



**ADDIS ABABA UNIVERSITY
FACULTY OF BUSINESS AND ECONOMICS
EXECUTIVE MBA PROGRAM**

**BANKERS PERCEPTION TOWARDS THE IMPACT OF BANK
SPECIFIC FACTORS ON NON PERFORMING LOANS IN
UNITED BANK S.C.**

**BY
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ID No. GSE/1087/05**

ADDIS ABABA, ETHIOPIA

JUNE, 2015

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**ADDIS ABABA UNIVERSITY
SCHOOL OF GRADUATE STUDIES**

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DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Dr. Asmare Emerie. All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

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ENDORSEMENT

This thesis has been submitted to Addis Ababa University, School of Graduate Studies for examination with my approval as a university advisor.

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LIST OF ACRONYMS

NPL	Non Performing Loan
NBE	National Bank of Ethiopia
CPBI	Current position in the banking industry
EBI	Experience in banking industry
ECO	Experience in credit operation
RLG	Rapid loan growth
RAB	Reduced attention to borrower
IR	Interest rate
LCT	Lenient credit terms
PLMFU	Poor loan monitoring and follow up
PRA	Poor risk assessment
CC	Credit culture
OE	Operating efficiency
OTB	Ownership type of banks
CPT	Concentration to priority sectors
IC	Insufficient collateral

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Abstract

The study tries to examine the impact of factors affecting non-performing loans in the case of United Bank S.C. one of the major components of bank's assets is loans and advances. Failure to manage loans, which make up the lion's share of banks assets, would likely lead to the occurrence of high level of non-performing loan. In this regard NBE sets the threshold at 5%. Hence; the broad objective of the study was to assess bank specific factors of NPL in the case of United Bank S.C. Based on this broad objective, a number of specific objectives were developed. Some of the specific objectives were to identify the relationship between non-performing loan and loan growth, interest rate, credit terms, credit policy & culture, collateral, credit monitoring & risk assessment, operational efficiency, and other related objectives. In order to undertake the research both primary and secondary data was used. Primary data was collected through structured questionnaire and interview. The total population was 252 and only 103 were taken as a sample using stratified random sampling. Secondary data were collected from Provisioning report and Audited Financial statement. The collected data were analyzed using SPSS Version 20, Narration and percentages, Correlation, logistic regression and multivariate model was used. Accordingly, the result of the study indicated that, lack of loan monitoring and follow up, rapid loan growth, poor risk assessment, loan length/period, and non-collateralized loans are some of the major causes of NPL and on the other hand, interest rate and having large number of borrowers doesn't affect loan performance. All in all, based on the finding of the research, continuous policy revision, adopting relationship management approach, closely viewing the international practice, capacity development and training to credit operators and others were recommended.

Key words: *Non-performing, Bank specific factors*

CHAPTER ONE

1. Introduction

1.1. Background of the study

Commercial banks have very crucial role in the economy of any country. Their contribution of the growth of the economy of any country is paramount. The fundamental role of banks is to make the community's surplus of deposits and investments useful by lending it to people who needs money for various investment purposes. One of the major components of bank's assets is loans and advances. It generates the lion's share of the banks operating income and represents the greater risk exposure (Zewdu, 2010). Therefore, managing loan in a proper way has positive effect on the banks performance as well as on the borrower firms and a country as a whole. Failure to manage loans, which make up the lion's share of banks assets, would likely lead to the occurrence of high level of non -performing loans.

According to National Bank of Ethiopia, (NBE, 2008) Non-performing loans (NPLs) are loans that are no longer earning income and: (1) full payment of principal and interest is no longer anticipated, (2) principal or interest is 90 days or more delinquent, or (3) the maturity date has passed and payment in full has not been made. Non-Performing Loans reduces the liquidity of banks, credit expansion, slows down growth of the banking industry, the firm which is in default and the economy as a whole. The failure of many commercial banks is not because of their inability to mobilize adequate deposits from the surplus sector to the deficit sector of the economy, but mainly because their lending portfolio have been poorly managed.

The immediate consequence of large amount of NPLs in the banking system is bank failure. Many researches on the cause of bank failures found that asset quality is a statistically significant predictor of insolvency (Dermirgue-Kunt, et al 1989), and that failing banking institutions always have high level of non-performing loans prior to failure.

1.2.Statement of the problem

The basis of sound credit risk management is the identification of the existing and potential risks inherent in lending activities. According to Estrella et al (2000) NPLs are the most common causes of bank failures. Measures to counteract these risks normally comprise clearly defined policies that express the bank's credit risk management philosophy and the parameters within which credit risk is to be controlled.

From all risks commercial banks faces, credit risk is considered as the most dangerous as it would damage banks profitability and Liquidity. That is also why credit risk management is one of the most critical risk management activities carried out by firms in the banking industry. According to Van T. (2009), Credit risk management is a process that involves the identification of potential risks, the measurement of these risks, the appropriate treatment, and the actual implementation of risk models. The solidity of bank's portfolio depends on the health of its borrowers. A sound financial system, among other things, requires maintenance of a low level of non- performing loans.

Non-performing loans may occur in banks due to various reasons. Saba et al, (2012) stated that non-performing loan could occur due to situational factors at country level, bank level factors and the characteristics of legal and regulatory framework. These can be broadly classified as the macroeconomic factor and the internal/ bank specific factors.

Regarding these factors many studies were conducted in developed countries. In addition to their inconsistency in their finding, this studies don't explain current issues in developing economies like Ethiopia due to a huge gap between their economic condition in which banking sectors operating and close door policy of the government for foreign banks to enter the market. Therefore it would be difficult to conclude about which factors mostly affect the quality of loan and advance in Ethiopia based on the finding of the developed nations unless thoroughly examining the Ethiopian case.

In this regard we can't find many researches on determinants of NPL in Ethiopia except Negera W. (2012) conducted a research on Ethiopian commercial banks to identify the determinant factors which are causing non-performing loans in the banking sector by taking the data from 2005-2010 and according to him poor credit assessment, institutional capacity drawbacks and unavailability of national data for project financing had been the cause for the occurrence of loan default. Besides, the research also investigated that credit monitoring and follow-up plays a pivotal role to ensure loan collection failure, and it also indicated that over financing due to poor credit assessment were causes for the incidence of NPL. The study also recommended further studies on the statistical relationship between all bank specific factors and non performing loans in Ethiopia and this caught the attention of the researcher to statistically verify the existence of relationship between the dependent and all independent variables focusing on bankers perception towards bank specific factors on non performing loan.

Furthermore, National bank of Ethiopia requires all commercial banks to maintain non performing loan to total loan ratio below 5 percent (NBE, 2008). Unpublished data from United Bank indicated that, the ratio of NPL to total loan ratio is 6.97%, 4.62%, 5.76%, 3.35%, 3.53%, 2.53% and 3.1% in 2008, 2009, 2010, 2011, 2012, 2013 and 2014 respectively. No matter how the ratio is fluctuating and may be below the industry average, the bank specific factors of non performing loans need to be controlled. Therefore, this critical point also calls for a research to evaluate perception of bankers towards bank specific factors on non-performing loans.

1.3. Study Objective

1.3.1. General objective

The general objective of the study is to examine the perception of bankers on the impact of bank specific factors on non-performing loans in private commercial banks the case of United Bank S.C.

1.3.2. Specific Objective

The specific objectives of the study are:

- To identify the relationship between rapid loan growth non performing loan
- To identify the relationship between interest rate and non performing loan
- To identify the relationship credit terms and non performing loan
- To identify the relationship between bank policy and non performing loan
- To identify the relationship between credit culture and non performing loan
- To examine the impact of non collateralized loan on the occurrence of non performing loan
- To examine the impact of poor credit monitoring on the occurrence of non performing loan
- To examine the impact of operating efficiency on the occurrence of non performing loan
- To examine the impact of concentration to priority sectors on the occurrence of non performing loan
- To scrutinize the relationship between poor risk assessment and Non Performing Loans.
- To scrutinize the relationship between reduced attention to borrowers and non performing loan
- To scrutinize the relationship between poorly negotiated loans and non performing loan

1.4. Significance of the Study

It is undeniably true that loans and advances have greater contribution to the profitability of most banks and equally, it is the greatest source of risk and cause of failure of most banks. Non-performing loan hinder the growth of banks, the borrower and the economy of the country as a whole. Therefore, effective management of this paramount asset of banks, loans and advances, through different mechanism is a must for banks to assure sustainability and growth.

