ST.MARY'S UNIVERSITY SCHOOL OF GRADUATE STUDIES

NON-PERFORMING LOANS IN PRIVATE COMMERCIAL BANKS OF ETHIOPIA

BY

ESAYAS G/MEDHIN

DECEMBER, 2015

ADDIS ABABA, ETHIOPIA

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A THESIS SUBMITTED TO ST.MARY'S UNIVERSITY, SCHOOL OF GRADUATE IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION

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APPROVED BY BOARD OF EXAMINERS

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DECLARATION

I the undersigned, declare that this thesis is my original work, prepared under the guidance of zemenu Aynadis(Ass Prof).All source of materials used for thesis have been duly acknowledged .I further confirm that the thesis has not been submitted either in part or full to any higher learning institution for the purpose of earning any degree.

____

Name Signature and Date

ENDORSEMENT

This thesis has been submitted to St.Mary's University, School of Graduate studies for examination with my approval as University Advisor.

_____________________________ _______________________________

Advisor Signature and Date

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ESAYAS G/MEDHIN

ADDIS ABABA

ETHIOPIA

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ABSTRACT

This study intends to asses non-performing loans in private Banks of Ethiopia ,survey was conducted with professionals engaged in private Banks in Ethiopia holding different positions using a self administered questionnaire.

The findings of the study shows that uncollateralized lending ,under developed credit culture, lenient credit terms, Rapid credit growth and greater risk appetite ascribe to the causes of loan default.

However, the study outcome failed to support the effect of interest rate they charge and occurrence of non-performing loans.

The study suggest that banks should put in place a vibrant credit process that ensures proper customer selection, robust credit analysis private monitoring and clear policy frame work that addresses issues of conflict of interest, ethical standard and check and balance in credit process, organizational capacity enhancement of banks, deliberate effort to develop culture of the public towards credit and its management by banks and ensuring prudent policies that govern bank loans.

List of Acronyms

CBO: - Cooprative Bank of Oromia

IMF: - International Monetary Fund

NBE: - National Bank of Ethiopia

NPL: - Non Performing Loans

RQ: - Research Question

SSA: - Sub Saharan Africa

CHAPTER ONE

1. INTRODUCTION

Banks role in the economy of any country is very significant. They play intermediation function in that they collect money from those who have excess and lend it to others who need it for their investment. Availing credit to borrowers is one means by which banks contribute to the growth of economies.

Lending represents the heart of the banking industry. Loans are the dominant asset and represent 50-75 percent of the total amount of most banks, generate the largest share of operating income and represent the banks greater risk exposure (Mac Donal & koch, 2006). Moreover, its contribution to the growth of any country is huge in that they are the main intermediaries between depositors and those in need of fund for their viable projects (creditors) there by ensure that the money available in economy is always put to good use. Therefore, managing loan in a proper way not only has positive effects on the banks performance but also on the borrower firms and a country as a whole. Failure to manage loans, which make up the largest share of banks assets, would likely lead to the episode of high level of non-performing loans (NPLs).

According to the international monetary fund (IMF, 2009) a non-performing loan is any loan in which interest and principal payments are more than 90 days overdue; or more than 90 days worth of interest has been refinanced. On the other hand the Basel Committee (2001) puts non performing loans as loans left unpaid for a period of 90 days.

Under the Ethiopian banking business directive, non-performing loans are defined as “Loans or Advances whose credit quality has deteriorated such that full collection of principal and/or interest in accordance with the contractual repayment terms of the loans or advances in question” National Bank of Ethiopia (NBE, 2008).

The causes for loan default vary in different countries and have a multidimensional aspect both, in developing and developed nations. Theoretically there are so many reasons as to why loans fail to perform some of these include depressed economic conditions, high real interest rate, inflation, lenient terms of credit, credit orientation, high credit growth and risk appetite, and poor monitoring among others. Bercoff *et. al.*, (2002) categorizes causes of nonperforming loans to bank specific and macroeconomic conditions.

