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ADDIS ABABA UNIVERSITY
SCHOOL OF COMMERCE
GRADUATE STUDIES

Assessment of Non-performing loan in Dashen Bank S.C

**A Research Paper Submitted to the School of Commerce of Addis
Ababa
University in Partial Fulfillment of the Requirements for the Degree
of Master of Art in Business Leadership.**

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**ADDIS ABABA, ETHIOPIA
FEBRUARY, 2020**

DECLARATION

I, the undersigned, declare that the thesis which is being prepared in this project paper entitled ``**Assessment of Non-performing loan in Dashen Bank**`` is my original work. I further assure that the thesis has not submitted to any other university or learning institution for any academic award.

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Approved by Board of Examiners:

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ABSTRACT

The main goal of commercial banks is to operate profitably in order to maintain its stability and improve growth and sustainability. The problem of non-performing loans is seen as a burden on any country's economy or financial institution and putting downward pressure on its growth. This is because the role of banks as financial intermediaries does not function properly due to the problem of non-performing loans (NPLs). In view of that, this study has been tried to examine the factors affecting non-performing loans in Dashen bank S.C. The research methodology adopted descriptive research design based on both open ended and close ended structured questionnaires to gain in-depth understanding. A sample size of 110 respondents was used and Simple random sampling method was adopted for the study. The findings indicated that poor risk assessment and poor monitoring/follow-up as the major reasons for the occurrence of loan default/ non-performing loan followed credit culture /orientation and interest rate. The study suggests that much attention should be given to proper credit assessment and risk management techniques, introducing and implementation of an aggressive debt collection policy, and strong loan follow-ups. Besides, the bank should exert additional effort to better manage its NPL position.

Keywords: *Banking industry, financial performance, Non performing loans,*

ACKNOWLEDGEMENT

It gives me a great happiness to extend my deepest gratitude for the help I received to accomplish the thesis. First and foremost I would like to thank the almighty God for his unreserved mercy, love, patience and strength in my life. My sincere thanks go to my supervisor, Dakito Alemu(Phd) for his invaluable comment, prompt advise, patience and guidance.

I extended my deepest thanks to my family for their backing and love. Special thanks to my late sister Selamawit Gezachew who encourage me in my life. I would also like to thank the staff Dashen Bank for their engagement in providing me all the necessary to carry out this project paper

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CHAPTER ONE

Introduction

1.1 Background

Ethiopia's banking industry goes as far as 1905, when the bank of Abyssinia emerged under the agreement between European banking group and Emperor Menelik II. The agreement prohibited the establishment of any other bank in Ethiopia, thus giving monopoly right to the Bank of Abyssinia. However Emperor Haile Sellassie, closed the Bank of Abyssinia, paid reimbursement to its stakeholders and established the Bank of Ethiopia which was fully owned by Ethiopians. The Bank started operation in 1932. The majority shareholders of the Bank of Ethiopia were the Emperor and the political elites of the time. The Bank was authorized to combine the functions of central banking i.e issuing currency notes and coins and commercial banking.

Following the 1974 Revolution, on January 1, 1975 all private banks and 13 insurance companies were nationalized and along with state owned banks, placed under the coordination, supervision and control of the National Bank of Ethiopia. The three private banks, Banco Di Roman, Banco Di Napoli and the Addis Ababa Bank S.C. were merged to form "Addis Bank." Eventually in 1980 this bank was itself merged with the Commercial Bank of Ethiopia S.C. to form the "Commercial Bank of Ethiopia," thereby creating a monopoly of commercial banking services in Ethiopia. (Fasil et al, 2012)

Post 1991, trade liberalization enabled the financial sector to re-recognized the existing state owned bank and enable establishment of private of financial institution. With 1991 reform private financial institutions started functioning with goal of provision of banking service throughout county and National bank of Ethiopia as a sole organ to license, supervise and regulate banks, financial institution and insurance companies

Financial institutions have very decisive contribution for any country. Banks take customer excessive deposits in return for paying customers an annual interest. The bank then uses the majority of these deposits to grant credit to other customers for a variety of loans. The difference

between the two interest rates is effectively the profit margin for banks. one of the major component of banks asset is loan and advance. it represents the majority share of the banks operating income with higher risk.

The term credit may be explained as the provision of financial accommodation to a person, in return for a promise to repay it at some future date. Credit may be extended as a cash loan, or through the medium of deferred payment for the supply of goods and services. Credit transactions may also be classified according to the purpose for which they were extended, method of repayment and whether security is taken. Whatever the classification may be, the economic function of credit remains the same, i.e. it enables a person to spend in excess of his current or actual receipts, and to facilitate the present enjoyment of goods and services other wise beyond his means (John P. Bonin and Yiping Huang ,2001).

Failure to manage loan, would likely lead the rate of high level of non-performing loan. According to National Bank of Ethiopia directive, (NBE, 2008) Non-performing loans (NPLs) are loans that are not expected to earn income and: (1) full clearance of interest and principal is no longer expected, (2) interest and/or principal not duly paid for 90 days or more, or (3) the loan advance expiry date has elapsed and full settlement has not been made. When repayment was not made at a timely manner, it affects the overall performance and profitability of the bank. The failure of loan collection in a timely manner leads to increase loan provision for bad and doubtful debt expense that decrease profit for the period in which it was made. Furthermore it affects the overall liquidity and creditworthiness of credit institution and limit further lending's. The financial institution with a large loan portfolio in non-performing, which in turn would affect their capital ratios. In such situations, the bank may find itself having to offer higher than average deposit rates to attract more capital. Inevitably, these higher rates will be reflected in the bank's lending rate. Higher lending rates may in return adversely affect the average quality of future lending, forcing the bank to lend high-risk borrowers. If the bank is to lend to the more creditworthy borrowers, it may be forced to cut margins to levels, which would be insufficient to generate profits (Brown Bridge 1998).

Credit monitoring implied to activities to guarantee that the financial institution realize existing non-financial and financial situation of the loanee or other parties such as guarantee and shareholder; to make sure that all loan and advance are in line with the existing policy and

procedure; follow the existing credit request and approval outlines; safeguard that expected cash flows on major credits meet loan repayment standards; confirm that pledged security safeguarded the request (Seppala, 2000).

Loan recovery is the process of pursuing loan which were not repaid on a timely manner as per the contract and handling to recover from non performing status by dealing with borrower and/or guarantee to repay the accrued arrears. In most banks there is loan recovery and management department which in the responsibility of controlling loan and advances prior to become NPL and tries to improve loan status. In order to minimize NPL recovery the following effort are taken; telephone call to the loanee and discuss possible way to repay the loan ,use of written reminders which has proved to be a good way to enforce loanee to pay up the expected advances. Furthermore Credit Reference Bureau (CRB) enable defaulters not to default in other financial institution as the institution (Banks) have a chance to identify loan history of defaulter and therefore enable to block loan defaulters from applying and taking loan and advance from other bank hence controls the continuing loan default culture across banks.

1.2 Statement of the problem

Credit is one of the main sources of income and basic services of banks. Banks offer arrange of credit product in terms of sector, facility, loan tenure to meet the existing and/or future benefit demands of the economy. The loan and advance availed to different sector and loanees should be collected with the aim of maintaining financial stability and to circulate the finance to match the mounting demand of loan request and to keep the financial institution stable and competitive in the sector. If the credit facility given to customer not paid regularly and timely it leaves the financial institution to loan default risk. It is wise to realize that in spite of careful assessment of customer in the loan appraisal practice which consist of others; proof reading of credit information from CRB, checking that customer does not have other obligation from government and tax authority, analysis of their past credit history, consistency of earned income, type and value of security and readiness to pay, there are problem in collecting repayment from loan and advances granted to customers.

In order to stay competitive in the market and optimize profit, banks expected to involve in managing credit risk. This include creating comprehensive credit assessment and evaluation

techniques that bank in protecting against any effects of credit risk. Furthermore, bank should periodically amend credit policies, procedure and recover strategies that insure that the losses arising from bad debt are decreased. This research hence plans to critically observe Non-performing loan and its recovery performance in commercial banks with the aim of being competitive and profitable with in the financial sector.

Credit management practice in financial institution could serve as a reagent for fast expansion in their extent of influence. By showing the way of the existing funds to economy, functional policy, procedure and portfolio mix of the banking system to huge extent will not only offer space for economic advancement in the country but also for wealth creation and income distribution. There are many studies were conducted outside of Ethiopia regarding non-performing. But non-performing loan occur due to reasons at state level, financial institution(Bank) level and the fourth coming legal and regulatory framework. Furthermore political, social, cultural, and other relevant factors vary greatly across boarder.

In our country case there are few research conducted specifically on commercial banks,(Endashaw,2015) conducted study on bankers perception towards the impact of bank specific factor on non-performing loan in United Bank S.C and found out Poor financial and risk assessment, self-dealing, monitoring and follow up, collateral status and loan period were cause for incidences of NPL. Abay,(2015) asses loan recovery performance of Construction and business bank which were later merged with Commercial Bank of Ethiopia with the objective of provision of consultancy service in construction and business activity. The study inclined to construction sector and found out providing advisory service to credit customer before and after granting credit is an important. There is no research done on done non-performing loan and its recovery performance in Ethiopian private Bank so far to my knowledge is concerned.

Dashen Bank, as one of financial institution in Ethiopia, has been providing various loans and advances in the form of different types of credit facilities based on its eligibility criteria to various economic activities ranging from agricultural projects to manufacturing industries found in different parts of the country, hence playing its role in supporting the national development endeavors since its establishment. However, prevalence of higher NPL amount, the profitability of the bank has not increased as expected that each NPL case is reviewed in tandem with the NBE's directive to accumulate provision which is the percentage of NPL amount to be deducted

from annual profit of the Bank each year to give allowance for possible loan losses that arise due to various causes (NBE directive No.SBB/43/2008).Therefore, this study was to assess the non-performing loan to find out factors affecting non-performing loan of the bank. Factors such as associated Identifying potential creditors, estimating and checking appropriate values of collateral and loan documentation of creditors, preparing customer's disbursement instruction and follow up their periodic loan repayments was assessed in depth.

1.3 Research questions

The study is designed to seek answers for the following major research question

- What are factors contributing to non-performing loan?
- How does the credit assessment of Dashen bank look like?
- How does the credit monitoring practice of Dashen bank look like?
- How does collateralized loan perform?
- How does interest rate affect non performing loan?

1.4 Objectives of the Study

1.4.1 General Objective

The main objective of the study is to examine and evaluate practice of non-performing loan and its recovery performance of the Dashen Bank.

