern software is the important instrument to improve the loan process performance in the bank like speed, information and resource sharing. In DBE credit follow up are supported with software.

The study result indicate that the major mechanisms that DBE used to decrees NPL are making high follow-up after the Loan approved and making KYC before the loan is approved.

The result of the research show that, the Bank faced during recovery of nonperformance Loan are unavailability of additional collateral, complicated Bank procedure, complicated Legal procedure and deprecation of collateral are the major problem for recovering non-performing loan.

The result of the study shows that, 51.22% of respondents replayed agree and 46.34% of the respondents strongly agree to strict monitoring and follow-ups ensure loan performance.

The result of the study show that 35.37% and 41.46% of respondents replayed strongly disagree and agree to poorly assessed and advanced loans may perform well if properly monitored or follow up are not substituted analysis.

The result of the study show that 52.44% of respondents replayed that Loan follow up is directly related to occurrence of nonperforming loans.

The results of the study show that 58.54% of respondents replayed Banks with higher budget for loan monitoring have lower nonperforming Loans.

The surveyed document shows that the Bank Loan recovery performances are decreased year to year this is a negative impact for the Bank performance.

The surveyed document shows that, from the total outstanding Loan balance of June 30 2018, report of the Bank the total Loan of status nonperforming Loan is 34% that is unfavorably higher.

5.4. Recommendation

After analyzing result obtained for responses to questioners and interview gathered from the Bank employees and comparing with the theoretical framework in various literatures and sound international practices, the following recommendations are made the view to improving the Loan Recovery performance of DBE.

- The bank should give continuous training for its employees on loan procedures and techniques of loan follow up.

- The bank has to use the five C's effectively for the evaluation of overall creditworthiness of borrowers.

- The bank must have to develop a strong credit assessment and follow up to facilitate the control of NPL status of Loans and improve its service delivery.

- The Bank has to give technical support for all financed projects that help for strengthen the collection and realize the smooth implementation and operation of the projects.

- Bank should have policies covering the acceptability of various form of collateral, procedures for the ongoing valuation of such collateral, and process to ensure that collateral is continues to be enforceable and realizable.

- The bank has to revise its interest rate for both priority and non-priority areas in order to enhance its loan recovery performance.

- To solve the problem of shortage of loan able funds, the bank should make strong effort to reinforce the ongoing Loan collection activity to achieve the objective of the bank and strong follow up by the Bank officers can help the Bank as to where the customer business status and the collateral position are, which in turn helps the management for sound decisions.

Questioners

Part I

SECTION ONE – BACKGROUND INFORMATION

1. Your current position in the Bank

Loan Officer	1	Relationship manager	4
Credit analyst	2	Recovery/ monitoring officer	5
Credit Director	3	Vice president	6

Other, please specify _____

2. Indicate your experience in the bank

Less than 1 year	1	6-10 years	4
1-5 years	2	Above 15 year	5
11-15 years	3		

3. Indicate your experience in bank credit processes

Less than one year	1	6-10 years	4
1-5 years	2	Above 15 years	5
11-15 years	3		

Macroeconomic factors affecting loan recovery performance	Rank 1=highest ……3=lowest
Interest Rate	
Rate of Inflation	
Gross Domestic Product	
Others, Please specify_____ _____ _____	

4. Please rank the factors that affect loan recovery performance in DBE

N.B Rank the factors in order of their importance in contributing to loan recovery performance from 1-3

SECTION TWO – QUESTIONS ON FACTORS AFFECTING LOAN RECOVERY PERFORMANCE

Please indicate your degree of agreement or disagreement to the statements that affect loan recovery performance

		Strongly Agree (1)	Agree (2)	Neutral (3)	Disagree (4)	Strongly Disagree (5)
1	Strict monitoring ensures loan performance					
2	Poorly assessed and advanced loans may perform well if properly monitored					
3	Loan follow up is directly related to occurrence of nonperforming loans					
4	Banks with higher budget for loan monitoring have lower non-performing loans					

Please indicate your degree of agreement or disagreement to the statements pertaining to Collateral and loan recovery performance

		Strongly Agree (1)	Agree (2)	Neutral (3)	Disagree (4)	Strongly Disagree (5)
5	Collateralized loans perform well					
6	Collateralizing loans help protect loan default					
7	Most of the time non collateralized loans are defaulted					

Please indicate your degree of agreement or disagreement to the statements pertaining to borrower's orientation and loan recovery performance

		Strongly Agree (1)	Agree (2)	Neutral (3)	Disagree (4)	Strongly Disagree (5)
8	Borrower's orientation/culture is related to loan performance					
9	There is a relationship between loan default and borrower's culture					
10	Default in some area is ascribed to the culture of the borrowers					
11	Society's cultural development leads to good loan performance					
12	Loans with big interest rate tend to turn to NPL					
13	Charging big interest rate leads to loan default					
14	Loan price affects loan performance					
15	Lenient / lax credit term cause loan default					
16	Borrowers default because they don't understand credit terms well					
17	Poorly negotiated credit terms lead to loan non-performance					

Please indicate your degree of agreement or disagreement to the statements pertaining to Credit size and loan recovery performance

		Strongly Agree (1)	Agree (2)	Neutral (3)	Disagree (4)	Strongly Disagree (5)
18	Aggressive lending leads to large NPL volume/ratio					
19	Banks whose credit growth is rapid experience huge NPL level					
20	Bank's great risk appetite is cause for NPL					
21	Compromised integrity in lending leads to loan default					
22	Having large number of borrowers causes loan default					

23. If you have further comments on the bank specific factors affecting loan recovery performance of DEB please use the space below

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