1.2 BACKGROUND OF THE STUDY

Banks are financial institutions that accept deposit from the general public and obtain money from such other sources as may be available to them (the 'haves') in order to extended loans to those in need of the money (the 'have-nots') as Goosen *et.al*., (1999) put it,

Loans and advances constitute the primary source of income by banks. As any business establishment a bank also seeks to maximize its profit. Since loans and advances are more profitable than any other assets, a bank is willing to lend as much of its funds as possible but banks have to be careful about the safety of such advances Radha. *et.al.*, (1980). Bankers naturally try to balance the issue of maximizing profit by lending and at the same time manage risk of loan default as it would impair profit and there by the very capital.

In other words loan loss or defaulted loans puts a bank in a difficult situation especially when they are in a greatest amount. Despite the fact that banks hold security for the loans grant they cannot be fully be certain as to whether they are paid or not. It is when such risks materialize that loans turns to be non-performing.

Historically, the occurrence of banking crises has often been associated with a massive accumulation of non-performing loans which can account for a sizable share of total assets of insolvent banks and financial institutions. Deterioration in banks' loan quality is one of the major causes of financial fragility. Past experience shows that a rapid build-up of bad loans plays a crucial role in banking crises (Demiqruc-kunt and Detrgiache, 1998; Gonzalez-Hermosillo, 1999).

Under the Ethiopian banking business directives, non-performing loans are defined a “loans or advances whose credit quality has deteriorated such that full collection of principal and/or interest in accordance with the contractual repayment terms of the loans or advances in question (NBE, 2008).

Modern banking in Ethiopia was introduced in 1905. The number of banks that are operating in the country reached 19 on 2014 fiscal year, of which 16 are privately owned and 3 of them are government owned from these 19 banks 18 of them are commercial banks and 16 of them are private banks. Ethiopian banks that have been operating in 2014 fiscal year in the order of their establishment are: Development Bank of Ethiopia (the only non commercial bank), commercial Bank of Ethiopia, Construction and Business Bank, Awash International Bank, Dashen Bank, Bank of Abyssinia, Wegagen Bank, United Bank, Nib International Bank, cooperative Bank of Oromia, Lion International Bank, Zemen Bank, Oromia International Bank ,Bunna International Bank, Berhan International Bank, Abay Bank, Addis International Bank, Debub Global Bank and Enat Bank.

The non-performing loan ratio of private banks is increasing from time to time; to register a sustainable profit from the bank industry and to reduce ratio of non-performing loans full understanding of determinants of non-performing loans specifically for banks specific factors is crucial ,according to many literatures there are both macroeconomic and bank specific determinants of banks NPLs .Most importantly literatures agree that specific factors are the most important determinants of commercial banks NPLs ,Hence the purpose of this study is to identify and factors and occurrences of non-performing loans in private commercial banks of Ethiopia.

1.3 STATMENT OF THE PROBLEM

Banks exist to provide financial intermediation services while at the same time endeavor to maximize profit and shareholder's value. Lending is considered the most important function for fund utilization of Commercial Banks as major portion of their income is earned from loans and advances (Radha.1980)

Despite the fact that loan is a major sources of banks income and constitutes their major assets, it is risky area of the industry. That is also why credit risk management is one of the most critical risk management activities carried out by firms in the financial services industry in fact of all the risks banks face, credit risk is considered as the most lethal as bad debts would impair banks profit. It has also to be noted that credit risk arises from uncertainty in a given counterparty's ability to meet its obligations.

If the uncertainties materialize they would lead to deterioration of loan qualities, deterioration in banks' loan quality is one of the major causes of financial fragility. Past experience shows that a rapid build-up of bad loans plays a critical role in banking crises (Demlrguc-kunt and Detrgiache, 1998; Gonzalez-Hermosillo, 1999). The solidity of banks' portfolio depends on the health of its borrowers. In many countries, failed business enterprises bring down the banking system (Alemu, 2001). A sound financial system, among other things, requires maintenance of a low level of non-performing loans which in turn facilitates the economic development of a country.