1.4.2 Specific Objective

The specific objectives of the study are:

- To find out the reasons for the happening of non-performing loans.
- To examine the effect of credit assessment on non-performing loan.
- To assess the effect of credit monitoring and follow up practice on non-performing loan.
- To examine the impact of non-collateralized loan on the occurrence of non-performing loan.
- To assess the effect of interest rate on non-performing loan

1.5 Significance of the study

The outcome of the study would benefit a number of partakers; the executive of various banks and credit relationship manager in particular would take advantage by receiving insight on different credit monitoring and follow up tactics. This will permit them in revising loan appraisal procedure and policies, manuals and other relevant documents. Furthermore it would assist the bank in designing sound and effective loan recover strategies. This will craft appropriate and effective credit recovery strategies. This will certainly affect the overall affect the overall performance of the financial institution and minimize the danger related with default loans.

For other researchers it can be served as additional reference. The finding would enhance value to the current finding in loan monitoring and recovery practice. It would also serve as the basis upon which other interrelated and replicated research can be founded on and also recommend possible research area for the future research.

1.6 Scope of the study

The study intends to address multiple issues regarding non-performing loan and recovery practice in Dashen Bank S.co. The study focuses on Credit Director, Credit Analysts, credit relationship Manager, Branch manager, credit relationship officers, credit Portfolio and recovery managers and officers at credit department of the bank.

1.7 Definition of term and concepts

Loan and advance – A financial asset of a bank arising from direct and indirect advance a financial institution to person, organization and any legal person that are conditioned on obligation of a loanee to repay the Advance or commitment with in a predetermined period.

Non-performing loans – Loans or advance whose credit quality has deteriorated. In which it is unable to collect the principal and/or interest in accordance with the predetermined repayment mode and amount. As per the NBE Directive, SSB/45/008 the loan classified as non-performing when principal loan and/or interest is not paid for 90 successive days or more above the preplanned repayment date or expiry date.

Borrower - is a person or organization that takes and use of loan under agreement to pay it back later with interest

Bank – is a financial institution licensed and supervised by a central organ to receive deposit and make money. Banks also provide currency exchange service and safe deposit boxes.

1.8 Limitation of the study

The outcome of the project is dependent on respondent response that participated in the study and most of the respondent had to stop their work to respond research questionnaires making it a hard, furthermore some other respondent were reluctant to fill research question and delayed in returning questionnaires. Regarding the matter of time limitation, the student had to undertake his project while employed on permanent job. This hinders the student to takeout more detailed study in the topic.

1.9 Organization of the paper

The paper has five chapters. The first one deals with the introductory parts, which have back ground of the study, statement of the problem, research questions, objectives of the study, significance of the study, scope of the study and definition of terms and concepts. The second chapter contains the related theoretical and empirical literature review. The third chapter deals with research design and approach, sample and sampling techniques, data collection instrument, data analysis tools and research methodology. The fourth chapter deals with the data presentation, analysis and interpretation of the study finally, the last chapter contains the conclusion and recommendations of the research study.

CHAPTER TWO

2. REVIEW OF RELATED LITERATURE

2.1 Theoretical review

2.1.1 The concept of credit

The word "CREDIT" is came from Latin word *credium*, which means to have faith in or confidence. In finance, the word credit denotes to the willingness and ability of the loanee to return the borrowed loan and advance or received service with in the predetermined time period. It is a means of interchange to obtain loan and advance on request at some fourth coming time. R.P Kent defines credit" as the right to receive payments or the obligation to make payment on demand at some future time on account of the immediate transfer of goods"(M.L Jhingon, 2015).

The main reason financial institution/bank is functioning in the financial sector is to maximize their earning by advancing loan and advances to the economy Banks/ financial institutions are expected to provide loan and advance with different facilities to their customer and to the overall community for genuine and trustworthy business and consumer demand/request and to charge reasonable price/interest rate. Indeed, it is the basic economic task of financial institution/Bank is provision of loans and advances and related service to the commercial units and individuals who are involved in different economic Sectors (Agriculture, Transport, construction, manufacturing, mining, import/ export, Domestic trade and services, personal loan etc...)The bank's expected to search, recruit and support potential loanee and advancing project finance for new or expansion project working capital for existing business from which it is capable of repaying the loan and advances.

The healthy functioning and sound loan processing in financial institution/Bank has a huge impact and implication to the economic development and growth of a given economy, because bank loan and advances provision help to grow new business and generate job opportunities, stimulate economic growth, promote social wellbeing, furthermore, loan and advance information convey the desirable information to the marketplace about borrower loan quality/Default, price, empower a loanee to get additional and cheap loan and advances from other financial institution.

For most commercial banks, loan and advances takes fifty percent or more of their total asset and sixty five percent of their income, furthermore majority of the risk in the financial sector emanate from this loan and advances. When a financial institution/bank gets serous finical problem, its problems usually come from loans and advances that have become irreversible due to misconduct, illegal handling of loan, unwise credit policies and procedure, or unanticipated economic recession. (Yonas, 2004)

2.1.2 Credit Lending Principles

According to (Bedi & Hardikar 1993) when evaluating loan requests, bankers can make two types of errors. The first is extending credit to a customer who ultimately defaults; the second is denying a loan request to a customer who ultimately could repay the debt. In both cases, banks loose a customer and its profits. To minimize such errors and prevent problems of loans before their occurrences, there are few general principles of good lending that should be noted while considering an advances proposal. (Genet,2018)

Liquidity: All loan requests can be positively entertained only when the business of the loanee is proved to show the required level of liquidness which can be firm by the Bank based on its periodical assessment of financial guidance for different sectors.

Profitability: The Bank extends loan facility only to value creating/adding businesses. The ability of a business to create value can be valued at least in the short term using the level of profitability. The minimum standard profitability for each sector is determined by the Bank based on its timely assessment.

Safety: The loan facility extended to loanee should be secured by the intangibles or tangible assets of the customers. The loan committee should determine the level of the security required to guarantee the approved loan.

Purpose: All loan requests should explicitly and precisely state the reason of the loan request and same should be checked by the Bank. Only legal and reasonable request that create economic and social value and are acceptable by entertained.

End Use: All loan facilities granted to customers should be closely monitored and followed to make sure that the ultimate use of the loan is in accordance with predetermined and agreed purpose agreed during the loan approval.

Feasibility: All loan requests related to new projects and expansion projects should be checked the viability of the project before financing; and for this reason customer or the project promoter should present feasibility study and all relevant document.

National priority: It is obvious that the basic reason for existence of the Bank is to ensure its profit maximization, the credit deployment activities should be tactically aligned to the country's economic priorities based on the related opportunities.

Sector diversity: The credit deployment plans of the Bank should be fairly distributed to all Business sectors taking in to consideration the respective economic prospects and threats.

Transparency: The loan serving process should guarantee that the loanee is well informed about the Bank's credit policies and procedures. And also, the Bank should be well informed of the customer's business condition and information's relevant to the credit decision making.

Commitment: The know-how and assurance of the loanee should be ensured before the Bank extends its financial grantees loan facility. The Bank extend loan facility after ensuring that the customers have the required level of tangible and intangibles resources, to conduct the business as expected.

2.1.3 Types of loan by maturity period

Short term loans- Short-term loans are named as such because they require quick repayment and require an extraordinary pledge loan of a sole purpose with a loan period of equal or less than one year. They are viable solutions to alleviate unexpected temporary financial trouble, such as unusual stock order, an unpredicted raise in account receivable or essential for temporary financing.

Intermediate or medium term loans – Medium term loans are loans with a repayment period between two and five year. To qualify for a medium-term a loanee should have to have average credit, and business should be producing revenue and/or constant income, this loans and

advances to funding the acquisition of fittings, equipment, automobiles, machinery and bureau equipment. Consumer loans for automobiles, boats home repair and remodeling are also intermediate loans.

Long term loans - Long-term loans are difficult for start-up businesses to obtain. Usually, only established businesses with some years of financial success, feasible project loan and mortgage loans and are secured by the asset itself. They usually run between five – twenty five years.

2.1.4 Type of credit facilities

Overdraft facility

An overdraft facility is a form of Credit Facility by which a loaner may be allowed to withdraw beyond the available balance of its current account to agreed limit. The facility is usually used to fill immediate working capital limitation arising in business between acceptance of funds and disbursement of funds. It is an open credit facility, which has a maximum time length one year and granted to businesses which transaction.

Term Loans

Term loan is a loan facility that shall be paid within a predetermined period of time with interest. The loan may be repaid in a lump sum on maturity or in monthly, quarterly, semi- annual or annual installments, depending on the business nature and projected cash flow. Any applicant of a term loan shall open a current or saving account at the Bank. All term loans shall be secured by acceptable collateral but the Bank may grantee loan on a clean basis to its trustworthy customers.

Merchandise Loans

Merchandise refers to a specific product or group of products or goods manufactured, Imported or acquired for the purpose of re-sale or for industries raw materials. The purpose of such loan is to relieve the customer from cash-flow problems arising from cash being tied up with the merchandise. This is a short-term credit facility, which may be availed to customers against physical pledge of merchandise or documentary evidence.

Import Letter of Credit

A Letter of Credit facility is a facility issued by the Bank at the demand of an importer. By issuing such instrument the Bank commits itself to pay to a seller agreed some of money upon presentation of quantified documents on behalf of the supply of goods within specific time limits and the documents assuring the terms and conditions agreed by the importer and exporter.

2.1.5 Loan Classification

Under the Ethiopian banking business directive, Banking Business Proclamation No. 592/2008 loans and advance are classified into five categories based on the repayment performance:

Pass loan

Loans or advances completely secured by the willingness and ability to pay the loan with in the pre-established term and condition and not suspected to default. In addition, any loan and advance which is totally secured, the advanced loan and interest, by cash substitute or cash ,shall be categorized under pass status regardless its past and current loan status.

Special mention loan

For term Loans and advances with predetermined payment arrangement elapsed thirty consecutive days or above, but not exceeding ninety days. If it is Overdraft facility that do not have predetermined payment arrangement it should justify one of the four conditions to be special mention

- A. The loan facility remains unpaid for thirty consecutive days or more beyond predetermined payment expiry date, but less than ninety days or
- B. The loan facility Passes the loanees` approved limit for 30 thirty consecutive days or more, but less than ninety days or
- C. Payable Interest is accrued and not cleared for thirty consecutive days or beyond; however it should not exceed ninety days or
- D. The loan and advance has been passive for thirty following days or beyond but less than ninety days or the account fails to exhibit one to four percent of the approved limit at least once over a year.

Substandard loans

For advances and loans with pre-determined payment arrangement elapsed ninety days or beyond but not exceeding 180 days of the scheduled payment date. For overdraft loan or advances that do not have a pre-arranged payment arrangement if:

- A. The loan facility remains unpaid for ninety successive days or above the predetermined loan collection or expiry date but not exceeding one hundred eighty days or.
- B. The loan facility Passes the loanees` approved ceiling for ninety days or beyond, not exceeding one hundred eighty days or
- C. Interest is accrued and not cleared for ninety successive days or beyond but below one hundred eighty days or
- D. The loan account has been passive for ninety following days or beyond but not exceeding one hundred eighty days or the loan account unable to exhibit 5% to 19% of the limit at least once over 360 days earlier the date of loan appraisal.