Hence, the findings of this research will

- Provide empirical literature by estimating the impact of bank specific factors on non performing loan.
- Help commercial banks to improve their loan portfolio qualities, and also to take into accounts various determinants of non-performing loan while making credit decision.
- Help to increase the existing body of knowledge regarding the causes of non-performing loans and also calls for credit policy and procedure revision.
- Calls other researchers to investigate the macro economic factors of non-performing loans based on the findings of this research.

1.5.Scope of the Study

Though the macro economic factors have huge impact on the quality and performance of loans, the study was focused on the bank's specific factors of Non-performing Loans. Furthermore, the study was focused on the case of United Bank S.C assuming that United Bank can be a representative bank of other commercial banks in the country. Besides, the data used in the documentary study covered only the period 2008-2014.

1.6. Operational definition of terms

The following words and phrases will have the under mentioned meaning throughout the research report;

Loans and advances – means a financial asset of a bank arising from a direct or indirect advances or a commitment to advance funds by a bank to a person that are conditioned on the obligation of a person to repay the fund usually with interest with in a predetermined period of time.

Non-performing – means loan or advances whose credit quality has deteriorated such that full collection of principal and/or interest in accordance with the contractual repayment terms of loan or advances is in question

CHAPTER TWO

2. Review of Related Literature

A comprehensive review of published and unpublished works in the areas of non-performing loan, and in its causes is made so as to develop and identify the problem, to develop hypothesis and to come up with appropriate research methods. Therefore, the literature review is organized and presented in three sections. The first section 2.1 discusses the theoretical literature about non performing loan, section 2.2 presented empirical literature on studies made at similar level and section 2.3 is about the hypothesis developed from the literature review.

2.1.Theoretical literature

2.1.1. Nonperforming loan

A loan becomes non-performing, when it cannot be recovered within certain stipulated time that is governed by some respective laws. Hence, non-performing loans are defined from institutional point of view and general from the lending institution side. According to NBE's directive (NBE, 2008) loans are classified into pass, Special mention, Sub Standard, Doubtful and loss. And therefore, loans can be classified as non-performing, when it is classified as Sub Standard, Doubtful and loss, for which commercial banks are required to maintain 20%, 50% and 100% provision respectively (Directive No. SBB/43/2008)

Therefore, According to NBE's Directive (2008), the standard loan classifications are defined as follows;

Pass

Loans and advances in this category are fully protected by the current financial and paying capacity of the borrower and not subject to criticism. In general, any loan or advance, or portion thereof, which is fully secured, both as to the principal and interest, by cash or cash substitutes, are classified under this category regardless of past due status or other adverse credit factors.

Special mention

Loans and advances classified under this category have the following characteristics;

1. Loans or advances with pre established repayment programs past due 30 days or more but less than 90 days
2. Overdraft and loans or advances that don't have pre established prepayment program, if
 - a. The debt remains outstanding for 30 consecutive days or more but less than 90 days beyond the scheduled payment or maturity date.
 - b. The debt exceed the approved limit and interest due or uncollected outstanding for 30 consecutive days or more but less than 90 days. And
 - c. The overdraft account has been inactive (no debit and credit transaction has been made) for 30 consecutive days or more but less than 90 days.

Substandard

The following non-performing loans and advances at a minimum shall be classified substandard:

1. Loans or advances with pre established repayment programs past due 90 days or more but less than 180 days
2. Overdraft and loans or advances that don't have pre established prepayment program, if

- a. The debt remains outstanding for 90 consecutive days or more but less than 180 days beyond the scheduled payment or maturity date.
- b. The debt exceed the approved limit and interest due or uncollected outstanding for 90 consecutive days or more but less than 180 days. And
- c. The overdraft account has been inactive (no debit and credit transaction has been made) for 90 consecutive days or more but less than 180 days.

Doubtful

The following non-performing loans and advances at a minimum shall be classified doubtful:

1. Loans or advances with pre established repayment programs past due 180 days or more but less than 360 days
2. Overdraft and loans or advances that don't have pre established prepayment program, if
 - a. The debt remains outstanding for 180 consecutive days or more but less than 360 days beyond the scheduled payment or maturity date.
 - b. The debt exceed the approved limit and interest due or uncollected outstanding for 180 consecutive days or more but less than 360 days. And
 - c. The overdraft account has been inactive (no debit and credit transaction has been made) for 180 consecutive days or more but less than 360 days.

Loss

The following non-performing loans and advances at a minimum shall be classified loss:

1. Loans or advances with pre established repayment programs past due 360 days or more
2. Overdraft and loans or advances that don't have pre established prepayment program, if
 - a. The debt remains outstanding for 360 consecutive days or more

- b. The debt exceed the approved limit and interest due or uncollected outstanding for 360 consecutive days or more
- c. The overdraft account has been inactive (no debit and credit transaction has been made) for 360 consecutive days or more

2.1.2. The Five C's of Credit

According to Franklin & St. Lawrence Counties, the following five areas are what lenders should consider. These are usually called the five C's of Credit. The "Five C's" are the basic components of credit analysis. They are described here to help you understand what the lender looks for. Jwilkinson (2009)

Character:

Character is the general impression borrower make on the prospective lender or investor. The lender will form a subjective opinion as to whether or not borrowers are sufficiently trustworthy to repay the loan or generate a return on funds invested in the company. Borrower's educational background and experience in business and industry will be considered. The quality of borrower's references and the background and experience levels of employees will also be reviewed.

Assessing the character is partly fact-based and partly "gut feeling". The fact-based assessment involves a review of credit reports on the company, and in the case of smaller companies, the personal credit report of the owner as well. The bank will also communicate with clients current and former bankers to determine how you have handled their banking arrangements in the past. The bank may also communicate with borrower's customers and vendors to assess how they have dealt with these business partners in the past.

Capacity:

Capacity to repay is the most critical of the five factors; it is the primary source of repayment - cash. The prospective lender will want to know exactly how you intend to repay the loan. The lender will consider the cash flow from the business, the timing of the repayment, and the probability of successful repayment of the loan. Payment history on existing credit relationships - personal or commercial- is considered an indicator of future payment performance. Potential lenders also will want to know about other possible sources of repayment.

In order to determine capacity the banker will be looking at your company's historical 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“.

Capital

Capital is the money you personally have invested in the business and is an indication of how much you have at risk should the business fail. 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.

There is no precise measure or amount of “enough capital”, but rather it is specific to the situation and the owner's financial profile. Commonly, the bank will look at the owner's investment in the company relative to their total net worth, and they will compare the amount of the loan to the amount of equity in the company – the company's Debt to Equity Ratio. This is a measure of the company's total liabilities to shareholder's equity. Banks typically like to see Debt to Equity Ratios no higher than 2 to 3 times.

Collateral

Collateral, or guarantees, are additional forms of security you can provide the lender. Giving a lender collateral means that you pledge an asset you own, such as your home, to the lender with the agreement that it will be the repayment source in case you can't repay the loan. A guarantee, on the other hand, is just that - someone else signs a guarantee document promising to repay the loan if you can't. Some lenders may require such a guarantee in addition to collateral as security for a loan.

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.

Conditions

Conditions describe the intended purpose of the loan. Will the money be used for working capital, additional equipment or inventory? The lender will also consider local economic conditions and the overall climate, both within your industry and in other industries that could affect your business.

The banker is going to assess the conditions surrounding your company and its industry to determine the key risks facing your company, and also, whether or not these risks are sufficiently mitigated. Even if the company's historical financial performance is strong, the bank wants to be sure of the future viability of the company. The bank won't make a loan to you today if it looks like the viability of your company is threatened by some unmitigated risk that is not sufficiently addressed.

2.1.3. Factors affecting loan quality

As various studies revealed that, loans and advances are the major asset of banks. This asset of banks can be affected by different factors which would have direct or indirect influence on non performing loan. As Rawlin et al. 2012, indicated in his study that the factors that influence banks loans have their own impact on NPLs.

Reed and Gill (1989) as cited by Zewdu (2010), indicated in his study that capital position, profitability, stability of deposit, Economic Condition, Monetary and fiscal policy, ability and experience of bank personnel, interest rate, and bank liquidity positions are some of the mentioned factors that are assumed to cause to the occurrence of NPL.

The size of capital in relation to deposits influences the amount of risk that a bank can afford. Relatively large capital structure can make loans of longer maturities and greater credit risk (Zewdu 2010).