High level of non-performing loan is linked with banks failure and financial crisis. Failure in one bank might lead to run on bank which in turn has contagious had recently been experienced in USA and Europe and other parts of the world.

Though the recent financial crisis began with Fanny May and Freddie Mac US banks, it rapidly spread from Wall Street to the rest of world economies (Jonathan and Peter; 20011).

In Ethiopia context the banks in the country are required to maintain ratio of their non performing loans below five percent (NBE, 2008) unpublished data from NBE shows that the

industry average is below the set threshold. Despite this ratio of non-performing loans Cooperative Bank of Oromia (CBO) stood at 11.64% on may 31.2013 though there seem to be some improvements during recent quarters the ratio stood at 7.62% and 6.75% on June 30,2014 and December31,2014 respectively, showing slight improvement the ratio was 6.1% on march 31,2015,on the other hand during the same period banks that are relatively found at the same level interns of their potential and size as CBO (like ,Zemen Bank, Oromia International Bank and Lion international bank) have had an average of less than 3.0% nonperforming loans ratio (NBE,2011),the deviant observation at CBO caught the attention of the researcher of what the causes of nonperforming loans are not only in this bank but also in other Ethiopian private banks

This problem along with the knowledge gap in the literature calls a researcher to investigate the causes for the existence of a high level of non- performing loans.

1.4 RESEARCH QUESTIONS

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RQ1 What are bank factors which are causes for non-performing loans in private banks of Ethiopia?

RQ2 Is there a relationship between collateralized lending and non-performing loans?

RQ3 What is the impact of credit culture on loan default?

RQ4 Do credit term and price affects loan performance?

RQ5 Does rapid credit growth and greater risk appetite lead to non-performing loans?

1.5 GENERAL OBJECTIVE OF THE STUDY

The general objective of the study is to describe causes for occurrences of Non-performing loans in private commercial banks of Ethiopia.

1.6 SPECIFIC OBJECTIVES:

1. To identify the relationship between collateralized lending and non-performing loans
2. To describe the effect of credit culture on loan default
3. To identify the effect of credit terms and price on loan performance
4. To describe the effect of rapid credit growth rate and greater risk appetite on non-performing loans

1.7 SIGNIFICANCE OF THE STUDY

This study help Ethiopian banks get insight on what to improve their loan qualities and the central bank (NBE) to examine its policy in private banks supervision pertaining to ensuring asset quality banks maintain. In addition the study also contributes to the existing body knowledge in regarding the factors and determinants of non- performing loans and motivates future research on Ethiopian Banking Context.

1.8 SCOPE OF THE STUDY

The study was limited to bank specific factor determinants of non-performing loans though macroeconomic factors has a huge impact on qualities and performance of loans, the study conducted on six selected private commercial banks of Ethiopia namely Awash International Bank, United Bank, Cooperative Bank of Oromia, Lion International Bank , Enat Bank & Addis International Banks.

1.9 LIMITATION OF THE STUDY

Due to the confidential policy of banks, access to customer and banks information, except officially disclosed financial information, was not possible. The study was also limited to bank employees' and officials' personal perception, beside Macroeconomic determinants of NPLs is not examined in this study.

1.10 ORGANIZATION OF THE STUDY

The research paper is organized according to the following chapters. Chapter one discusses Introduction of the study that gives a brief overview of banking industry in Ethiopia it also discusses research question, objectives, scope and significance of the study. The second chapter briefly presents literature review, the third chapter contains Research methodology, and the fourth chapter contains data presentation, analysis and finding of the study. And finally the fifth chapter incorporates conclusions and recommendations of the finding.