Other than term loans and overdraft facilities presented earlier the subsequent loans shall be classified as substandard.

i. Renegotiated advances with pre-determined payment arrangement, except equal amount of all accrued interest is repaid by the loanee in cash while dealing with the bank and consecutive repayment are done by the loanee on regular and timely basis in line with the renegotiate term and condition of loan and advance;

1. In the instance of term loans with repayment schedule of either monthly or quarterly, a minimum of three successive payments;

2. In the instance of advances with half yearly payment program, a minimum of two successive payments;

3. In the instance of advance with yearly payment program, a minimum of one payment;

ii. Renegotiated nonperforming overdraft advances except e equal amount of all accrued interest is paid by the defaulter in cash while dealing with the bank and the loan account exhibits at a

smallest:

1. zero figure a minimum of one occasion, or

2. A turnover amount of once the granted loan facility ceiling.

iii. Renegotiated bad debt of merchandize facility except stock of merchandize booked by the bank at the instance of discussion exhibit that the total loan and advance are adequately protected and the safety margin decided subsequent stock is a minimum nit lower than the margin quantified in the loan agreement signed by the financier and the loanee while dealing of rearrangement of the facility.

d. If the financial institution/bank has more than one unsettled loan balance as calculated in line with loan limit of single borrower, and a minimum of one advance or loan exhibit non-performing loan condition, then the current loanee`s solvency shall be evaluated by considering future payment prediction for the rest of loan and advances are rationally secured; such written assessment recommend that loan payment forecasts for the rest of advances are in problem or else indeterminate, then all loan and advance of the debtor shall at least categorized substandard irrespective of any necessities placed in national bank of Ethiopia directives.

Doubtful loans

For Loans and advances with pre-scheduled payment arrangement elapsed one hundred eighty days or further however not exceeding one year beyond the pre-established payment date shall be classified as Doubtful. Overdraft and loans or advances that do not have a pre-arranged payment platform if:

- A. The unpaid balance remains unpaid for one hundred eighty successive days or above the programmed loan collection date or loan expiry date but not exceeding one year or
- B. The unpaid balance exceeds the granted ceiling for one hundred eighty successive days or beyond but not exceeding one year or
- C. Interest is accrued and not paid for one hundred eighty days or beyond but not exceeding one year or.

- D. For overdrafts loan advances the account has been passive for one hundred eighty successive days or beyond but not exceeding one year and/or the account not capable to exhibit 20% to 49% of the limit once a year over earlier the date of loan appraisal.

Loss loans

Loans and advances with pre-determined scheduled payment arrangement elapsed one year or more beyond the programmed loan collection date or expiry date shall be classified as Loss. loan such as Overdraft and loans or advances that do not have a pre-arranged payment arrangement if:

- A. The debt balance unpaid for one year or above beyond the predetermined collection date or loan expiry date.
- B. The loan balance surpasses the permitted limit for one year or more
- C. Interest is accrued and uncollected for one year or more.
- D. For overdrafts the account has been passive for one year or beyond and/or the account unable to exhibit 50% and above of the limit at least once over a year preceding the date of loan approval.

2.1.6 The Five C's of Credit

The first stage in controlling the risk emanates from granting a loan and advance contains identifying loanee to assure that they have the willingness and capability to repay the loan. The common evaluation framework is the 5 'C's of credit: capacity, capital, collateral, conditions and character.

2.1.6.1 Character

It is the general impression borrower make on the prospective loanee or investors. The lender subjectively evaluates the borrower capabilities with the aim of checking the readiness of the potential borrower to meet the loan obligations. This is carried out by factoring the client's business experience , knowledge of industry, educational background, customer's savings

behavior from historic record, the type of training, connection to tax authorities, quality of borrower's credit references and history of dealings with bank.

Contemporary developments in IT permit for loan status and history examination to undertaking assisting to not just reveal past extraordinary and poor conduct loan and advance repayment and handling of commitments but will equally disclose the degree of loanee gaining of loan limit (YAW,2015). The bank may also communicate with borrower's customers and vendors to assess how they have dealt with these business partners in the past. Better and sound credit profile of the loanee, will imply the higher the reply of the loanee to changes.

2.1.6.2 Capacity

Capacity to repay is the most important of the five factors and assesses borrower's capacity to pay the obligation when given in the obliged time period. This is decided by analysing the valuation of loanee investment and resource presented as assurance for the loan and advance. Payment history on past and current credit worthiness either personal or commercial is considered as an indicator of future payment prospect.

In order to assess the loanee capacity to serve the loan lender will be looking history of loan repayment and projected cash flow and compare that to the company's projected debt service requirements. There are a variety of credit analysis metrics used by bankers to evaluate this, but a commonly used methodology is the ``debt service coverage ratio``.

2.1.6.3 Capital

Capital is the cash and in kind investment in the business and is a sign of how considerably is at threat should the business collapsed. Interested lenders and investors will expect you to have contributed from your own assets and to have undertaken personal financial risk to establish the business before asking them to commit any funding Lenders will generally consider the company's debt-to equity ratio to understand how much money the lender is being asked to lend (debt) in relation to how much the owners have invested (equity). A high debt-to-equity ratio also indicates that the company already has a high level of loans and could be a higher financial risk.

2.1.6.4 Collateral

Collateral is a means of guarantee for the creditor. Creditors customarily necessitate collateral as a kind of assurance in instance if the loanee unable to repay loan and advances. If you default on the loan, then the lender takes possession of the collateral in place of the debt. Buildings, machinery and Vehicles, inventory share certificate and personal guarantees are the most common form of collateral.

In most cases, the bank wants the loan amount to be exceeded by the amount of the company's collateral. The reason the bank is interested in collateral is as a secondary source of repayment of the loan. If the company is unable to generate sufficient cash flow to repay the loan at some point in the future, the bank wants to be comfortable that it will be able to recover its loan by liquidating the collateral and using proceeds to pay off the loan.(Endashaw,2015)

2.1.6.5 Condition

Conditions refer to the intended purpose of the loan, for example working capital, additional equipment, or new offices. At this point there is principal financial and commercial situation which may impact or be a limitation to the loanee's ability to repay the commitment and which may turn out to be negative consequence to the Bank. Instance in fact, under inflationary inclinations, it is wrong to extend loan facility as the leaser is confident to invite loss on the borrowed outstanding if not receiving lower revenues (YAW,2015).

The banker is going to assess the conditions surrounding of Loanee Company and overall industry and political and social factors to determine the key risks factors affecting the company, and also, whether or not these risks are mitigated. Even if the company's historical financial performance and loan serving culture is strong, the bank wants to be sure of the future feasibility of the business. The bank would not advance loan if it looks like the viability of the business is threatened by some unmitigated risk.

2.1.7 Factors Affect loan quality

Different studies shown that, loans are the main asset of banks. This valuable asset of banks can be affected by different reasons which would directly and indirectly affect non-performing loan

and hence profitability of the institution. As Rawlin et al. 2012, shown in his study that the factor that affects banks loans have their own effect on none performing loans.

2.1.7.1 Interest rate

Interest rate is the price of the loan able funds and serves to allocate credit and moderate the level of investment (Ross, 1991). Interest rates can be seen at from the lenders' and borrowers' view. To the lender, interest rate is the costs of borrowing money expressed as a percentage of the amount borrowed (Martin, 1998). A lender asses all costs including interest rates to depositor and expected returns before deciding to take a loan or not. To the lender, interest rate is determined by analyzing other costs such as costs of deposit (Deposite interest), the inflation rate, administrative expense, loan default provisions and capital growth (Kasibante, 2001). The charged interest rate should be able to cover all costs and make a contribution for profit.

2.1.7.2 Collateral

Collateral tangible and intangible assets including personal guarantee that the debtor initiates for advance and loans to lessen the creditors` threat in instance loan default. Collateral is reserved to lessen the creditor`s threat in the incident of loan default and work as a alternative way of collecting advances. Sound collateral increases the loan availability and improves the terms and condition of the available credit. The type and value of availed collateral influences the banker decision on the amount, term and condition of the contract, and interest rate.

According to De Lucia and Peters (1998), in the financial sector, collateral is necessary for the following three aims:

- ✓ To Guarantee the complete assurance of the loanee to its commitment.
- ✓ To serve as a protection for borrower not to deviate from the plane
- ✓ To provide as insurance while the borrower is default

2.1.7.3 Loan Follow up

Loan granted after credit risk assessment and appraisal of financial and non-financial information's credit despite of that recorded history and loanee condition at the time of loan grantee cannot guarantee future payment and borrower intentionally or unintentionally may not commit responsibilities as per the pre-established and agreed standings and settings of the loan agreement. Hence loan follows up and monitoring is very important. It is important in the way that

- ✓ Guaranteed loanee obedience with agreed loan contracts.
- ✓ Follow-up finale use of ratified loan and advances
- ✓ Ensure viability of the operation and existence of the business/project
- ✓ Detect deviation from the planed course of action
- ✓ Safeguarding retrieval of the repayments of the outstanding balance in instance of term loan in accordance with the agreed mode and amount
- ✓ Recognizing timely warning indicators, if any, and to take corrective action.

Mainly there are three types of loan monitoring and follow up systems. These are financial follow up, physical and legal follow up.

According to Harrison, D (1962) and Anjichi (1994), most of the distresses and hindrances of deliberate and distresses advances can be prevented by loan monitoring and supervision. It helps keeping the loan to be clean. It may be go to see the loanee' business area to assess the overall condition of activities and pledged securities. Inappropriate handling of business and collaterals is serving as a primary indication of mismanagement and default.

2.1.8 Credit Recovery Strategies Adopted by Commercial Banks

Loan recovery is the course of following advance and loan which have not been paid as per the contract and handling to improve them by arguing with loanee to exert efforts to pay their principal and interest. Generally, this role of improving advance and loans is not a simple action as borrowers will change their address and telephone to verify unapproachable to the bank. The financial sectors in most scenarios has a loan recovery department which is responsible in

monitoring loans prior to become delinquent and make effort to improve the advance (Garber, 1997).

Loan recovery is highly important element in financial sector because it plays a important part in safeguarding that non-performing loans are regularized. Loan recovery department is engaged in the daily task of safeguarding that loan and advances granted to borrower are collected as per the timetable of agreement contracted by the borrower and financier. The responsibilities of loan recovery involves gathering a list of expired and unpaid loans and proactively handling the credits by communicating borrower where loans are non-performing, draft request letters to default creditor and sending the same to the borrower who are not meeting the obligation. There are numerous loan follow-up and retrieval approaches that have been implemented by many financial institutions.