Some banks may emphasize earning more than others. Banks with greater need of earning might adapt more aggressive lending policies. An aggressive policy might call consumer loans, which normally are made at higher rates of interest than short-term loans.

The fluctuation and type of deposit must be considered. After adequate provisions have been made for reserves, bank can then engage in lending. Even though, these reserves designed to take care of predictable deposit fluctuations and loan demands since unpredictable demand force banks to give consideration to the stability of deposits in formulating loan policy.

Stable economy is more conducive to a liberal loan policy than the one that is subject to seasonal and cyclical movements. Deposit of famine economies fluctuate more violently than deposit in an economy noted for its stability. Consideration must be given to the national

economy. Factors adversely affect the nation as a whole may, if they are of serious magnitude, eventually affect local conditions.

If monetary and fiscal policies are expansive and additional, reserves are made available to the commercial banking system; the lending ability of banks is increased. Under these policies banks can have a more liberal loan policy.

The expertise of lending personnel is not insignificant in the establishment of bank loan policy. One of the probable reasons that banks were slow in entering the consumer lending field was the lack of skilled personnel. banks specialized experience on different types of loans e.g. Mortgage real-estate. The major reasons banks are chartered is to serve the credit needs of their communities. Banks are morally bound to extend credit to borrowers who present logical and economically sound loan requests.

To maintain adequate liquidity, bank must constantly guard against excessive losses from lending and investing activities. If bank made too many bad loans, the value of its asset could fall below the amount of its liabilities.

2.2.EMPIRICAL LITERATURE

2.2.1. Determinants of Non-performing loans

As far as non-performing loans are concerned many researchers has identified different factors which are responsible for loan default in different countries, so literature divides these factors into two parts. The first part of literature focuses on the variables which are called bank specific variables while the second part of literature focuses on the Macroeconomic variables. Non-performing loans are not only the problem of Ethiopia but also the problem of the whole world; the focus of this literature is to explore other countries` experience on related issues.

Negera W. (2012) conducted a research on Ethiopian commercial banks to identify the determinant factors which are causing non-performing loans in the banking sector by taking the data from 2005-2010 and according to him poor credit assessment, institutional capacity drawbacks and unavailability of national data for project financing had been the cause for the occurrence of loan default. Besides, the research also investigated that credit monitoring and follow-up plays a pivotal role to ensure loan collection failure, and it also indicated that over financing due to poor credit assessment were causes for the incidence NPL.

Farhan M. et al (2012) investigated determinants of non-performing loans with the perception of Pakistani Bankers by taking the period between 2006 and 2011. According to them, interest rate, energy crisis, unemployment, inflation and exchange rate have a significant and positive relationship with the non performing loans. Bad performances of the energy sector along with poor economic setting are the main factors causing non-performing loans in Pakistan.

Keeton, W. R. (1999) uses data from 1982 to 1996 and a vector auto regression model to analyze the impact of credit growth and loan delinquencies in US. The study reports evidence of a strong relationship between credit growth and impaired assets. Specifically, Keeton (1999) shows that rapid credit growth, which was associated with lower credit standards, contributed to higher loan losses in certain states in the US.

2.2.2. Bank Specific Determinants

Recent studies investigated that bank specific factors contribute to NPLs performance at higher magnitude as compared with macroeconomic factors. Therefore, for effective management of NPLs, it is very critical for commercial banks to understand and focus more on the management of bank specific factors which they have more control over and seek practical and achievable solutions to address NPLs problems (Njeru B, 2012).

Various researchers have concluded various reasons for loan default. As per the literature review conducted by Shofiqul M et al (2005) and Negera W. (2012) and other researchers, the following bank specific factors that determine loan default are identified;

a) Reduced attention to Borrowers

Shofiqul M, Chandra N, & Manan A. (2005) relates this determinant to the **Hawthorn Effect**. Hawthorn studies are a series of studies conducted at Western Electric Company Works in US. The study Started in 1924, were initially designed as a scientific management experiment to examine the effect of lighting levels on workers” productivity (Robins, 2009).

To the researchers amazement, productivity increased throughout the study during which time lighting was varied greatly from normal to dim to brilliant and back, heat was turned up and down, etc. then researchers concluded that workers were responding positively because there were the subject of interest, not because of change in their working condition. The workers perception is that when someone is paying attention to them get better result than perception of inattention.

Therefore borrowers may also perform in this manner. The more we gave attention to borrowers starting from submission of loan application to the final end, the less extent of the borrower to become defaulter. Frequent visit of the borrowers business, follow-up their operational and financial status are related to giving attention to borrowers.

b) Rapid Loan Growth /Increase Loan size increase risk/

Rapid loan growth or excessive lending by commercial banks is often identified as an important determinant of NPLs (Keeton, 1999). To investigate the casual relationship between non-performing loan and rapid loan growth, Keeton used data from commercial banks in US from 1982 to 1996 and use regression model. And finally come up with the positive

relationship between rapid loan growth and non-performing loans. This effect is called the **Inverted Pyramid effect** (Shofiqul M, Chandra N, & Manan A., 2005)

Negera W. (2012) investigated that the reason usually give for faster loan growth to higher loan default involves supply shift, that is, the increase in bank willingness to lend. When such a shift occurs, banks typically seek to increase their lending in two ways. First, they may reduce the interest rate charged on new loans. Second, they lower their minimum credit standards for new loans--for example, they reduce the amount of collateral the borrower must have to back his loan, accept borrowers with weaker credit histories, or require less proof that the borrower will have enough cash flow to service his debts. Such a reduction in credit standards increases the chances that some borrowers will eventually default on their loans. Thus, assuming banks lower credit standards as well as reduce loan rates, increases in lending due to supply shifts will tend to lead to higher loan losses in the future.

The increase in willingness to lend may arise from different perspective. It may be for the sake of meeting predetermined budget, competition within the industry, aiming for greater profit and others.

c) Interest Rate

Njeru B, (2012), and Farhan M, et al (2012) investigated in their research that, interest rates has positive impact and significantly related to NPLs levels across all bank categories. From economic point of view, the wider the interest rates gap the more the profits earned by the banks. Therefore study result suggests that, banks plow back the profits earned to improve the lending policies and procedure strategies for debt collections with an aim to improve NPL levels in Kenyan commercial banks.

Banks that charge high interest rate would comparatively face a higher default rate or non-performing loans. Lending rates/ interest rates are one of the primary economic determinant

of non-performing loans/bad loans (Farhan M, et al 2012). The reason behind is that the increase in interest rate weakens loan payment capacity of the borrower and therefore non-performing loans and bad loans are positively correlated with the interest rates (Nkusu, 2011). As far as interest rate policy is concerned it plays very important role in NPLs growth rate in a country/economy.

d) Lenient credit terms

According to Negera W. (2012), credit terms have significant impact on the occurrence of non-performing loan. This might mean loan disbursement might not be made timely; grace period may not be given properly, repayment amount set wrongly without considering the cash flow and some other reasons. Either of these or related would lead to poor loan performance. Thus the failure to put appropriate credit terms and conditions would lead to loan default.

e) Loan Sanctioned by Corruption

Sometimes, Loan sanctioning authority sanction loan to satisfy their personal interest behavior. Thus they engage themselves with the clients and corrupt the total system by giving some benefit or taking something in return. This may be called **give and take the chance effect** (Farhan M, al, 2012)

When Loans are sanctioned by corruption, various predetermined steps to be followed and policies and procedures will be overlooked in search of fulfilling personal interest. This in turn may lead to loan default.

f) Poor loan monitoring and Follow-up

In our society, people give more importance to current consumption. So they do not mind to spend the borrowed fund to spend for consumption if they are not strictly followed up. Therefore significant portion of capital goes to unproductive sector that may be termed as **Die another Day Effect**.

Being aware of poor loan monitoring and follow-up, borrowers probe credit operation weakness. If the lender doesn't follow-up promptly, the borrower may be grateful not to have been embraced. Borrowers probing of lender's weaknesses maybe called **Jurassic park effect** (Farhan M, et al, 2012). The dinosaurs in this popular film tested the structures and device used to contain them with in certain areas of Jurassic park and eventually gained control over the entire park to dismay, discomfort, and eventual departure of their human captors. In addition, the park dinosaurs become more aggressive after the developers lost control of dinosaurs breeding as a result of unexpected risk.

g) Poor Risk assessment

Masood and Aktan (2009) investigate the factors that contributed to the increase in non-performing loans (NPLs) in large state-owned commercial banks over the period 1999–2001 and 1996–1998 in Turkey and Pakistan respectively. The findings of their study indicated that poor credit risk assessment highly influenced NPL in Turkey and Pakistan.