CHAPTER TWO

2 LITERATURE REVIEW

2. 1 Determinants of Nonperforming Loans

Deterioration in banks' loan quality is one of the major causes of financial fragility. Past experience shows that a rapid build-up of bad loans plays a crucial role in banking crises (Demirgüc-Kunt and Detragiache, 1998; González-Hermosillo, 1999). In recent years, the global financial crisis and the subsequent recession in many developed countries have increased households' and firms' defaults, causing significant losses for banks.

Default culture is not a new dimension in the arena of investment. Rather in the present economic structure, it is an established culture. The redundancy of unusual happening becomes so frequent that it seems people prefer to be declared as defaulters (Sonali, 2001).

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

The literature reviewed concentrate on two grand factors- macroeconomic and bank specific factors. Studies in the US and the rest of the world provide this result. For instance, Bercoff *et al* (2002) examine the fragility of the Argentinean Banking system over the 1993-1996 periods; and came up with a finding that NPLs are affected by both bank specific factors and macroeconomic factors.

The rest of this section discusses determinants of nonperforming loans beginning with macroeconomic and then bank specific factors.

2. 2 Macroeconomic Determinants of Nonperforming loans

The macroeconomic determinants of the quality of banks' loans have been area of various researchers during the past two decades. The literature on the major economies has confirmed that macroeconomic conditions matter for credit risk. These literatures among others have investigated the linkage between macroeconomic factors like GDP, inflation, real interest rates, unemployment etc. and loan performance. The paragraphs that follow critically review the existing literature on the major macroeconomic factors that have bearing on Nonperforming loans (NPL).

George G (2004) states the fact that large number of the literatures indicates the linkage between the phases of the business cycle with banking stability. Macroeconomic stability and banking soundness are inexorably linked. Both economic theory and empirical evidence strongly indicate that instability in the macroeconomic is associated with instability in banking and financial markets and vice versa.

The researches indicates that the expansion phase of the economy is characterized by a relatively low number of NPLs, as both consumers and firms face a sufficient stream of income and revenues to service their debts. However as the booming period continues, credit is extended to lower-quality debtors and subsequently, when the recession phase sets in, NPLs increase. (Fisher, 1933; Minsky, 1986; Kiyotaki and Moore 1997; Geanakoplos, 2009).

Studies conducted by Keeton and Morris (1987) on a sample of nearly 2,500 US commercial banks using simple linear regressions indicate that large portion of loan losses recorded by the banks ascribe to adverse local economic conditions along with the poor performance of certain sectors. Similar study by Sinkey and Greenwalt (1991) on large commercial banks in the United States from 1984 to 1987 by employing simple log-linear regression model and data also indicates that depressed regional economic conditions explain the loss-rate of the commercial banks. Other authors who looked at asset-price evidence also found a linkage between credit risk increase and adverse macroeconomic conditions (Mueller, 2000; Anderson and Sundaresan, 2000; Collin-Dufresne and Goldstein, 2001).

Study made on Australian banks by Kent and D'Arcy (2000) suggests that, risks peaked at the top of business cycle. Rajan and Dhal (2003) looked at Indian banks and uncovered a similar relationship. Marcucci and Quagliariello (2008) studied the Italian banking system by employing a reduced form value at risk (VAR) to assess, among other things, the effects of business cycle conditions on bank customers' default rates over the period 1990-2004 found out that the default rates follow a cyclical pattern, falling during macroeconomic expansions and increasing during downturns.