Daily loan collection actions usually are performed by the loan officers or a credit relationship officer. While loan collection difficulties exist or loan performance deteriorated and risk scores worsen, most of financial institutions find it better to handover default customer to a department that concentrates in loan work-out activity. The extra resources and nearer administration observation of a loan work out department usually improve conditions. An effective loan work out department can help design a plan to recover a troubled borrower to financial wellbeing (Endale, 2015).

Debt rescheduling signifies a change in the existing terms and condition of a loan. A bank had better look rearranging a loan while it is believed that the renegotiating remains in the best interests of the bank and that recovery of some or all part of the loan is rationally guaranteed. In advance of renegotiation a loan, the Bank must reevaluate the borrower's financial situation, capability and source of income to repay the debt if rescheduled. While concerning mode and amount change, the terms and conditions of the renegotiation, comprising the stepping up section, essential is in writing and contracted by the creditor. Rescheduling of loan may include change of mode of payment, change of facility, extension of loan period, waiver of arrears and extension of grace period.

Seizure of collateral is targeted at retrieval of unpaid outstanding loan and advance and not to possess the loanee assets. The recovery procedure through possessing of collateral will involve

possession, estimation of collateral and apprehension of collateral through proper ways. All these would be undertaken in a reasonable and clear way. Reclamation will be made if and only if the notice detailed above is. Due process of law will be reclaiming the pledged collateral. The bank will take all reasonable care for safeguarding the safety and security of the collateral after taking custody, in the ordinary course of the business (Umoh, 2007).

In its efforts to recover a delinquent debt, a bank may use the services of private collection agencies. Hiring a collection agency increases odds of collecting delinquent debts. Collection agency's primary focus is recovering debt. Private collection agencies charge fees, which are paid out of amounts collected. The creditor agency retains the final authority to resolve disputes, compromise debts, suspend or terminate collection action, and refer accounts to Credit Reference Bureaus.

Credit scoring methods implemented by financial institution as a loan recovery strategy. A credit score is a figure that is dependent on an arithmetical examination of a creditor's credit report, and is implemented to identify creditworthiness of creditor. A credit score is mainly dependent on loan report evidences. Financial institution, implement credit scores to assess the possible risk raised while advancing loans to creditor and to minimize losses arising from bad debt. Using credit scores, financial institutions decide who are the utmost capable for a loan, at what rate of interest, and to what loan limits (Capon, 2002).

2.2 Empirical Evidence

The following section reviewed empirical studies till now conducted loan recovery performance and possible cause of loan default. More specifically, studies touching loan recovery performance and possible causes or default risk were reviewed. The literature divides these factors into two parts. The first part of literature focuses on the variables which are called Macroeconomic variables second part of literature focuses on bank specific variables.

2.2.1 Macroeconomic variable

Basel (2013) using appraisal method and panel statistics covering seventy five state over ten year ranging from 2005 to 2010 calculated the major economic causes of default credits. The Investigation offered that real gross domestic product growth was the chief promoter of loan default ratio. In addition, exchange rate depreciations lead to an increase of non-performing loans in countries with a high degree of lending in foreign currencies to un-hedged borrowers.

Keeton (1999) take into account 1982-1996 statistics and used a vector auto regression model to examine the effect of loan and advance growth and non-performing loans in the united states. This testified indication of a solid correlation among loan and advance growth and impaired assets. Keeton(1999) presented that rapid loan and advance progress, which was related by way of diminished credit standards, added to greater credit losses in some states in the United State. In this study non-performing loans was well-defined as loans which are unpaid for more than 90 days or does not accumulate interest.

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 researcher showed that the reason for the kindness were attributed to disaster myopia, crowd conduct, ethical threat and agency problems that may invite loan officers to take risk and advance unreasonably through boom time.

On the other hand, financial institutions that exert high loan price would comparatively face a higher non performing advance rate. A study by Sinkey & Greenwalt (1991) reveals on large commercial Banks in United States a higher loan price charged by banks is linked with non-performing loan. Rajiv & Dhal (2003) utilized a panel regression investigation showed that

monetary factors like higher interest rate have got substantial effect on non-performing loan. Bloem and Gorter (2001) also presented that “bad loans” may noticeably increase by unprecedented interest rate changes. The researcher conferred different international values and practices on recognizing, valuing and following recovery of non-performing loans to discourse the subject from the standing point of monitoring, administering and reduction actions. In the same way, a research by Espinoza and Prasad (2010) focused on macroeconomic and specific factors of banks affecting non-performing loan and their effects in financial System create that higher loan price increase non-performing loans but the relationship was not statistically significant.

Skarica (2013) also conducted a research on the determinants of NPLs in Eastern and central European state. By using the model of fixed effect and seven Eastern and Central European countries for 2007-2012 periods, the research identified that credit growth, actual gross domestic product growth, marketplace loan price, and unemployment and inflation rate as a major factor of non-performing loan. The outcomes implied gross domestic product increment rate and unemployment rate have substantial negative correlation with none performing credit with explanation of rising recession and falling at a time of development has effect on the levels of nonperforming loans. This indicated that economic growth has a strong influence on the economic steadiness. The outcome also revealed that price rises has positive direct effect on non-performing loan with the assertion that inflation might affect creditors’ loan returning capabilities. On the same manner, Jimenez and Saurina (2005) offer confirmation that bad loans are decided by gross domestic product advance, bigger real interest rates and compassionate loan conditions and terms. Meanwhile, Rajiv & Dhal (2003) applied panel regression assesment and testified the fact that promising economic situations and monetary reasons such as expiry date, price and credit, size of bank, and credit culture have significant implication on the nonperforming loan banks in India.

Shehzad et al. (2001) brought experimental proof, by using the data collected five hundred bank from 2005 to 2007, that ownership denoted by 3 stages of ownership ten, twenty and fifty percent has a constructive influence on the possession absorption is defined at ten percent but a adverse effect when the level of possession concentration is well-defined at fifty percent. The finding of the research recommended that allocation of control may brought negative

consequence on the excellence of credit granted up to the limit, however in scenario where robust monitoring owner bank's administration turn into minimized non-performing loan

As per Khemraj and Pasha (2009) study there exist affirmative correlation among actual rate of exchange and bad debt. An increase in rate of exchange possibly will have unlike implications i.e. it can adversely affect the loan payment ability of export sector loan and negatively affect import sector (Fofack, 2005) on different study implies it can certainly affect the advance repayment ability of those creditor who took loan in vehicle currency, the association among exchange rate which account inflation and bad debt is uncertain.

Wondimagegnehu (2012) in his study revealed that weak loan culture, weak loan analysis, aggressive loaning, poor credit monitoring and follow up, compassionate loan condition and terms, bargained honesty, weak organizational capability, in appropriate bank competition, deliberate defaults by loanee and their understanding drawback, unintended use of loan and late funding has substantial effect on non-performing loans. Messay (2017) identified credit spick, profit margin of business, ratio of loan to deposit and saving interest rate remained the substantial promoter of non-performing loan in Ethiopian, And recommended focusing and reengineering the institutions alongside these indicators could reduce the probability of nonperforming loans in Ethiopian. Negera (2012) in his study on Ethiopian commercial banks to identify the determinant reasons which are triggering bad debt financial sector by taking the data from 2005-2010 and according to him poor credit appraisal organizational incapability and inaccessibility of countrywide information for project loan are the reason for non-performing loans. Besides, the research also found out that credit follow up and monitoring plays a crucial role to timely loan collection and hence minimizes non performing loan, and it also showed that over financing were causes for non-performing loan.

2.2.2 Bank Specific Factors

Different studies investigated that bank specific factors contribute to NPLs performance at higher magnitude as compared with macroeconomic factors. The unique future and service of financing sector and the strategy selection of every individual bank in line with their attempt for determined effectiveness and development in the loan threat handling have significant effect on NPLs. hence it is very important to understand and focus more on the management of bank

specific factors which they have a better control and seek practical and achievable solutions to address NPLs problems.

2.2.2.1 Credit monitoring and follow-up

Loan follow-up and monitoring is an important part of loan and advance activity. Financial institution have the accountability to preserve health credit and to recover the outstanding balance which were not paid on due time. Hence satisfactory safety measures are taken during analysis and disbursement of credit, a banker has to be more cautious after disbursement of the loan. Without identifying prior cautionary indications are taken, a financial institution unable to takings important corrective actions against non-performing loans. Financial institutions expected to position a comprehensive and real loan follow up system to observe and identify the creditor's from different scenarios.

In our society, people give more importance on current consumption.so they do not mind to spend the borrowed fund to spend for consumption and divert to un intended purpose if they are not strictly followed up. People hold a very short vision of thinking for today consumption and suffer for tomorrow.

A weak credit analysis and assessment also have role in increasing non performing loans. The standing of loanees to pay credit and the marketplace price of collateral are not properly analysed though giving credit being a reason for non-performing loan (Petersson, 2004). The researsc undertake by Ning (2007) implied the creditor use their individual understandings to advance credit instead of depending on historical data, loan portfolio administration abilities and credit reference bureau information. The financial institution must have basic facts regarding creditability of the loanee, so that non perming loan can be minimized. The researches undertake by Podpiera and Weill (2008) observes empirical correlation among poor loan risk administration and non-performing loan. They conclude there exist positive relationship between bad loan administration and non-performing loan and suggested that supervisory authorities in developing countries must concentrate on managerial execution to improve the constancy of financial system.

2.2.2.2 Increased loan size

Rapid loan and advance growth or too much lending by banks is often identified as significant determinant of bad debt, the study of Keeton (1999) shows direct relationship between NPLs and fast and steady loan growth. The researcher implied a model of vector auto regression on banks found in US between the year 1982-1996 and found out that lenient credit terms and condition is one of the major factor for the happening of non-performing loan. To extend loan, institutions shall lower the criteria of loan terms, follow of loanee and minimize interest rates which crates condition for NPL. In this respect developing countries like Ethiopia financial sector is far from these scenarios because mainly there is high demand of loans and can serve the market without easing standards of credit terms.

Panetta (2013) point out that the main obstacle for loan growth is deterioration of loan risk because of extended recession. In 2013 first quarter, yearly level of bad debt increased to two pint eight percent of total loan and advance to four point five percent for business loans. Panetta (2013) displays affirmative correlation among NPLs and loan decline by banks, or bank lending conduct. He underscore indeterminate economic predictions, high probability of default and the problem in analyzing the trustworthiness of each loanee brought negative selection and dislike to increased credit risk between financial institutions, which therefore implement policies of loan limitations (Stringlitz and Weiss, 1981)

2.2.2.3 Interest Rate

Lending interest rate has an inherent implicit cost on the credit issued by banks with implication on non-performing loans. Most of these studies on interest rate provided widespread evidence emphasizing the importance of NPL recovery strategies in reducing the level of NPLs to attain financial stability and to avoid the financial crisis to happen.