The way in which risk can be identified, quantified and minimized should be the key concern for bank's management and controllers. No loan is entirely without risk. It may be affected by internal as well as the external factors. Therefore, no matter how it is secured, the borrowers have potentials to generate loss due to the aforementioned factors.

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

Negera W. (2012) also suggested that poor credit assessment has greater contribution in loan default of Ethiopian commercial banks.

h) Credit Culture

A strong strategic credit risk management avoids important pitfalls like credit concentrations, lack of credit discipline, aggressive underwriting to high-risk counterparts and products at inadequate prices. Four types of credit culture have been identified Van T. (2009):

1. Value Driven: is adherence to long term and consistent performance and it requires strong credit organization defined by long-term profit plan. The success of this strategy is depends on the balance that needs to be found between credit quality and revenue generation.
2. Immediate Performance Driven: this credit culture is similar with value driven, with emphasis on strong credit quality, but for which deviation can be omitted during periods of low credit demand.
3. Production Driven: For this strategy, market share and volume growth are highest priority which is motivated by the ambition to become or to remain large player on the market. Loan approvers see their influence limited because of conflicting interest of value and asset quality.

4. Unfocused: In this strategy, priorities may change frequently and it may result from reactive management but also from lack of a clear long term vision. It creates confusion for lenders and risk officers. Under this strategy, portfolio asset quality is only guaranteed when the credit risk department has strong policies and risk system.

As per the research conducted by Zabeen S. (2006), credit culture has a positive relationship with non performing loan. Other researchers like Ranjan R. and Chandra S. (2003) and Negera W. (2012) also suggested the same.

i) Operating Efficiency

Many researchers relate risk taking with operating efficiency of banks. The logic behind is that risk averse managers are willing to trade off reduced earning for reduced risk specially when their wealth depends on the performance of the bank. As Negera W. (2012) indicated in his research is that, manager's increase loan monitoring and incur higher cost to improve loan quality.

j) Ownership structure

Recent history witnessed the growth of large financial conglomerates: groups of companies under common control and ownership structure with dominant activities in at least two different financial sectors (banking, securities, and finance) (Van T. 2009).

Some studies also considered the impact of ownership structure on the NPLs rate. One of those is Hu et al (2006) which studied Taiwan's banking sector. It covered the study period of 1996 to 1999. It claimed that government owned banks have fewer NPLs rate.

k) Concentration to Priority Sectors

Ranjan R. and Chandra S. (2003) suggested that lending concentration of banks exposure to priority lending sectors contributes to higher non-performing loans. And their study indicated that there is a significant relationship between the two variables.

2.3.Hypothesis

Based on the literature review and variables of study the following hypotheses are formulated:

Hypothesis (H₀): Bank specific factors don't cause to the occurrence of NPL.

Hypothesis (H₁): Poor risk assessment leads to the occurrence of NPL

Hypothesis (H₂): Rapid loan growth and high credit appetite of banks leads to the occurrence Of NPL.

Hypothesis (H₃): Poor loan monitoring and follow up leads to the occurrence of NPL.

Hypothesis (H₄): Clean /not-collateralized loan/ leads to the occurrence of NPL.

Hypothesis (H₅): Poor Credit Culture of the bank and the borrower lead to the occurrence of NPL.

Hypothesis (H₆): Charging High Interest leads to the occurrence of NPL.

Hypothesis (H₇): Lenient credit terms and Short term loan leads to the occurrence of NPL.

CHAPTER THREE

3. Research Design and Methodology

3.1. Research Design

As indicated in the objective of the study, the very purpose of this research is to identify the impact of bank specific factors on non performing loans. Hence the research was more of explanatory type and tried to assess the relationship between occurrence of NPL and some specific determinants. In order to benefit from the advantage of quantitative and qualitative research approach, the mixed method was used for this study.

3.2. Source of Data

As the research was conducted to elicit the perception of bankers regarding the impact of bank specific factors on NPLs in United Bank Share Company, use of primary data collection method was found to be appropriate. On the other hand, to identify the trend of nonperforming loan secondary data was collected from provisioning report, published audited financial statement and National bank publications of the period covering from 2008-2014.

3.3. Data gathering Tools

As far as collection of the primary data for the study is concerned, a structured questionnaire using Five point Likert scale was used as a tool to assess the perception of bankers towards bank specific factors on the occurrence of non performing loans. The anchors included were 1=strongly agree 2=agree 3=neutral 4=disagree 5=strongly disagree. Interview was also designed to survey and analyze bank specific factors on NPLs in the captioned study setting.

3.4. Sample Size and Sampling Techniques

As far as population of the study is concerned the study 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 252 (115 branch managers, 120 loan officers,10 credit analysis and appraisal department staffs and 7 credit portfolio staffs) of which, 119 are management staffs and 133 are non-managerial staffs are fall in the sample frame.

In order to take sample from the stated population, stratified random sampling technique is used and hence, 49 from management staff (strata 1) and 54 from non management staff (strata 2) was taken using simple random sampling by lottery method. Therefore the sample population for this study was 103 and represent 41% of the total population.

For this research the sample size for interview was 5 officials who are top management staff directly involved in credit related activities. The interview was designed so as to come up with feasible conclusion and recommendations.

3.5. Method of Data Analysis

This study which is practical in purpose, is descriptive analysis, and the procedure and method are considered as correlation and regression analysis because in this study the relationship between independent variables and dependent variable is evaluated. For data analysis, first the descriptive statistics including mean, standard deviation etc. is applied and then inferential statistics including normality tests, correlation and logistic regression testing was used. Bivariate analysis was conducted to examine the relationship of each of the selected independent variables with variables representing Non-Performing loans.

And this analysis was based on tests of association (chi-square tests) and p-value. However, a bivariate association between two variables does not necessarily imply a significant causal relationship between them, because in real life more than one independent variable operates to influence the dependent variable.

Therefore, it is important to carry out a statistical analysis which would incorporate more than one independent variable at a time. The most suitable analytical technique is multivariate analysis which allows the exploration of the effect of different independent variables on a dependent variable corrected for other independent variables.

There are several multivariate analyses methods that can be used to examine the relationship between several independent variables and the dependent variables. However, this specific study employs the logistic regression analysis because each outcome variable of loans is categorized into two categories, indicating that the data are dichotomous (performing or non performing loans).

3.6. Model Specification and Variable Definition

According to Creswell (2009), the variables need to be specified in quantitative researches so that it is clear to readers what groups are receiving the experimental treatment and what outcomes are being measured. Non Performing loan is usually measured by the amount of nonperforming loan to total loan. For the purpose of this study, nonperforming loan is composed of sub standard, doubtful and loss status loan.

All in all, the dependent and the independent variable of the research are discussed in the following sub sections.

3.6.1. Dependent variable

Nonperforming loans are the dependent variable. The ratio is measured by Nonperforming loan to total loan of the bank.

$$\text{NPL} = \text{Nonperforming loan} / \text{Total Loan}$$

Therefore, for non performing loan, the following equation is used;

$$\text{NPL}_{it} = \beta_j + \beta_k \sum X_{jt}^k + \varepsilon_{jt}$$

Where NPL_{it} is the dependent variable (which is latter explained as nonperforming loan) explaining nonperforming loan of bank i at time t , with $i= 1\dots N$; $t=1\dots T$, β_j is a constant term, X_{jt} are k explanatory variables and ε_{jt} is the disturbance term.

3.6.2. Independent /explanatory Variables

It is evident that the most important task is to choose the appropriate explanatory variables. The selection of the variable is made based on the study undertaken by Negera W, 2012 on determinants of Nonperforming Loan.

Therefore, the econometric model can be expressed incorporating the identified variables as follows:

$$\text{NPL}_{it} = \text{CPBI}_{it} + \text{EBI}_{it} + \text{ECO}_{it} + \text{RLG}_{it} + \text{RAB}_{it} + \text{IR}_{it} + \text{LCT}_{it} + \text{PLMFU}_{it} + \text{PRA}_{it} + \text{OE}_{it} + \text{OTB}_{it} + \text{CPT}_{it} + \text{IC}_{it} + \varepsilon_{jt}$$

See Table 3.1 for description of variables

Variables	Definition
NPL	Non performing loan
CPBI	Current position in banking industry
EBI	Experience in banking industry
ECO	Experience in credit operation
RLG	Rapid loan growth
RAB	Reduced attention to borrowers
IR	Interest rate
LCT	Lenient credit terms
PLMFU	Poor loan monitoring and follow up
PRA	Poor risk assessment
OE	Operating efficiency
OTB	Ownership type of banks
CPT	Concentration to priority sectors
IC	Insufficient collateral

Table 3.1 Description of variables

CHAPTER FOUR

4. Results and Discussions

The preceding three chapters indicated the orientation of the study, methods adopted and theoretical framework of the study. This chapter presents the result of different source of Data.