Using a dynamic model and a panel dataset covering the period 1985-1997 to investigate the determinants of problem loans of Spanish commercial and saving banks, Salas and Saurina (2002) reveal that real growth in GDP is among the factors that explain variation in NPLs. Meanwhile, Rajan and Dhal (2003) utilized panel regression analysis to report that favorable macroeconomic conditions (measured by GDP growth) is among the factors that have significant impact on the NPLs of commercial banks in India. Empirical studies tend to confirm the aforementioned link between the phase of the cycle and credit defaults. Quagliarello (2007) find that the business cycle affects the NPL ratio for a large panel of Italian banks over the period 1985 to 2002. Furthermore, Jimenez and Saurina (2005) who examined the Spanish banking sector from 1984 to 2003; provided evidence that NPLs are determined by GDP growth, high real interest rates among others. Salas and Saurina (2002) estimate a significant negative contemporaneous effect of GDP growth on the NPL ratio and infer a quick transmission of macroeconomic developments to the ability of economic agents to service their loans.

Furthermore, Cifter *et al,.* (2009), using neural network based wavelet decomposition, find a lagged impact of industrial production on the number of non-performing loans in the Turkish financial system over the period January 2001 to November 2007. Berecoff, Giovanni and Grimard (2002) analyzed Argentina's banking system using an accelerated failure time model and found that the money multiplier, reserve adequacy among other are factors affecting NPLs.

Further macroeconomic instability which is mostly manifested by high inflation rate also makes loan appraisal more difficult for the bank, because the viability of potential borrowers depends upon unpredictable development in the overall rate of inflation, its individual components, exchange rates and interest rates. Moreover, asset prices are also likely to be highly volatile under such conditions. Hence, the future real value of loan security is also very uncertain (Martin Brownbrigde, 1998). We also see that banks do poorly both when product and asset price prudential policy, inflation accelerates unexpectedly and when inflation decelerates unexpectedly, unemployment increases, and/or aggregate output and income decline unexpectedly. Unexpected accelerations in inflation adversely affect banks that, on average, lend longer term at fixed-rates than they borrow because nominal interest rates will raise more than expected. This will increase their cost of deposits core than their revenues from loans.

An increase in the unemployment rate could influence negatively the cash flow streams of households and increase the debt burden. With regards to firms, increases in unemployment may signal a decrease production as a consequence of a drop in effective demand. This may lead to a decrease in revenues and a fragile debt condition.

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

Macroeconomic instability would have consequences for the loan quality of banks in any county. High inflation increases the volatility of business profits because of its unpredictability, and because it normally entails a high degree of variability in the rates of increase of price of the particular goods and services which make up the overall price index. The probability that firms will make losses rise, as does the probability that they will earn windfall profits.

Studies conducted on banks in different economics also depict the correlation between macroeconomic factors like inflation, unemployment and interest rate and loan defaults. Some of the studies would further be pinpointed in the paragraphs that follow.

Study by Fuentes and Maquieira (2003) on Chilean banks; indicates that interest rates had a greater effect on NPLs than the business cycle. Other macroeconomic variables, in particular the exchange rate, unemployment, and asset and house prices are also important factors affecting NPL (IMF, 2006).

Hoggarth *et al*., (2005) employed UK quarterly data for the period 1988-2004 to evaluate the dynamics between banks' write-off to loan ration and several macroeconomic variables found out that banks' write-off ratio also increases after increases in retail price inflation and nominal interest rates. Similarly, Babouček and Jančar (2005) quantify the effects of macroeconomic shocks on the loan quality of the Czech banking sector for the period 1993-2006 and report evidence of a positive correlation of non-performing loans with the unemployment rate and consumer price inflation.

Gambera (2000) assesses the impact of state and nation-wide macroeconomic variables on the quality of different types of loans (agricultural, commercial, industrial and residential) using US quarterly data for 1987-1999. The author reports that the unemployment rate, farm and non-farm incomes, bankruptcy filings and car sales, among various explanatory variables, were significant predictors of bank asset quality.

Filosa (2007), estimating three distinct value at Risk (VAR) models over the period 1990-2005 with different indicators of banks' soundness, finds a somewhat weaker relation between macroeconomic developments and banks' soundness. On the other hand, he finds that deterioration (improvement) in the quality of loans weakens (reinforces) real activity and inflation.