Asari et al., (2011) also found direct relationship between lending interest rate and NPLs. Higher ratios of bad loans will reduce the banks' assets quality and capital erosion. Beck et al., (2013) also found the positive relationship between lending interest rate and NPLs where NPLs can be affected by an increasing interest rate of debt servicing between a borrower and variable rate of contracts. Not only that, but NPL also is likely to be affected by a rise of debt servicing costs of borrowers with variable rate contracts.

Bahrudin et al., (2013) shows the lending interest rate and non-performing loan has an asymmetric relationship in the short-run and symmetric relationship in the long-run. Banks increase or decrease their lending interest rates during the economic recessions; the level of non-performing always increase in the short-run however, in the long-run, the level of NPL is proportionately related to the lending interest rates offered by banks.

2.2.2.4 Loan Sanctioned by Corruption

Recent empirical studies lean toward a common finding suggesting that corruption leads to an increase in nonperforming loans and a decrease in the soundness of the banking system. In developing countries, Sometimes Loan sanctioning authority sanction loan to satisfy their personal interest behavior. Thus they engage themselves with the loanee and commit dishonest activity against the system by granting some advantage or taking something in return. This may be called give and take the chance effect. This is the result of excessive lobbying and rent seeking character in the institutional system (Farhan M, al, 2012)

Using the sample of 107 countries, Barth et al. (2004) find a significantly positive correlation between corruption and nonperforming loans, and the relationship conditions on the degree of development of governance and supervisory mechanisms. Using a sample of 76 countries over the period 2002–2004, Park (2012) investigates the impact of corruption on the banking sector and his results suggest that corruption increases bank nonperforming loans.

2.2.2.5 Ownership structure

The impact of ownership structure on the bank riskiness as measured by NPLs, by view that concentrated ownership results in enhanced banking performance by reducing the bank riskiness, whereas dispersed ownership results in the reduced banking performance and increased bank riskiness.

Banks that are publicly owned have different agency problems and challenges than those of the privately owned because of the wide separation of control and ownership. In publicly owned banks ownership is widely dispersed because of which the control of owners on the managers is relatively weak resulting in the asymmetric of information and divergence of incentives between managers and owners (Jensen and Meckling, 1976). On the other hand private banks are mainly

characterized with centralized ownership because ownership is less dispersed and owners are having larger shares and interest in the performance of banks.

2.2.2.6 Concentration to Priority Sectors

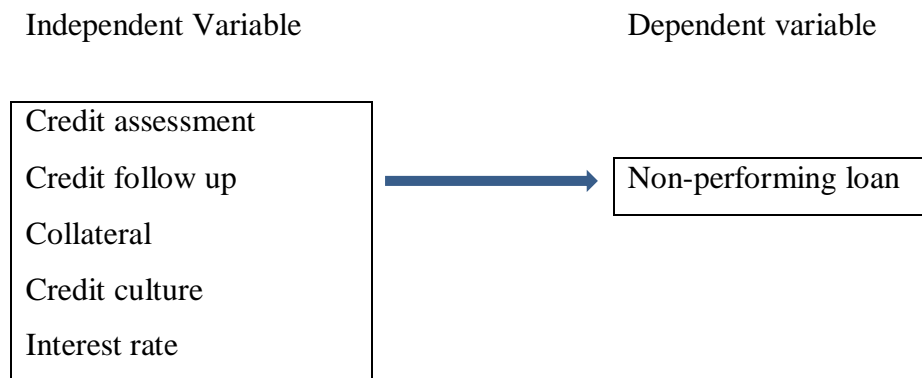
Priority sector lending contributes substantially to non-performing loan of banks. It is important to note that every sub-sector of priority sector is not equally risky and contribute towards non-performing loan. Ahmed (2010), in his research work, studied the lending pattern of banks in different sectors along with growth in different sectors. Researcher also studied how different sub-sectors in priority sector affect the NPL and found that priority sector lending has positive relationship with NPL, but it was not statistically significant. Shabbir and Mujoo(2014) compared the NPL resulting from priority sectors and non-priority sectors in public sector banks, private sector banks and foreign banks. They took panel data of 11 years (2001 – 2011) and compared the growth in sector wise loan advances and sector wise NPL and concluded that public sector banks are having more NPL in priority sector as compared to private sector which leads in terms of higher NPL in non-priority sector.

2.2.2.7 Political interference and NPLs

The commercial banks suffer a great deal when the projects which are being financed by one government face hurdles and banks with strong affiliation with government when there is change of government. When the governments tend to favor a particular sector for their personal benefits, ignoring the future prospects, therefore causing Non-Performing Loans for the banks (Chijoriga, 1997). Khwaja and Mian (2005) present the only empirical study related to information sharing and corruption in setting of Pakistan. This study shows that lending of political firms is 45% greater than other firms. These political firms incur Non-Performing Loans, 50% more than any other firms. State-owned banks are main creditors of these political firms as private owned banks do not take political pressure. The loans of these State-owned banks are turned to bad due to weak implementation of legal framework and political pressure. There is a need to explore the social factors of Non-Performing Loans with reference to Pakistani banking sector, which are missing in previous literature.

2.3 Conceptual Framework Model

The diagrammatic representation of conceptual framework shows how the variables were related. Credit assessment, credit monitoring and follow up, collateral, and interest rate are independent variables; Non-performing loan is dependent variable which depends on the occurrences of the said independent variables



Source: Researcher 2021

Theoretically there exists a relationship among them (i.e. dependent and independent variables). The relationship can be expressed as factors affecting non-performing loans (Y) Credit assessment, credit monitoring and follow up, collateral, credit culture and interest rate(Abay,2015)

CHAPTER THREE

3. RESEARCH METHODOLOGY

3.1 Introduction

The third chapter is an explanation of the methodology applied in the research to find answers to the research problems. In this chapter, the research methodology is presented in the following order, back ground of the organization, research design, Sample Size and Sampling Techniques, Sources of Data and data Collection Instruments, Procedures in developing Instruments, and method of data.

3.2 Backgrounds of the Organization

The Ethiopian banking industry is dominated by a Government owned bank, Commercial Bank of Ethiopia(CBE), and Development bank of Ethiopia ahead of the two prominent private banks, Awash International Bank and Dashen Bank, who together hold significant market share ahead of the other 16 private banks. Given the competitive environment and economic setups, the Ethiopian banking industry has been growing across all key indices such as deposits, loans, assets, revenue and profitability over the last few years.

Dashen Bank S.C Established legally in 1995 E.C as a share company, Prompt Dashen Bank (DB) coined its name from the highest peak in the Country, mount Dashen, and aspires to be unparalleled in banking. Dashen is the most reputable brand in the domestic banking market; a reputation earned through consistent delivery of values and preeminence unmatched by its competitors.

It is one of the leading private banks with assets of worth of Birr 68.26 billion as at June2020; playing its part in the economic progress and development of the country. By the close of June 2020, it operated through a network of 423Branches, 6 dedicated Forex Bureaus, and 355 ATMs and 931 plus Point-of-Sale (POS) terminals spread across the length and breadth of the nation.

Currently, DB has more than 2.2 million account holders and with over 872,297 cardholders using prestigious brands like American Express Gold and Green cards, and Visa branded debit

cards. The Bank has continued to lead the innovation avenue with the introduction of Omni-channel, dubbed AMOLE. The number of AMOLE subscribers has reached 1.98 million.

At the close of the 2019/2020 reporting period, Dashen bank`s Aggregate deposit amounted birr 53.4 billion and the total loan and advance reached to 42.6 billion birr. During the period under consideration a total revenue of birr 7.29 billion and expensed birr 5.5 billion

Dashen Bank strategic corporate statements:

Vision statement: “To be best-in-class bank in Africa”

Mission statement: “To provide efficient customer-centric banking service using the expertise of inspired professionals and cutting-edge technology, while creating sustainable value for our stakeholders.”

3.3 Research Design

A research design is the procedures for collecting, analyzing, interpreting and reporting data so as to obtain answers to research questions. It is the general plan for linking the research problems with the relevant empirical research. In other words, the research design sets the procedure on the required data, the methods to be applied to collect and analyze this data, and how all of this is going to answer the research question (Grey, 2014).

In order to answer the basic research problem the researcher was used descriptive type of research method were results presented, either in words, pictures, charts, or tables,. The major purpose of descriptive research is to describe the state of affairs as it is. It gives a brief explanation of the numerical items under investigation by presenting a profile of group of people and relevant events and to identify the event, characteristics of the phenomenon and this type of study is an appropriate and measure factors affecting non-performing loan and its recovery performance.

3.4 Sample Size and Sampling Techniques

The researcher was collect data by means of simple random sampling technique which gives every member equal chance of being selected. It is the widespread method for choosing a sample

among population for a wide range of purposes. In simple random sampling each member of population is equally probability to be chosen as part of the sample. In this study, the target population was employees of Dashen Bank's at deferent level of credit process (District and corporate relationship managers, credit analyst, Credit relationship officers (CRO), head office credit portfolio and credit monitoring and loan recovery department).

Regarding the population of the study it was focus on credit and risk management department staffs, branch managers and loan officers who are directly related to credit processing, handling non-performing loans portfolio and decision making. Therefore the total population is 549 (318 branch managers, 115 Relationship managers, 34 credit analysts, 60 credit relationship officer, 9 loan recovery office staff and 13 credit monitoring and portfolio management staff). Conferring to Yount, (2006) as cited in Gay recommend that a researcher shall consider her/his sample size 10% of large big population and 20% of small population as minimums. Using Gay's suggestion, the sample size of a research would be 110.

The questionnaire was distributed to credit related practitioners (District and corporate relationship managers, credit analyst, Credit relationship officers (CRO), head office credit portfolio and credit monitoring, Branch Manager and loan recovery department) selected randomly. The questionnaire was distributed physically and through Microsoft outlook to 150 employees (whose posts are linked to bank lending). From the total of 110 questionnaires 98 were completed and collected. Hence the respondent rate was 89.1 percent. While taking in to account of the poor response culture and burden of manager on deposit mobilization this is impressive.

response culture and burden of manager on deposit mobilization this is impressive.

Tabel 3.1 survey response rate

sample size	110
Completed return	98
Response rate	89.1%

Source: Survey outcome and own computation

3.5 Sources of Data and data Collection Instruments

Both primary and secondary data were used in this study. The primary data was collected from Questionnaire prepared for Dashen bank S.C, District and corporate relationship managers, credit analyst, Credit relationship officers (CRO) , head office credit portfolio and credit monitoring and loan recovery department. Secondary data was collected from National Bank of Ethiopia (NBE) and Dashen Bank s.c annual reports. Employing multiple data collection instruments was favored by the researcher in order to improve the quality of data. As a result; three methods were employed, namely: questionnaire, interviews and review of secondary data were used to collect the relevant data.