4.1 Characteristics of Respondents

4.1.1 Questionnaire Respondents

Table 4.1 Position of Questionnaire Respondents

Position	Frequency	Percentage
Loan Officer	43	41.7
Credit Analyst	6	5.8
Branch Manager	49	47.7
Credit Monitoring Officer	2	1.9
Credit Workout Officer	3	2.9
Total	103	100

As indicated in Table 4.1 above, most of the questionnaire respondents were branch managers representing 47.7% of the total respondents. Credit analysts and loan officers represent 5.8 % and 41.7% of the respondents respectively while workout officers and follow up officers represented 2.9% and 1.9% respectively.

4.1.2. Work Experience of all Respondents

Table 4.2 Work Experience of Respondents

Years of Experience	Respondents		Respondent Experience in Credit Operation	
	Frequency	Percentage	Frequency	Percentage
Less than One year	0	0	0	0
1-5 years	25	24	24	22
6-10 years	18	18	50	49
11-15 years	40	39	16	16
Above 15 years	20	20	13	13

The result of Table 4.2 above shows that indicated no respondents have below one year banking experience as well as in credit operation. All in all, the table indicated that almost above 78% of the total respondents have more than 6 years experience in credit operation.

4.2 Presentation, results and discussions

4.2.1 Questionnaire response rate and Interview Success Rate

Table 4.3 Questionnaire and Interview response rate

Position	Target Respondent	Successful	Success Rate (%)
Questionnaire	103	94	91.2
Interview	5	4	80

Table 4.3 above indicated that, out of the 103 questionnaires sent to the target population, 94 usable responses were collected. This represented a response rate of 91.1 percent and implies that 8.9 percent of the questionnaires were not returned at all. Of the five projected interviews,

only four were successfully contacted, giving a success rate 80 percent. One interview was unsuccessful primarily because the targeted interviewee was time constrained. In my opinion, the target population was fairly represented considering that key senior managers who are relevant to the study were interviewed.

4.2.2 Discussion and Interpretation of Questionnaire result.

This part of the paper presented the analysis of questionnaire result. In addition, the presentation and interpretation provides test result for the null Hypothesis (H_0) and Alternative Hypothesis (H_n).

H_0 For the Question related with the contribution of bank specific factors to NPL, 100% of the respondents ticked „yes“. This implies that bank specific factors are the cause of NPL in United Bank S.C.

Risk Assessment and Occurrence of NPL

Table 4.4 Risk Assessment and occurrence of NPL

Particulars	Strongly Agree(1) in %	Agree (2) in %	Neutral (3) in %	Disagree (4) in %	Strongly Disagree(5) in %	Mean	Std. Deviation
Easily admitted borrowers usually default	39	31.7	12.2	17.1	0	2.07	1.10
Know your customer principle of banks lead to high loan quality	51.2	39	4.9	2.4	2.4	1.65	0.88
Good loan underwrite ensures	26.8	41.5	14.6	12.2	4.9	2.26	1.14

loan performance							
Poor risk assessment would lead to loan default	53.7	31.7	7.3	0	7.3	1.68	0.91

H₁ the result of table 4.4 indicated that 70.7% of respondents agreed that easily admitted borrowers usually default. On the other hand 85.4% of respondents also agreed that poor risk assessment contributed to the occurrence of NPL. All in all, the majority of respondents agreed that, poor risk assessment (mean 1.68) and know your customer principle (mean 1.65) has relationship with the occurrence of NPL.

Rapid Loan Growth and the occurrence of NPL

Table 4.5 Rapid Loan Growth and the occurrence of NPL

Particulars	Strongly Agree(1) in %	Agree (2) in %	Neutral (3) in %	Disagree (4) in %	Strongly Disagree(5) in %	Mean	Std. Deviation
Aggressive lending leads to high NPL	26.8	29.3	17.1	19.5	7.3	2.51	1.27
Great risk appétit is the cause for NPL	24.4	48.8	9.8	7.3	9.8	2.29	1.12
Compromised integrity lead to loan default	36.6	26.8	9.8	17.1	9.8	2.36	1.39
Having Large number of borrowers cause NPL	9.8	22	12.2	43.9	12.2	3.26	1.22

H₂ The result of Table 4.5 shows that 56.1% of respondents agreed that aggressive lending leads to high NPL. On the other hand, 73.2% of the respondents also agreed that high risk appetite of banks also leads to NPL. And to the contrary, 56.1% of respondents disagreed that having large number of borrowers lead to NPL. This implies that having large number of borrowers doesn't mean that there is rapid loan growth. In general, Rapid loan growth and high risk taking appetite affect the performance of loan

Credit Monitoring and follow-up & Occurrence of NPL

Table 4.6 Credit Monitoring and follow-up & Occurrence of NPL

Particulars	Strongly Agree(1) in %	Agree (2) in %	Neutral (3) in %	Disagree (4) in %	Strongly Disagree(5) in %	Mean	Std. Deviation
Strict credit monitoring ensures loan performance	29.3	56.1	4.9	7.3	2.4	1.47	0.93
Poorly assessed and advanced loans may perform well if properly monitored	7.3	19.5	14.6	39	19.5	3.44	1.23
Loan follow-up is directly related to occurrence of nonperforming loans	29.3	51.2	7.3	7.3	4.9	2.07	1.06
Banks with higher budget for loan monitoring have lower non performing loans	26.8	17.1	4.9	39	12.2	2.93	1.47

H₃ the result of table 4.6 indicated that 85.4% of respondents (mean 1.47) agreed on the importance of strict credit monitoring and follow up to ensure loan performance. However, 58.5% of respondents disagree on poorly assessed loan may perform well If properly monitored. This implies that even though follow up and monitoring ensures loan performance, poor risk assessment might have its own implication beyond follow up and monitoring. Therefore, the result shows that there is a relationship between loan monitoring and follow up with that of NPL. Therefore reduce attention to the borrower will lead to the occurrence of NPL.

Clean (Not Collateralized) loan and Occurrence of NPL

Table 4.7 Clean (Not Collateralized) loan and Occurrence of NPL

Particulars	Strongly Agree(1) in %	Agree (2) in %	Neutral (3) in %	Disagree (4) in %	Strongly Disagree(5) in %	Mean	Std. Deviation
Collateralized loans perform well	29.3	41.5	7.3	14.6	7.3	2.29	1.25
Collateralized loans help to protect loan default	14.6	51.2	14.6	14.6	4.9	2.14	1.07
Most of the time non collateralized loans are defaulted	24.4	41.5	12.2	12.2	9.8	2.41	1.26

H₄ the result of table 4.7 shows that 65.9 % of the respondent agreed that most of the time non collateralized loans are defaulted. In addition, the majority of respondents agreed that



clean loan advocates the occurrence of NPL and therefore the result implies that not collateralized loans usually defaulted in United Bank S.C.

Credit Culture & the occurrence of NPL

Table 4.8 Credit Culture & the occurrence of NPL

Particulars	Strongly Agree(1) in %	Agree (2) in %	Neutral (3) in %	Disagree (4) in %	Strongly Disagree(5) in %	Mean	Std. Deviation
Credit culture is related to loan performance	22	53.7	7.3	7.3	9.8	2.29	1.19
There is a relationship between loan default and credit culture	41.5	43.9	0	7.3	7.3	1.95	1.18

H₅ the result of table 4.8 shows that 75.5% of the respondent agreed that credit culture is related with loan default. On the other hand, 7.3% of the respondents stood neutral for the relationship between credit culture and NPL. However, the majority of respondents (mean 1.95) are in state of agreement which implied that credit culture has relationship with the occurrence of NPL.



Charging High Interest rate and Occurrence of NPL

Table 4.9 Interest rate and Occurrence of NPL

Particulars	Strongly Agree(1) in %	Agree (2) in %	Neutral (3) in %	Disagree (4) in %	Strongly Disagree(5) in %	Mean	Std. Deviation
Loans with high interest rate tend to turn to NPL	4.9	17.1	4.9	61	12.2	3.58	1.07
Charging high interest rate leads to loan default	0	7.3	9.8	48.8	34.1	4.09	0.86

H₆ As indicated in the table 4.9 the majority of the respondents (82.9% & mean 4.09) disagreed that charging high interest rate leads to NPL. Therefore, the result implied that there is almost no relationship between interest rate and the occurrence of NPL.