Study by Kaliral and Scheicher (2002) who employed a simple linear regression to examine the interdependence of credit risk for Austrian banks during the period 1990-2001 concluded that the loan quality was influenced in particular by the short-term nominal interest rate, industrial production, the stock market return and a business confidence index.

Arpa *et al*., (2001) assess the effects of macroeconomic developments on risk provisions (calculated as the ratio of total provisions for loans to the sum of total loans and total provisions for loans) of Austrian banks for the period 1990-1999 by the use of a single-equation time series model indicating that, risk provisions rise when real gross domestic product growth declines, real interest rates fall and real estate prices increase/

Shu (2002) used a single-equation time series model to examine the impact of macroeconomic developments on loans quality in Honk Hong for the period 1995-2002. The results show that the ratio of bad loans to performing loans falls with higher real gross domestic product growth, higher consumer price inflation rate and higher property prices growth, whereas it rises with increases in nominal interest rates.

Bercoff et al (2002) examined the fragility of the Argentinean Banking system over the 1993-1996 periods; they argue that NPLs are affected by both bank specific factors and macroeconomic factors.

2.3 Bank Specific Factors causing Nonperforming Loans

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

2.3.1 Rapid Loan Growth

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

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

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

2.3.2 High Interest Rate

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

2.3.3 Lenient Credit Terms

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

Rajan (1994) hypothesizes that bank managers have short-term decision horizons because their reputations are strongly influenced by public perceptions of their performance, as evidenced by short-term earnings. Managers' reputations suffer if they fail to expand credit when the economy is expanding and bank earnings are improving. This herd behavior will result in some loans going to customers with higher default risk than would occur otherwise. Weinberg (1995) also suggests that bank managers adjust lending standards as market conditions change, seeking to smooth overall lending risk.

The Office of the Comptroller of the Currency (OCC, 1988) concludes that the dominant reason for bank failure in the early 1980s was poor bank management, which encompasses lax lending standards. An FDIC study of the causes of the banking crises of the 1980s and early 1990s (FDIC, 1997) finds that a combination of factors – economic, legislative, managerial, and regulatory – led to the banking crises.

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

2.3.4 Credit Orientation

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

2.3.5 Cost Efficiency

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

2.3.6 Poor Loan Follow-up (Monitoring)

Regular monitoring of loan quality, possibly with an early warning system capable of alerting regulatory authorities of potential bank stress, is essential to ensure a sound financial system and prevent systemic crises. (Agresti et al., 2008).

The need to give due attention to borrower thus need not be overemphasized in order to ensure loan performance. There is a tendency by borrowers to give better attention to their loans when they perceive they got better attention. Some of the loans defaults ascribe to lower level of attention given to borrowers. It is advised that banks keep up with their loans timely (Mayers, undated).

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

In order to meet these objectives banks need to see whether the character of the borrower, its capacity to repay the loan, capital contribution, prevailing market conditions and the value of the collateral that was taken during loan approval time continues to remain the same (George G. 2004).

As has been mention a bank can use different ways to monitor the borrower. Follow up the financial stability of a borrower can be done by periodically scrutinizing the operations of the accounts, examining the stock statements and ascertaining the value of security. Visiting the borrower periodically to have understanding of the progress of the borrower’s business activity and thereby give advice as necessary is also among the methods Banks adopt to follow up their loans.

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

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

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

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

2.3.7 Poor Risk Assessment

Risk, and the ways, in which it can be identified, quantified and minimized, is key concerns for a bank's management and its auditors when they are considering the need to provide for bad and doubtful loans. No loan is entirely without risk. Every loan, no matter how well it is secured, and no matter who is the borrower, has the potential to generate loss for the lender. It is the degree of risk to which a loan is susceptible and the probability of loss that vary; these should normally be reflected in the interest margin and other terms set at the inception of the loan (Brown, 1993)

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

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

Basically, the non-performing loans are a result of the compromise of the objectivity of credit appraisal and assessment. The problem is aggravated by the weakness in the accounting, disclosure and grant of additional loans. In the assessment of the status of current loans, the borrower's credit worthiness and the market value of collateral are not taken into account thereby rendering it difficult to spot bad loans (Patersson, 2004). Compromise in quality of risk assessment thus leads to occurrence of nonperforming loans.