A questionnaire consisting of closed and open-ended questions for the survey was prepared. The questionnaires were distributed for all the sample population. In general, the questions revolved around factors affecting non-performing loan and its recovery performance

3.6 Procedures in developing Instruments

Research papers with similar areas of this study were reviewed. With the help of clues from the research and other related literatures, both the questionnaires and interview questions were developed in English language. The questionnaires were given to the advisor of the researcher in order to take important corrections.

3.7 Methods of Data Analysis

An attempt was made to employ relevant data analysis tools which are in compliance with the very nature of the data at hand. Tables were also employed to analyze the gathered data. In addition, notes were taken during the interview and the information obtained from secondary data was used to carry out findings of the informants and written materials. Furthermore, the data analysis is presented by compiling the information gathered from both the interviews and questionnaires.

CHAPTER FOUR

4. DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.1 Introduction

The previous chapters presented orientation of the study, literature review and the research methods adopted in the study. This chapter offers an overview of the study and discussion results of the empirical collected data and analyzed from which conclusion are made and recommendation presented for further study and Improvement on Non-performing loan and recovery practice.

The final results are presented to reflect the objective of the study; the analysis is done with two main source of data that is, primary and secondary data sources. The primary data are analyzed using statistical methods for data analysis percentages and tabulation whereas the secondary data are descriptively analyzed.

4.2 Demographic Information

4.2.1 Frequency distribution of respondents by Sex

The respondents were asked to specify their sex in order to make the study gender sensitive. Their response is indicated in table below.

Table 4.1 Frequency distribution of respondents by Gender

Gender	Frequency distribution	Percentage
Female	37	37.8%
Male	61	62.2%
Total	98	100%

Source: Survey outcome and own computation

According to the above table 37.8% of the respondents are female and the remaining 62.2% are males. This data of Gender composition indicates there is relatively good proportionate

employee's participation this research that helps the researcher to collect opinion from both Genders.

4.2.2 Frequency distribution of respondents by Level of Education

In order to be guarantee of the quality of the information given, the respondent were requested to give their level of education and the response is presented below.

Table 4.2 Frequency distribution of respondents by Education qualification

Qualification	Frequency Distribution	Percentage
Diploma	2	2.0%
Degree	45	45.9%
masters	51	52.0%

Source: Survey outcome and own computation

Finding in the table indicate that a large number of respondents were highly educated. This is shown by the 52% of respondents who had postgraduate Degrees, and 45.9% of the respondents were Degree holders and the remaining 2% of the respondents were Diploma holders. By the quality of their education structures, the research presumes that they know the organization mission, vision and goal and will contribute to organizational performance.

4.2.3 The level of Position in the organization

Table 4.3 Frequency distribution of respondents by Education qualification

Position	Frequency	Percentage
Customer relationship manager	23	23.5%
Portfolio management officer	11	11.2%
Credit relationship officer	19	19.4%
Credit Analyst	9	9.2%
Loan recovery officer	7	7.1%
Branch managers	29	29.6%

Source: Survey outcome and own computation

According to Fowler (1986) researcher survey organization varies substantially in the degree on which they dedicate time and finance to make response rate better; thus, there is no standard for response rate. In order to get a better response on the subject matter and issues raised such as non-performing loan, monitoring and follow up staffs who expertise on the issue are selected.

Out of the total respondent 29 were managers including branch and department managers who directly involved on loan processing and disbursement, followed by customer relationship manger and credit relationship officer accounts 23.5% and 19.4% portfolio management officer, credit analyst and recovery officer contribute the rest.

4.2.4 Respondents' experience

Table 4.4 Frequency distribution of respondents by Education qualification

Year of experience	Frequency	Percentage
Less than 1 year	0	
1-5 years	11	11.22%
6-10 years	48	48.98%
Above 10 years	39	39.80%

Source: Survey outcome and own computation

Regarding work experience, 48.98 percent of research respondents' indicate that they had 6-10 years of banking experience. The next higher number of respondents, 39.8 percent, had banking experience of above 10 years. The remaining (11.2 percent) respondents had banking experience of 1-5 years only. This clearly shows that respondents had better understanding in issues raised and providing response and had knowhow

4.3 Presentation, results and discussions

This section focuses on the results of the study in line with the research questions and objectives. The first objective of this study was to identify the factors that influenced nonperforming loans in Dashen Bank. These factors included; Speedy credit advance by banks, Weak credit risk valuation, Weak credit risk valuation, Soft loan term and condition, Loan culture, Bank size, Weak loan follow up and monitoring, Bank ownership structure. Show the factors which influenced non-performing loans in Dashen Bank from the respondents 'opinions. Other research objective also credit assessment, credit monitoring, collateralized loan and their relation with non-performing loan were presented

4.3.1 Respondents rate with credit policy and procedure of the banks

All Banks have their own policy, procedure and memos that directs employee to provide standardize service according to the policy. Dashen have policy and procedure and respondents were asked to confirm whether the credit policy and procedure of Dashen bank is flexible or not.

Table 4.5 Respondent rate of credit policy and procedure of the banks

Answer	Frequency	Percentage
Rigid	8	8.2%
Somehow rigid	43	43.9%
Somehow Flexible	34	34.7%
Flexible	13	13.3%

Source: Survey outcome and own computation

From the analysis of the above table, 43.9% of respondents are reply on the policy of Dashen Bank is ``somehow rigid``. 34.7% reply that banks policy is ``somehow rigid``, 13.3% of respondents give answer is ``flexible`` and the 8.2% perceive it as ``rigid``. As per the collected data, a total of 52 % respondents choose the policy of Dashen is under rigid and somehow rigid category and 48% is under flexible and somehow flexible category.

loan policy is a customary of standard and rules that sets credit and mode of payment and loan period for loanee and set aside clear sequence of act for non-performing loan or late repayment.

There are three main variables (elements of credit policy) namely; Credit terms, credit standards and credit procedures (Hulmes, 1992). Credit policy varies from Bank to bank depending up on the type of sector/business unitfocus, Industry competition and standard, liquidity of the bank, current economic and political condition and the level of risk involved. Credit policy affects banks` performance, as Flexible credit policy to give customers a very liberal, lax terms and standards, increase loanee and outstanding loan balance but also increases Non performing loans. Flexible credit policy has to have a clear framework. Whether the advantages of such a policy outweigh the disadvantages depends on whether you can develop the appropriate terms and conditions and apply them to your customer base in a positive way. Rigid credit policy gives credit to loanee on a highly selective basis. Only customers who have recorded and proven credit history and worthiness and strong financial position are given loans, the main goal of a rigid credit policy is to minimize the cost of collection, bad debts and unnecessary legal costs.

Therefore, the researcher observed and support with theories that the credit police of Dashen is somehow moderate. The risk involved in expanding loan and attracting new loanee were balanced.

4.3.2 Respondent rates with factors that are responsible for incidence of nonperforming loans

Loan default or non-performing loan (NPL) is a loan in where the borrower is in a situation of default and incapable to pay the outstanding loan payment in a as per the agreed term and condition. Respondents were also required to put in order reasons initiating non-performing advance in Dashen Bank in order of importance (from 1 to 8)

Table 4.6 Ranking of factors affecting occurrence of nonperforming loans

Factor that are responsible for nonperforming loans	1	2	3	4	5	6	7	8
Speedy credit advance by banks	9%	4%	9%	14%	16%	26%	10%	14%
Weak credit risk valuation	22%	36%	18%	11%	3%	0%	0%	6%
Higher loan price/rate	11%	7%	18%	22%	31%	3%	5%	6%
Soft loan term and condition	7%	4%	18%	13%	21%	35%	10%	4%
Loan culture	14%	25%	17%	9%	15%	0%	16%	6%
Bank size	9%	3%	0%	12%	4%	26%	23%	21%
Weak loan follow up and monitoring	18%	21%	13%	10%	10%	7%	5%	12%
Bank ownership structure	9%	0%	6%	8%	0%	3%	33%	32%

Source: Survey outcome and own computation

The results in this regard indicated that 40 percent of respondents ranked Weak credit risk valuation and weak loan follow up and monitoring as the top ranking factor responsible for occurrences of nonperforming loans while loan culture is ranked third factor by 29 percent of the respondents. Thus weak credit risk valuation by banks, weak loan follow up and monitoring, loan culture and higher loan price/rate were the topmost factors placed to cause loan default/nonperforming loans. On the other hand, Speedy credit advance by banks and ownership structure of the bank were ranked seventh and eighth.

Weak credit risk valuation would leads to high non-performing loan these mean that the loan analysis's and appraisal lack accurate and suitable valuation to reasonably determine the viability and future prospect of the investment/business. In this scenario, credit relationship officer accept unprofitable business and projects which eventually collapsed and loan repayment is impossible. If the bank has strong knowledge about the credit profile of a borrower then this would bring promote improved loan performance. The five Cs (Character, Condition, Collateral, Capital and Capacity) shall be considered as a basic tool for loan appraisal. In case of failure to conduct proper and adequate credit risk evaluation it would lead to missing any or all of the five Cs and

would lead to loan default/nonperforming loan. Consistent and appropriate follow up and monitoring of a loan would have constructive result on Non-Performing Loans. The research is also in line with, the earlier research voiced that the loans are more protected if the banks have a consistent check on the creditors. Agresti et al (2008) Salas and Saurina (2002), (Berger and DeYoung,1997).

A thorough look into response to the subjective question indicate that some of the factors such as, diversion of fund, under or over financing, lack of integrity, capacity limitation, business failures, political instability are commonly shared view by respondents attributing to cause occurrence of nonperforming loans.

4.3.3 Respondent rate factor relating to credit evaluation and the occurrence of NPL

Credit evaluation performed by a credit analyst/specialist to define a debtor's capability to meet their debt serving obligations. The purpose is to make assure the creditworthiness of debtors by measuring the risk of default that the financial institution is exposed to. The following identified and summarized credit evaluation and occurrence of NPL.

Table 4.7 Credit Evaluation and occurrence of NPL

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Easily accepted debtors are defaulter	25%	28%	28%	11%	8%
Knowing customer`s policy improve loan quality	14%	6%	14%	36%	31%
Strong loan guarantee safeguards credit performance	0%	50%	28%	19%	3%
Weak credit risk evaluation would lead to non-performing loan	53%	39%	0%	8%	0%

Source: Survey outcome and own computation

The result of table 4.4 indicated that 53% of respondents agreed that Easily accepted debtors are defaulter. On the other hand 67% of respondents also agreed that Knowing customer policy does not leads to High NPL,50% respondent Agreed that Strong loan guarantee safeguards ensure

loan performance and 22% claim strong loan performance doesn't safeguard loan performance. Whereas 92% of respondent agreed Weak credit risk evaluation leads to loan default.