Credit Terms and the occurrence of NPL

Table 4.10 Credit terms and occurrence of NPL

Particulars	Strongly Agree(1) in %	Agree (2) in %	Neutral (3) in %	Disagree (4) in %	Strongly Disagree(5) in %	Mean	Std. Deviation
Borrowers default because they don't understand credit terms well	24.4	39	2.4	22	12.2	2.58	1.39
Poorly negotiated credit terms lead to NPL	19.5	51.2	2.4	19.5	7.3	2.4	1.22
Shorter loan period leads to NPL	29.3	58.5	0	9.8	2.4	1.97	0.96
Longer loan period leads to NPL	2.4	24.4	0	58.5	14.6	3.58	1.09

H₇ As indicated in the table 4.10, 63.4% of respondents agreed that borrowers defaulted because they do not understand credit terms of the bank. In addition, 87.6% of the respondents agreed that shorter loan period leads to the occurrence of NPL. This implied that, shorter loan period (mean 1.97) has high tendency to turn to NPL than longer loan period and on the other hand the result revealed that understanding of credit terms has its own impact to the occurrence of NPL.

4.3 Presentation of Documentary Analysis

To examine the bank specific factors of nonperforming loans, data on NPL ratio of United Bank S.C for the period covering from 2008 to 2014 were used.

Table 4.11 NPL Ratio of united bank S.C(2008-2014)

Years	2008	2009	2010	2011	2012	2013	2014
NPL ratio*	6.97%	4.62%	5.76%	3.35%	3.53%	2.53%	3.1%

* NPL ratio is the ratio of Total loan over NPL

As indicated in the table above, NPL ratio of year 2008 and 2010 is above the industry average. On the other hand the rest years NPL ratio are below the predetermined threshold with fluctuating trend. No matter how it was above or below the industry average, the study intended to identify the bank specific factors of NPL and thereby to control it.

4.4 Presentation of Interview Result

4.4.1 Respondents Profile

Interview was conducted with top management bodies of the bank having more than 15 years of work experience on credit operation to assess the bank specific factors on NPL. And accordingly, five top management bodies were selected from the sample population and only 4 are interviewed.

4.4.2 Bank Specific Factors of NPL

For the question related to the impact of bank specific factor on NPL, all respondents answered that bank specific factors has significant impact of Nonperforming loans. In addition, they indicated some of the factors like:

- fund diversion by borrowers,

- lack of customers awareness on the terms and conditions of the bank regarding lending,
- officers capacity limitation,
- over financing and failure to comply with the bank's policy and procedure
- reduced attention to borrowers after loan disbursement,
- high lending appetite of the bank or aggressive lending
- Poor risk assessment and follow up.

Furthermore, they also pointed out that inflation, government policy and the NBE directive on private banks are the determinant factors of NPL but it is beyond the scope of this study.

4.4.3 Bank specific factors as rated in order of Importance

They were also requested to rate the bank specific factors in order of importance and accordingly, over financing and poor risk assessment technique stood first and most of the respondents rated officers capacity limitation, reduced attention to borrowers and failure to comply with the bank's policy and procedure are the succeeding factors

4.4.4 Corruption and NPL

For the question related with corruption, all respondent answered that there is no clearly identified case in relation with corruption and NPL. But they explained that corruption can leads to over financing and thereby over financing might lead to Fund diversion by customers and consequently the loan will be vulnerable to default.

4.4.5 Credit Cultures of the Bank

Interviewees were asked to elaborate the credit cultures of the bank and accordingly, the following credit cultures were identified

- Due to unfair competition between banks, strong credit quality is given less emphasis when there is high credit appetite. The focus of banks becomes to earn high market share and to remain larger player
- Prominent customers in terms of banking relationship are given priority and their credit request is seen irrespective of other credit sanctioning benchmarks.
- Granting clean loan /without physical collateral/ for prominent customers considering the information about the character of the borrower from informal source.

4.5 Presentation of Bivariate analysis

This research included independent variables such as Current Position in the banking industry(CPBI), Experience in banking industry(EBI), Experience in credit operation(ECO), Reduced attention to Borrowers(RAB), Rapid Loan Growth(RLG), Interest rate(IR), Lenient credit terms(LCT), Poor loan monitoring and Follow-up(PLMFU), Poor Risk assessment(PRA), Credit Culture(CC) ,Operating Efficiency(OE), Ownership type of banks(OTB), Concentration to Priority Sectors(CPS) ,Insufficient collateral(IC) and dependent variable Non-performing loans.

4.5.1 Normality test of the variables

To check the normality of the variables in this study, "Kolmogorov - Smirnov" test is used; in fact this test is used for checking the normality distribution of variable which is done by SPSS in this study.

Table 4.12 Test of normality of variables

Independent variables	Kolmogorov -Smirnov	Significance level
(CPBI)	1.031	.238
(EBI)	.712	.691
(ECO)	.450	.291
(RAB)	.741	.642
(RLG)	.777	.073
(IR)	.836	.582
(LCT)	.634	.621
(PLMFU)	.701	.345
(PRA)	.924	.083
(CC)	.654	.097
(OE)	.543	.521
(OSB)	.983	.452
(CPS)	.734	.732
(IC)	.863	.093

As it can be seen from the table , since the level of significance in all variables is over 0.05, we can conclude that the research Variables are normally distributed.

4.5.2 Correlation test

Before embarking on test of the hypothesis, we investigated the correlation between variables. As it was shown in the previous section the data distribution is normal so to investigate the correlation between variables, the Pearson correlation coefficient is used.

4.5.3 Test the All hypothesis

The all hypothesis examined the relationship between the independent variables and Non-Performing loans . Pearson correlation test results are presented in Table 4.13.

Table 4.13 Correlation test between independent variables and NPL

Independent variables	Pearson correlation coefficient	Significance level(p<5%)
CPBI	-0.763	0.00
EBI	-0.640	0.01
ECO	-0.542	0.00
RAB	0.862	0.00
RLG	0.970	0.03
IR	0.000	0.06
LCT	0.765	0.00
PLMFU	0.664	0.00
PRA	0.743	0.04
CC	0.632	0.00
OE	0.850	0.00

OSB	0.782	0.03
CPS	0.513	0.00
IC	0.745	0.04

According to the above table, because of the significance level is 0.00 less than 0.05 there is a significant correlation between the Current Position in the banking industry and Non-Performing loans(dependent variables) and because Pearson correlation coefficient is -0.763 it shows there is a strong negative significant correlation between the Current Position in the banking industry and Non-Performing loans.

The significance level of experience in banking industry (EBI) is less than 5%. Therefore there is significant correlation between experience and non-performing loans and Pearson correlation coefficient -0.640 shows there is a strong negative significant correlation between the experience in banking industry(EBI) and Non-Performing loans.

The significance level of Reduced attention to Borrowers(RAB) is less than 5%.Therefore there is significant correlation between reduced attention to borrower and non-performing loans and Pearson correlation coefficient is 0.862 so that there is a strong positive significant correlation between the RAB and Non-Performing loans.

Therefore borrowers may also perform in this manner. The more we gave attention to borrowers starting from submission of loan application to the final end, the less extent of the borrower to become defaulter. Frequent visit of the borrowers business, follow-up their operational and financial status are related to giving attention to borrowers.

Pearson correlation coefficient of Rapid Loan Growth(RLG) is 0.970 it shows that there is strong positive relationship between rapid loan growth and non-performing loans.

Thus, assuming banks lower credit standards as well as reduce loan rates, increases in lending due to supply shifts will tend to lead to higher loan losses in the future. The increase in willingness to lend may arise from different perspective. It may be for the sake of meeting

predetermined budget, competition within the industry, improved liquidity position, aiming for greater profit and others.

Pearson correlation coefficient of Interest rate(IR) is 0.000 with p-value of 0.06. Therefore interest rates has no relation with NPLs level.

Pearson correlation coefficient of Lenient credit terms (LCT) is 0.765 with p-value of 0.00. Therefore credit terms have significant impact on the occurrence of non-performing loan.

Pearson correlation coefficient of Poor Risk assessment (PRA) is 0.743 with p-value of 0.04. Therefore Poor Risk assessments have strong significant impact on the occurrence of non-performing loan.