2.3. 8 Lack of Strict Admittance Exit Policies

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

inaccurate assessment, the risk of loans is not fully covered and the risk on group customers and affiliated enterprises are not identified effectively. The factors above damage the loans at the early stage (Brownbrige, 1998).

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

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

2.4 Theoretical review of Banking

This section discuses the theory of banking with major focus on role of banks and their lending activities

2.4.1 Banking

Banking are financial institution that accepts deposits from the general public and obtain money from such other sources as may be available to them (the' haves') in order to extended loans to those in need of the money (the' haves-nots'). As Gossen *et.al.*(1999) put it, banks provide channel(Financial intermediation) for linking those who have excess funds with those who are in need of funds ,thus ensuring the money available in economy is always put to good use. In so doing banks earn income when they lend money out at a higher interest rate than they pay depositors for use of their money. A Bank's main source of income is interest. A banks' pays out at lower interest rate on deposits and receives a higher interest rate on loans. The difference between these rates represents' the bank's net income. Banks and other financial institutions exist in order to earn a profit and to ensure that shareholders' value is maximized.

Currently in most jurisdictions commercial banks are regulated by government entities such as central banks and require a special bank license to operate.

2.4.2 Role of Banks

The banking sector makes a meaningful contribution to the economic growth of every country. Banks contribution to the growth lies in the role they play in mobilizing deposits and allocating the resources efficiently to the most productive uses investment in the real sector. So making credit available to borrowers is one means by which banks contribute to the growth of economies, Banks pool resources together for projects that are too large for individual shareholders to undertake(Bagehot,1873**).** They are also considered the most important enabler of financial transactions in any country's economy and are the principal source of credit (Rose,2002). Bank finance is the primary source of debit funding. Commercial banks extend credit to different types of borrowers for many diverse purposes, either for personal, business or corporate clients(Saunders & Cornett,2003). Beside, banks are also the custodian of nation's money, Which are accepted in the form of deposits and paid out on the client's instructions (Sinkey,2002;Harris,2003).

A bank's role has expanded considerably and is no longer limited to the taking of deposits and providing credit. Banks also perform the following activities (Furie et al., 1998;Valdez,2000)

Money creators: Commercial banks create money by way of deposit liabilities. In contrast to liabilities of other business, bank liabilities (cheques) are generally accepted as a means of payment.

Managers of payment system: This refers to the payment of cheques through the Automatic Clearing Bureau (ABC). It also facilitates payments of credit and debit cards, internet and cell phone banking and automatic teller machines.

Creators of indirect financial securities: Commercial banks hold assets that are subject to specific risks, while issuing claims against them in which these risks are largely eliminated through diversification.

Information agents: Commercial banks developed sound database of client information and the information is not publicly available (asymmetric information). The information is only shared with other banks by way of a bank code or a full general bank report.

Dealers in foreign currency: Due to the globalization of the world's economies this has become a very important function. Commercial banks assists in the conversation of currencies, transfers of funds and negotiate foreign financing.

2.4.3 Bank Lending

Investment on a productive sector is the precondition for achieving the economic growth from a country perspective. Capital formation postively supports this investment function. Once a satisfactory level of capital formed, the option of sound investment comes, that ultimately leads to flow of capital in the future. Financial institutions, mainly banks do these functions through different mechanisms such as loans (Islam,2009).Provision of resources (granting loan) by one party to another is termed as lending. Lending presumes the fact that the second party doesn't reimburse the first party immediately rather **arranges** either to repay or return those resource at a later date, making it a debt.