Easily Accepted loanee could involve hurry loan approval, without appropriate loan analysis and appraisal of the business as well as the character of the borrower. Credit relationship manager and branch managers should carry out comprehensive and detailed analysis in order to determine the potential loanee by analyzing financial and other factors prior to providing loan facilities. Hence we can conclude that if Dashen banks that employ a strong Know your credit policy in enrolling loanee and also perform good risk assessment it would have a better loan quality and able to minimize Non performing loans. Know your customer information includes the potential loanee business and financial information, organizational structure, loan history or overall track record, and complete profile. On the other hand when the loan guarantee is poor, the loans had high probability of default.

4.3.4 Respondent rate on loan monitoring and follow-up on the occurrence of loan Performance

Banks have a responsibility to maintain the quality of the loan and expected to set up a very sound and effective credit monitoring system for watching the customer's consideration from various perspectives. After the loan request is accepted and entertained, the credit should be consistently supervised. The following identified and summarized response on credit monitoring and loan default.

Table 4.8 Factors indicating loan follow-up and monitoring

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Strict monitoring and follow-ups ensures loan performance	28%	57%	6%	9%	
Poorly evaluated and granted credit may do well if appropriately followed/monitored	9%	41%	13%	37%	
Credit monitoring is directly linked with incidence NPL	16%	38%	27%	14%	5%
Banks having higher financial budget for credit Monitoring have Minimum NPL	14%	43%	22%	14%	7%

Source: Survey outcome and own computation

From the prior 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. This indicates that loan follow up would never substitute poor credit assessment. On the other hand though loan monitoring requires budget, allocating higher budget might ensure loan performance.

4.3.5 Respondent rate on interest rate on the occurrence of NPL

The following identified and summarized response on credit monitoring and loan default.

Table 4.9 Factors indicating loan price/Interest rate

	strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Loans having higher loan price/rate inclined to Default	15%	38%	19%	27%	
Charging high loan price/rate leads to NPL	3%	46%	23%	28%	
Shorter loan maturity leads to Default	4%	4%	38%	46%	8%
Longer loan maturity leads to Default	4%	8%	23%	62%	4%

Source: Survey outcome and own computation

Loan price/Interest rate is well-defined as the price charged by the debtor for the service and money they lent from a financial institution/Bank (Colins and Waanjau, 2011). Loan price has an intrinsic hidden cost on the loan issued by financial institution with antecedent consequence on non-performing loan. Fluctuations of loan price/Interest rate apply considerable impact on the performance and profit of financial institution/bank. It can be understood in the way that a higher loan price yields better bank's profitability. However, the reciprocal will happen if the debtors unable to afford payments which eventually results in higher non-performing assets. From the discussion it can be conclude that higher interest rate is not the major reason for loan default. Only 27 percent of the respondents agree with the statement that loan with higher loan price tend

to turn to Default .In a like manner only 28 percent of the respondents concur with the argument that Charging high loan price/rate leads to default.

Regarding term of loan more than half of the respondent argued neither short nor long term loan by the selves drive non-performing loan only 8% and 12% of respondent argued that sort and long loan period significantly affect loan performance.

4.3.6 Respondent rate to borrower’s orientation and the occurrence of NPL

The following identified and summarized response on borrower orientation and occurrence of Non-performing loan.

Table 4.10 to borrower’s orientation and the occurrence of NPL

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
There exist a strong relationship among is a creditor culture and NPL	23%	65%	10%	2%	0
NPL in certain location is recognized as the culture of the debtors.	8%	71%	13%	8%	0
Peoples` cultural improvement leads to improved credit performance	13%	73%	10%	4%	0
credits with high loan price have the chance to be Default	10%	40%	27%	19%	4%
Loan price affects the well performance of loan	6%	52%	33%	4%	4%
weak loan term and condition cause NPL	4%	60%	25%	8%	2%
Debtors default because unable to understand loan terms	6%	52%	21%	19%	2%
Weakly negotiated loan term lead to NPL	19%	52%	21%	6%	2%

Source: Survey outcome and own computation

When considering the relation between borrowers' culture and Non-performing loan, less than 10 percent of the respondents disagree with the claim that loan performance is affected by culture of a society and its development. Thus the result indicates strong relation between culture and occurrence of non-performing loans. Referring to the table the entire factor relating to culture indicates agreement. Research conducted by Rajan and Dhal (2003) in India showed that credit orientation significantly touches NPL. Response to four of the questions stood to ascertain the link between credit orientation and NPLs in the survey indicates agreement, the socio economic underdevelopment of the country which is also associated with poor access to the formal banking as depicted by higher bank branch population ratio (NBE, 2011) implied that loan culture yet to develop in Ethiopia, that was also why Financial institution in Ethiopia have NPL ratio.

Study by Sinkey and Greenwalt (1991) showed that high loan price by banks is associated with NPL. However the study noted that 40 percent of the respondents come to an agreement that loan with big interest rate have a tendency to change to NPL. In a like manner only 52 percent of the respondents agree with the argument that loan price might affect loan performance. With respect to factors relating to credit terms (compassionate credit terms, weakly understood and /or negotiated credit terms) responses are agreed with the fact that there is a relation between loan default and credit terms set by banks upon loan approval. Researches indicate that failure to put appropriate credit terms and conditions would lead to loan default. Rajan and Dhal (2003) who perform research Indian commercial banks found out that terms of credit determines occurrences of NPLs. Jimenez and Saurina (2005) also stated that NPLs are determined by lenient credit terms.

4.3.7 Statements pertaining to loan size and ownership type

The following identified and summarized response to loan size and ownership type of the bank on the occurrence of NPL

Table 4.11 loan size & ownership type of banks on the occurrence of NPL

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Aggressive loan advance promote higher Default	13	63	8	15	2
higher risk appétit is the reason for Default	8	64	5	23	0
Bargained honesty promote higher Default	8	44	33	13	2
Having Big number of debtors promote Default	6	13	19	58	4
NPL is interrelated to bank`s size	4	19	23	48	6
NPL is not correlated with type of ownerships	6	31	21	33	8

Source: Survey outcome and own computation

So it can be indicated that when the bank pursue aggressive credit advance and thereby experience rapid credit growth they might heap up large volume of nonperforming loans. Rapid lending may lead to an opposing selection, and may be related with deterioration of loan quality as risk taking increases during such periods, unfavorably affecting the level of non-performing loans.

The assessment response on the number of borrower and NPL reveal that having big number of loanee and banks `size indicates that it is not the cause for Non-performing loan. However Studies of Rajan and Dhal (2003), show that size of a given financial institution have significance effect on NPLs. Responses to questions relating to ownership type and default are inclined towards disagreement. See Table 4.12.

4.3.8 Statements pertaining to pledged security/collateral and the occurrence of NPL

The following identified and summarized response to pledged securities/collateral the occurrence of NPL.

Table 4.12 securities/Collateral and the occurrence of NPL

	strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Well secured credit has good performance	10	58	15	17	0
Loans with strong collateral protect loan from defaulting	6	75	6	13	0
In most cases unsecured loan tend to turn NPL	10	44	21	25	0

Source: Survey outcome and own computation

As part of Loan police and procedure, financial institution/Banks require security/collateral to serve as safeguard against loan extended to loanee.58 percent of respondent claimed well secured advances performed well in like manner 75 percent believe loan with strong collateral helps to protect loan default, only quarter of respondent disagreed with the question of non-collateralized loan are defaulted.

Collateral/security is considered to lessen the Financial institution risk in at a time were debater is unable to pay and is considered an alternative way of compensation (Koch&Macdolad,2003). As per the study of De Lucia & Peters(1998),in the financial sector ,security/Collateral is obligatory with others in order to assure full outstanding loan and advance commitment of the debtor to offer protection if the borrower scheduled plan is bargained and to offer protection the debtor in time of default.

4.4 Document study

Dashen Bank offers various loan products to the public who operate within the country. It entertains requests personal consumption, working capital and capital acquisition, regardless of size, economic sector, ownership and location. However, loan approval requires soundness and viability of the business and or apprised project proposals. By wise selection and monitoring the bank can minimize credit risk.one important way of doing it is by analyzing sectorial concentration of credit portfolio. If the bank concentrates on specific industries, it acquires

specific industry knowledge and can monitor and follow loans. However it will exhibit a concentration risk in a given industry. Acharya et al. (2006) empirically examine the impact of loan portfolio concentration versus diversification on performance indicators of Italian banks. they found out that sectorial portfolio diversification will not have significant return however it increased credit risk of the bank. Tabak (2011) assess the effect of credit portfolio concentration on Brazilian banks' profit and credit risk, and found out positive relationship between bank profit and sectorial concentration. To manage the Asset and avoid concentration risk Dashen Bank diversify loans in different sectorial portfolio. The major economic sectors identified in the banking environment are Agriculture, Manufacturing, Domestic trade and services, Export, Import, Construction Machinery working fund, Staff loan, Transportation, personal and Real Estate. Dashen Bank categorizes loans by their “end-use”. Based on these classifications the balance of the outstanding loans by economic sector presented in the following tables.

Tabel 4.13 loan outstanding by economic sector

,000

Sector	outstanding	Percentage
Agriculture	399,667	0.9%
Manufacturing	10,019,229	23.5%
Domestic trade and service	11,286,999	26.5%
Export	5,083,395	11.9%
Import	2,192,916	5.1%
Construction and Machinery working Fund	2,175,527	5.1%
Staff loan	2,198,026	5.2%
Transport	1,950,865	4.6%
Personal	2,102,484	4.9%
Real Estate	5,200,770	12.2%
Total	42,609,878	100.0%

Source: Dashen Bank 2020/21 annual report and own computation

In general 50 percent of Dashen bank loan advance goes to Domestic trade and services and manufacturing sector with 26.5 percent and 23.5 percent respectively. Followed by Real estate and Export sector with 12.2 and 11.9 percent. The rest of six sectors attributed to 26 percent with

a variation from 0.9 percent to 5.2 percent. Hence majority of the income and risk arise from the proper functioning and performance of the two sectors namely Domestic trade and service and manufacturing.