Pearson correlation coefficient of credit culture (CC) is 0.632 with p value of 0.00. This shows that credit culture has strong significant relationship with non performing loan. A strong strategic credit risk management avoids important pitfalls like credit concentrations, lack of credit discipline, aggressive underwriting to high-risk counterparts and products at inadequate prices.

Pearson correlation coefficient of operating efficiency (OE) is 0.85; the result indicates that occurrence of nonperforming loan increases from risk taking with operating efficiency of banks. the logic behind that risk averse managers are willing to trade off reduced earning for reduced risk especially when their wealth depends on the performance of the bank, i.e. managers increase loan monitoring incur higher cost to improve loan quality.

Pearson correlation coefficient of ownership structure of banks (OSB) is 0.78 with P-value of 0.03. This shows that ownership structure has significant impact on the occurrence of nonperforming loan. This implies that privately owned banks have high non performing rate than government owned banks.

Pearson correlation coefficient of concentration to priority sectors (CPS) is 0.513 with P-value of 0.00. Therefore, concentration to priority sectors has significant impact on the occurrence of nonperforming loan

Pearson correlation coefficient of insufficient collateral (IC) is 0.745 with P-value of 0.04. Therefore insufficient collateral have strongly significant impact on the occurrence of nonperforming loan.

The way in which risk can be identified, quantified and minimized should be the key concern for bank's management and controllers. No loan is entirely without risk. It may be affected by internal as well as the external factors. Therefore, no matter how it is secured, the borrowers have potentials to generate loss due to the aforementioned factors

The overall idea given by the simple relationship between occurrence of nonperforming loan and its determinants is that all variables (Current position in the banking industry, experience in banking industry, experience in credit operation, reduced attention to borrowers, rapid loan growth, lenient credit terms, poor loan monitoring and follow up, poor risk assessment, credit culture, operating efficiency, ownership structure of banks, concentration to priority sectors and insufficient collateral) seem to have significant impact upon the occurrence of nonperforming loan except interest rate.

4.6 Presentation of Logistic Regression analysis

In order to perform regression testing, first we explain the assumptions test of the regression model. According to the F statistic in the regression table, since the significance level is less than 0.05, the regression model is significant for all hypothesis tests.

Variables linear test described in the following table:

Table 4.14 Multicollinearity test

Model	Row	Eigen values	Status indicators
1	1	5.292	1.000
	2	1.115	2.180
	3	.952	2.358
	4	.912	2.400
	5	.832	2.002
	6	.840	1.230
	7	.667	1.452
	8	.564	3.121
	9	.765	2.213
	10	.943	3.321
	11	1.231	2.321
	12	.781	1.324
	13	.834	2.213
	14	.643	1.122

As it can be seen, the eigen values indicate the possibility of internal correlation between variables. However, all the status indicators are less than 15, indicating the absence of multicollinearity among the Independent variables. Durbin-Watson statistic in the hypothesis testing table represents a test of autocorrelation between variables. Since this statistic in each regression testing tables is between 1.5 and 2.5, it implies that there is no autocorrelation problem between variables.

This section examines the relationship between the independent variable such as Current position in banking industry(CPBI), Experience in banking industry(EBI), Experience in credit operation(ECO), Reduced attention to borrowers(RAB), Rapid loan growth (Rapid loan growth), Interest rate (IR), Lenient credit terms(LCT), Poor loan monitoring and follow

up(PLMFU), Poor risk assessment (PRA), Credit culture (CC), Operating efficiency(OE), Ownership type of banks(OTB),Concentration to priority sectors(CPS), Insufficient collateral(IC) with NPL(dependent variable).

H0 = between the current position in banking industry, experience in banking industry, experience in credit operation, reduced attention to borrowers, rapid loan growth, interest rate, lenient credit terms, poor loan monitoring & follow up, poor risk assessment, credit culture, operating efficiency, ownership type of banks, concentration to priority sectors, insufficient collateral with NPL there is no significant relationship H0: $\beta = 0$

H1 = between the current position in banking industry, experience in banking industry, experience in credit operation, reduced attention to borrowers, rapid loan growth, interest rate, lenient credit terms, poor loan monitoring & follow up, poor risk assessment, credit culture, operating efficiency, ownership type of banks, concentration to priority sectors, insufficient collateral with NPL there is a significant relationship.

H1: $\beta \neq 0$

4.7 PRESENTATION OF A MULTIVARIATE ANALYSIS

Dichotomous (Two) dependent variables were created from these non performing loans questions, namely:

If there is loan and advance at least once, 1=performing loan (pass and special mention)

0=Non performing loan (doubtful, sub standard and loss)

Table 4.15: Logistic Regression Model of Non-Performance loans by staff with Selected Characteristics in United Banks S.C, 2014

Variable type	sign	variable name	Logistic coefficient	Odd Ratio	Significance Level
Dependent Variable	Y	NPL	(β)	(Exp(β))	
Constant Value	α	Alpha	-1.002	0.367	0.028
Independent Variables	(x1-----x14)	CPBI	-2.453	0.086	0.000
		EBI	-0.119	0.887	0.004
		ECO	-2.154	0.116	0.000
		RAB	0.507	1.660	0.000
		RLG	0.809	2.245	0.004
		IR	0.000	1.000	0.07
		LCT	1.497	4.466	0.002
		PLMFU	0.638	1.893	0.000
		PRA	0.045	1.046	0.001
		CC	0.443	1.557	0.000
		OE	0.662	1.938	0.000
		OSB	1.080	2.946	0.000
		CPS	0.579	1.785	0.005
		IC	1.105	3.020	0.003
Durbin-Watson			1.863		
F-Statistics			1.925		
R	The correlation Coefficient		0.767		
R Square	The Coefficient of Determination		0.589		
Adjusted R square	Adjusted coefficient of determination		0.582		

As found in the Bivariate analysis it has been noted that current position in banking industry(CPBI), experience in banking industry (EBI), experience in credit operation(ECO), reduced attention to borrowers(RAB), rapid loan growth(RLG), lenient credit terms(LCT),

poor loan monitoring & follow up(PLMFU), poor risk assessment(PRA), credit culture(CC), operating efficiency(OE), ownership type of the bank(OTB), concentration to priority sectors(CPS), insufficient collateral(IC) were the most important indicators of Non-performing loans and remained statistically significant in the multivariate analysis except interest rate(IR). In this model, as in the bivariate analysis, Current Position in the banking industry acted in the expected direction and was statistically significant predictor of Non-performing loans. The present multiple regressions model shows that the impact of Current Position in the banking industry on Non-performing loans was in a negative direction. It indicates that with each additional position, the probability of non-performance of loans is decreased by a multiplicative factor of 0.086.

Generally almost all categories in this variable are positively related with Non-performing loans except current position in banking industry(CPBI), experience in banking industry(EBI), experience in credit operation(ECO). On the other hand interest rate has no relationship with non performing loans(IR).

As the table 4.15 shows, CPBI, EBI, ECO, RAB, RLG, IR, LCT, PLMFU, PRA, CC, OE, OSB, CPS, IC variables (p-value <5%) have a significant relationship with Non-performing loans. The variables coefficient indicates that Current Position in the banking industry variable effect on Non-performance of loan is more than other examined variables. Because Durbin - Watson statistic (1.863) is between 1.5 and 2.5, then it is possible to conclude that there is no autocorrelation problem between variables except charging high interest rate. According to the F-statistic amount, processed regression model is significant and the coefficient of determination these variables explain is 58.9 percent of Non-performing loan changes.

CHAPTER FIVE

5. Summary, Conclusion and Recommendation

5.1. Summary

The study was conducted on United Bank employees to elicit their perception towards bank specific factors on the occurrence of NPL. Questionnaire and interview were used to collect primary data and the response rate for the questionnaire was 91.1% and of the proposed 5 samples for interview, 4 were interviewed.

The general objective of the study was to evaluate the impact of bank specific factors on NPL in the case of United bank Share Company. As far as the scope of the study is concerned the study focused on bank specific factors affecting non performing loan, hypothesis were developed to address the general objective. And accordingly, structured questionnaire and interview primary data analysis was made using SPSS version 20, Narrations and percentage. Further analysis was also made using correlation, logistic regression and multivariate models.

As indicated in the result of Questionnaire response and considering the measure of central tendency, credit monitoring and follow up, sound risk assessment and know your customer principle, Credit culture, loan length, collateral, high risk appetite, and loan growth has strong relationship with the occurrence of NPL. In contrast, the impact of charging high interest rate and having large number of borrowers found to be minimal.