Tabel 4.14 Non performing loan by economic sector

,000

Sector	outstanding	Percentage
Agriculture	18,725	3.0%
Manufacturing	136,407	21.6%
Domestic trade and service	180,629	28.6%
Export	26,161	4.1%
Import	1,307	0.2%
Construction and Machinery working Fund	122,210	19.3%
Staff loan	4,253	0.7%
Transport	104,374	16.5%
Personal	33,410	5.3%
Real Estate	4,933	0.8%
Total	632,409	1.5%

Source: Dashen Bank 2020/21 annual report and own computation

As the same with loan outstanding balance nearly half of the loan risk emanate from domestic trade and service and manufacturing sector followed by construction and machinery working fund which accounts about 16.5 percent of non-performing loan but 5.1 percent of outstanding loan the lowest rate of non-performing loan recorded from Import and staff loan.

After loan grantee, the credit relationship officer should regularly observe the loanee premises to make sure the availed loan is used for the intended purpose, and to remind debtor's next payment. According to Rouse (1989) this is one area many lenders pay little attention but if it is properly followed, the incidence of unsettled loans can be reduced considerably. According to Harrison, D (1962) and Anjichi (1994), many of the pains and frustrations of measured and sudden problem of credits can be prevented by follow up.

According to the loan policy, manual and different internal memos, in Dashen bank utilized after disbursement instrument to reduce the total non-performing and to loan recovery it through loan

follow up and monitoring. After loan disbursement the concerned loan officer, CRO and branch manager expect that all repayments will be collected as scheduled. Therefore, by preparing loan schedule which contain collection date and address of the loanee and guarantee in order to make the follow up task easy. After this the officer is expect to call when payment is not made on the payment date. Sometimes borrowers unable to repay loans in regular manner for one reason or another. In such case, Dashen bank undertake practice the following follow-up activities:

- Giving Verbal reminder after calling the customer and discussing the matter. If this fails and no payment is made then the bank choose to the second step.
- Sending first written reminder using language of general persuasion. This should be done if installment is overdue by a month.
- If the first reminder fails, second written reminder that shows the bank is legally and morally bound to collect the debt would follow. The remainder will be written in such a way as to show the bank's determination to proceed with further measures if repayments are not forth coming.
- On the third reminder the loan officer tell the borrower that if payments are not made within 15 days the bank would be compelled to pass the matter to the legal services.

After the third remainder the loan file will be transferred to loan recovery department for further action.

CHAPTER FIVE

5. SUMMARY AND RECOMMENDATION

The previous chapter presented the finding while this chapter is dedicated for summery and recommendations. It starts with the summary; then provides the conclusion and policy implications; recommendations and areas for further research are given.

5.1 Summary

The study which was conducted on Assessment of Non-performing loan and recovery practice of Dashen Bank shows that there are different factors contributing to NPLs.

In respect of the factors affecting non-performing loan , the subjective question in the survey identified factors such as Rapid loan growth, poor risk assessment, High interest rate, lenient credit terms, credit culture/orientation, size of the bank, poor credit monitoring and ownership type.

The survey indicated that 40 percent of respondents ranked poor risk assessment and poor monitoring/follow op as the top ranking factor causing occurrences of nonperforming loans while credit culture /orientation is ranked third factor by the respondents. Credit risk assessment deals with a thorough analysis of the five Cs, namely capacity, capital, collateral, conditions and character, to help indicate whether to lend or not and how much, under what term and conditions, at what price to lend, to mention a few. Thus unable to undertake out proper credit risk assessment would lead to lost any or all of the captioned issues, which has a probability for the creation of Non-performing loan. There is also inclination that loanee will repay loans if they are properly monitored and follow up. Otherwise borrowers would be tempted to divert the fund to other purposes.

Study conducted by Rajan and Dhal (2003) indicated that credit orientation significantly affects loan default. Response to the questions posed to ascertain the relations between credit orientation and NPL in the survey indicates strong agreement that Weak credit culture loads to loan default. Other factors like loan with big interest rate, loan price

lenient credit term poorly negotiated credit term. They have direct relationship with the occurrence of NPL. On the other hand the study did not support the existing literature that state occurrences of NPL is related to bank's size, and ownership type of banks.

Collateral is considered as a means guarantee the availed loan in time of default and is considered a secondary source of repayment next to regular and timely repayment from proper running of business/income. According to De Lucia and Peters (1998), in the banking environment, security is required among others, to ensure the full commitment of the borrower, to provide protection should the borrower deviate from the planned course of action outlined at the time credit is extended, and to provide insurance should the borrower default. 58 percent of respondent argued collateralized loan performed well in like manner 75 percent present of collateralized loan helps to protect loan default, only quarter of respondent disagreed with the question of non-collateralized loan are defaulted

Dashen Bank provides loan facilities to different economic sectors. These economic sectors also defined as credit sector in financial industry. Credit availed by financial institutions to various economic sectors are categorized by their end use. From the loans approved and disbursed to different economic sectors by Dashen Bank, domestic trade and service takes the largest share of outstanding loans during the period under the study. Even if Ethiopian economy characterized by Agriculture the loans disbursed to this sector take the least share out of the total outstanding loan balance.

5.2 Recommendations

After analyzing result obtained for responses to questioners gathered from the Bank employees and comparing with the theoretical framework in various literatures and sound international practices, the following recommendations are made

- Dashen Banks should create a better loan process that would cover concerns of appropriate loanee identification i.e KYC, strong loan appraisal, active loan follow-up and monitoring and strong loan recovery strategies for non-performing advance and loans.

- Dashen Banks should put in place a clear policy framework that addresses issues of conflict of interest, ethical standards, check and balance in decision making process loan processing and implementation
- Dashen Banks 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.
- Awareness for loanee should be created regarding the loan term and condition and they should be in a close contact and supervision and communicate with the loan officer when they get difficulty on meeting obligation.
- Short-term training and seminars for personnel involved in the analysis work should be prepared in a regular fashion and also to avail pertinent reading material and publications.
- Dashen Banks should provide loan advisory service before and after Loan disbursement in order to create credit awareness in the mind of the borrower and also after extending the loan the bank should be follows the borrower to assess project implementation status, review financial management, identify operational problems and propose corrective actions.
- Dashen Banks Should try to diversify its Loan types, since most of the outstanding balance of the Loan is Domestic trade and service and manufacturing sector. Due to this, the bank must give emphasis on the increased of the outstanding balance of other business sector to minimize risk of loan default.

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Appendix



SEEK WISDOM, ELEVATE YOUR INTELLECT AND SERVE HUMANITY !

Addis Ababa University
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ADDIS ABABA UNIVERSITY

SCHOOL OF COMMERCE

QUESTIONNAIRE

My name is Ermias Gezachew and I am now working with the research paper of the Master's of art in Business Leadership at Addis Ababa university school of Commerce. The reason of my research is to Assessment of Non-performing loan in Dashen Bank .To this end, the research plans to collect data from selected loan related experts (Branch Manager, analysts, Relation shop Manager, loan recovery officers, credit portfolio management officer,) by a self-administered questionnaire. The involvement is completely volunteer and replies will be private. The report described without give in the anonymity of respondents. The research questionnaire is taking around 10 minutes to Finalize. I would appreciate your favorable consideration in finalizing the questionnaire and supporting me in the study effort.

In case you have any questions please call 0911434745 or email Ermiasgezachew12@gmail.com.

Thank you in advance
Ermias Gezachew

Part I. Demographic information please put a tick (√) in the appropriate box.

1. Gender

Male Female

2. Level of Education

Diploma Degree Postgraduate Degree
other (specify) _____

3. The level of position in the organization?

Customer relationship manager Credit Analyst

Portfolio management officer Loan recovery officer

Portfolio management officer Branch managers

4. Indicate your experience in bank credit processes

Less than 1 Year Year 1-5 year 6 – 10years more than 10
years

Part II. Study's related question

1. How did you rate the credit policy and procedure of the banks giving loan service to the customer?

Rigid Somehow rigid somehow flexible Flexible

2. Do you think that the Dashen's lending procedure manual has got a defect?

Yes No

If yes, explain

3. Please rank the reasons that Create NPL in Dashen banks

Note: As per the importance from 1=highest and 8=lowest

Factor that are responsible for nonperforming loans	Rank
Speedy credit advance by banks	
Weak credit risk valuation	
Higher loan price/rate	
Soft loan term and condition	
Loan culture	
Bank size	
Weak loan follow up and monitoring	
Bank ownership structure	

Please specify others

4. Please indicate your degree of agreement or disagreement to the statements pertaining to credit assessment and the occurrence of NPL

	Strongly Agree	Agree	Neutral	Disagree	Strongly disagree
Easily accepted debtors are defaulter					
Knowing customer`s policy improve loan quality					
Strong loan guarantee safeguards credit performance					
Weak credit risk evaluation would lead to non-performing loan					

5. Please indicate your degree of agreement or disagreement to the statements pertaining to credit monitoring and follow-up the occurrence of loan recovery

	strongly agree	Agree	Neutral	Disagree	Strongly disagree
Strict monitoring and follow-ups ensures loan performance					
Poorly evaluated and granted credit may do well if appropriately followed/monitored					
Credit monitoring is directly linked with incidence NPL					
Banks having higher financial budget for credit Monitoring have Minimum NPL					

6. Please indicate your degree of agreement or disagreement to the statement pertaining to interest rate on the occurrence of NPL

	strongly Agree	Agree	Neutral	Disagree	Strongly disagree
Loans having higher loan price/rate inclined to Default					
Charging high loan price/rate leads to NPL					
Shorter loan maturity leads to Default					
Longer loan maturity leads to Default					

7. Please indicate your degree of agreement or disagreement to the statements pertaining to borrower's orientation and the occurrence of NPL

	Strongly Agree	Agree	Neutral	Disagree	Strongly disagree
There exist a strong relationship among is a creditor culture and NPL					
NPL in certain location is recognized as the culture of the debtors.					
Peoples` cultural improvement leads to improved credit performance					
credits with high loan price have the chance to be Default					
Loan price affects the well performance of loan					
weak loan term and condition cause NPL					
Debtors default because unable to understand loan terms					
Weakly negotiated loan term lead to NPL default					

8. Please indicate your degree of agreement or disagreement to the statement pertaining to loan size & ownership type of banks on the occurrence of NPL

	strongly Agree	Agree	Neutral	Disagree	Strongly disagree
Aggressive loan advance promote higher Default					
higher risk appétit is the reason for Default					
Bargained honesty promote higher Default					
Having Big number of debtors promote Default					
NPL is interrelated to bank`s size					
NPL is not correlated with type of ownerships					

9. Please indicate your degree of agreement or disagreement to the statements pertaining to Collateral and the occurrence of NPL

	strongly Agree	Agree	Neutral	Disagree	Strongly disagree
Well secured credit has good performance					
Loans with strong collateral protect loan from defaulting					
In most cases unsecured loan tend to turn NPL					

10. What mechanism bank use to decrease its NPL?

Making credit monitoring giving high attention to Securit

Making deep assessment prior to credit advance

If any others please specify _____

11. Please Give your suggestion or comment if you have any additional information that you may think can enrich this study.