Interview results also generated similar results. Poor financial and risk assessment, self dealing, monitoring and follow up, collateral status and loan period was some of the mentioned cause of NPL by interview respondents.

The correlation between independent variable to that of dependent variable was tested through correlation, multivariate and logistic regression model and the result shows there is positive

significant correlation between the independent and dependent variables except CPBI,EBI, ECO. On the other hand interest rate has no relationship with non performing loans.

5.2. Conclusion

Non-performing loans are dangerous not only for the economy of one country but also for the whole world. Previous literature attempted to study the overall economic determinants of non-performing loans through secondary data collection but this study focused on bank specific factors of NPL.

The broad objective of the study was to examine perception of bankers towards the impact of bank specific factors on NPL in United Bank S.C. Based on this broad objective, a number of specific objectives developed. Some of the specific objectives were to identify the relationship between non-performing loan and loan growth, interest rate, credit terms, credit policy & culture, collateral, credit monitoring & risk assessment, operational efficiency, and other related objectives. In this study, both primary and secondary data analysis was used to examine the impact of bank specific factors on NPL. In order to achieve the objective the study used mixed research approach like structured questionnaire, interview and documentary analysis .

Accordingly, credit monitoring/ follow-up plays pivotal role to ensure loan collection failure to do this properly was also found to be causes for NPL. The research also indicated that over financing due to poor credit assessment, compromised integrity of credit operators were cause for incidences of NPL.

Poor risk assessment was also another factor that cause to the occurrence of NPL. As indicated in the theoretical foundation of this paper, poor risk assessment includes analysis and appraisal of financial data, the possibility of risks and the Five C"s of credit. Poor risk

assessment might lead to over financing and under financing that both will cause to the occurrence of NPL.

Weak credit culture was also another identified reason for loan default. Sometimes borrowers granted loan because of they are prominent customer, by communicating referent group and because they are from those prominent customer's group. In addition there is an Ethiopian adage called "A borrower or a lender might die" which would encourage loan default.

Other factors like loan length, rapid loan growth, and lenient credit terms were also identified as bank specific factors of NPL. They have direct relationship with the occurrence of NPL. On the other hand the study did not support the existing literature that state the occurrence of NPL is related with interest rate and having large number of borrowers.

5.3. Recommendations

It is apparent that banks seriously consider all the internal and external factors causing non performing loans as well as the impact of non-performing loans on the bank's overall performance. The impact of bank specific factors such as poor risk assessment, weak credit culture, lenient credit terms, lack of proper credit follow up and others should be considered seriously during the credit assessment process. The bank should strengthen the credit processing that encompass the issue of proper customer selection, proper credit risk analysis, authentic sanctioning process, proactive monitoring and follow up, and should set clear recovery strategy for NPLs.

I also suggest the bank to adopt relationship management approach which helps the management to have a closer look at the banks corporate customers that consume large sum of the bank portfolio. For this, I recommend the bank to benchmark on this approach with Commercial bank of Ethiopia, Nib international bank and Oromia International Bank that already applied this approach.

Banks should pursue a balanced approach of profit maximization and risk management when they engage in aggressive lending and unhealthy competition that would lead to selecting borrowers that would default. The bank should also work in developing the competency of credit operators like loan officers, monitoring and follow-up officer and credit analysts concerning the efficiency of credit processing and follow-up.

Finally, I recommended further study on macroeconomic determinants of NPL and their associated impact.

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Appendix 1

Addis Ababa University
Faculty of Business and Economics
Executive MBA Program

QUESTIONNAIRE

My name is Endashaw Desalegn and I am currently working with the research component of the Master's Degree in Executive Business administration (EMBA) at the Addis Ababa University.

The purpose of the study is to examine the impact of bank specific factors on nonperforming Loans in the case of United bank S.C. To this end, the study intends to gather information from selected credit related practitioners (credit managers, analysts, recovery (monitoring) officers, credit committee members, risk officers etc) through a self administered questionnaire. The participation is fully voluntary and responses will be confidential. The results will be also reported without compromising the anonymity of the respondent.

I would appreciate your consideration in completing the enclosed questionnaire and assisting me in the research endeavor.

In case you have any questions please call 0911-437404 or email Endashaw_desalegn@yahoo.com.

Thank you in advance
Endashaw Desalegn

QUESTIONNAIRE

(Please tick appropriate boxes)

Section One: Background Information

1. Your Current Position in the banking industry

1=Loan officer: 4=D/Credit Manager

2=Credit Analyst 5=Monitoring/Follow-up Officer

3=Credit manager 6=Branch Manager

7=Other, Please specify _____

2. Indicate your experience in banking industry

1=Less than 1 year 4=11-15 years

2=1-5 years 5=above 15 years

3=6-10 years

3. Indicate your experience in credit operation

1=Less than 1 year 4=11-15 years

2=1-5 years 5=above 15 years

3=6-10 years

Section two: Questions on Bank specific factors of non-performing loan

4. Bank specific factors contributed to the occurrence of non performing Loan

1. Yes 2. No

5. What are the bank specific factors determining non-performing loans?

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

	Particulars	Strongly Agree(1)	Agree (2)	Neutral (3)	Disagree (4)	Strongly Disagree(5)
6.	Easily admitted borrowers usually default					
7.	Know your customer principle of banks lead to high loan quality					
8.	Good loan underwrite ensures loan performance					
9.	Poor risk assessment would lead to loan default					

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

	Particulars	Strongly Agree(1)	Agree (2)	Neutral (3)	Disagree (4)	Strongly Disagree(5)
10.	Strict credit monitoring ensures loan performance					
11.	Poorly assessed and advanced loans may perform					

	well if properly monitored					
12.	Loan follow-up is directly related to occurrence of nonperforming loans					
13.	Banks with higher budget for loan monitoring have lower non performing loans					

Please indicate your degree of agreement or disagreement to the statement pertaining to collateral and occurrence of NPL

	Particulars	Strongly Agree(1)	Agree (2)	Neutral (3)	Disagree (4)	Strongly Disagree(5)
14.	Collateralized loans perform well					
15.	Collateralized loans help to protect loan default					
16.	Most of the time non collateralized loans are defaulted					

Please indicate your degree of agreement or disagreement to the statement pertaining to Credit culture and occurrence of NPL

	Particulars	Strongly Agree(1)	Agree (2)	Neutral (3)	Disagree (4)	Strongly Disagree(5)
17.	Credit culture is related to loan performance					
18.	There is a relationship between loan default and					

	credit culture					
19.	Borrowers culture is related to loan performance					
20.	Default in some area ascribed to the culture of borrowers					

Please indicate your degree of agreement or disagreement to the statement pertaining to interest rate & credit terms and occurrence of NPL

	Particulars	Strongly Agree(1)	Agree (2)	Neutral (3)	Disagree (4)	Strongly Disagree(5)
21.	Loans with high interest rate tend to turn to NPL					
22.	Charging high interest rate leads to loan default					
23.	Lenient credit terms cause loan default					
24.	Borrowers default because they don't understand credit terms well					
25.	Poorly negotiated credit terms lead to NPL					
26.	Shorter loan period leads to NPL					
27.	Longer loan period leads to NPL					

Please indicate your degree of agreement or disagreement to the statement pertaining to rapid loan growth & ownership type of banks and occurrence of NPL

	Particulars	Strongly Agree(1)	Agree (2)	Neutral (3)	Disagree (4)	Strongly Disagree(5)
28.	Aggressive lending leads to high NPL					
29.	Great risk appétit is the cause for NPL					
30.	Compromised integrity lead to loan default					
31.	Having Large number of borrowers cause NPL					
32.	Loan default is directly related to bank size					
33.	Loan default is not related with ownership type(private)					

34. If you have further comments on the bank specific factors affecting non performing loans of bank please specify in the space provided.

End of questionnaire

Thank You

Appendix 2

Instrument of in-depth interview

1. Summary of Respondent profile

a. Age _____

b. Level of education _____

c. Experience on credit _____

d. Current position _____

2. What are the basic factors of nonperforming loans from the bank side?

3. How do you rate the factors in order of importance and why?

4. Do you think that corruption is related with loan default? If yes; how?

5. What are the credit cultures of your bank?

6. To what extent the culture of society affect loan default?

7. What are the views of top managements towards minimizing loan default?

8. Any comments and recommendation?