To enable them function as financial intermediaries, banks collect funds from savers in the form of deposit and then supply it to borrowers as loans, Thus banks accept customer deposit and use those funds to give loans to other customers or invest in other assets will yield a return higher than the amount banks pays the depositor(Mc Carthy *et al*.,2010). It follows that customers' deposit is thing e primary source of a bank loan and hence ,increasing or guaranteeing deposits directly has a positive effect on lending

CHAPTER THREE

3. RESEARCH METHODOLOGY AND DESIGN

3.1 Research Design

The purpose of this study is to identify the bank specific determinants of selected private commercial banks NPLs. The study considered six private banks from the total population, in addition to this, the study used primary source of data. The study also used survey design with a structured self administered questionnaire to gather data self administered questionnaires were distributed to research participants.

3.2 Sample size & Sampling technique

For this research the target population are private banks registered by National Bank of Ethiopia (NBE) and under operation, private banks were selected since it is difficult to compare private banks with that of government owned banks as the play ground is not equal for both private and state owned banks, state owned banks mostly share policy favors by the government not applicable to the private banks.

There are eighteen Commercial Banks in Ethiopia of which two are government owned and the remaining sixteen are private owned, for this study bank are stratified in to three levels the researcher used the total asset of selected banks for classification. According to the NBE, banks are classified as large, mid-size and small, for assets of greater than 9 billon between birr 3 billion and birr 9 billion and less than birr 3 billion respectively.

The classification of NBE for the period 2014/15 as per the aforementioned trait is tabulated below.

Table.1 National Bank of Ethiopia Banks Asset Classification

Total Asset	Private Commercial Banks	Classification
Greater than Birr 9 Billion	• Awash International Bank S.C • Bank of Abyssinia • Dashen Bank • NIB International Bank S.C • United Bank S.C • Wegagen Bank S.C	Large Size
Between Birr 3 billion and 9 billion.	• Cooperative Bank of Oromia • Oromia International Bank • Zemen Bank • Abay Bank • Buna International Bank Lion International Bank	Medium size
Less than Birr 3 billion	• Addis International Bank • Berhan International Bank • Debub Global Bank • Enat Bank	Small size

Based on the expected relative homogeneity of impact of NPLs across each stratum a sample of six banks with a frequency of two from each stratum is selected, the researcher used a simple random sampling technique to select the four sampled banks under large and small size banks, this method offers equal chance of selection insures that the researcher was unbiased in selecting the samples. Accordingly Awash International Bank & United Bank were selected from large size banks and Lion International Bank from Mid-size Bank, while Enat Bank & Addis

International Banks are selected from small sized banks however for selectivity the Mid –size banks ,the researcher used Purposive sampling so as to select Cooperative Bank of Oromia (CBO) from the stratum. This was merely due to the fact that the major reason causing this study was the enormous NPLs in Cooperative Bank of Oromia,. The s ample frame was confined to those individuals involved in credit analysis and appraisal, credit monitoring and credit risk management team members of the sampled banks, Hence, a sample element of a total of 100 individuals with a frequency of each 25 from Awash International Bank and United Bank 15 each from Cooperative Bank of Oromia and Lion International Bank and 10 each from Addis International Bank & Enat Bank respectively was considered for this study.

3.3 Source of Data & Tools of collection

The purpose of this study is to seek information that can be generalized about the relationship between NPLs and bank specific factors the study used primary source of data, primary data has collected through a self administered questionnaires which is distributed to research participants, the instrument of collection that is the questionnaire is prepared in English language and classified in to two sections. The first part of the question is designed to collect participant's profile (background information), the second part questions is related to factors that determine loan default or occurrence of non-performing loans.

3.4 Data Analysis Technique

The researcher used quantitative data analysis technique ,the data collected from survey questioner was carefully coded and checked and entered in to the SPPS 20 spreadsheet; hence Descriptive statistics employed to analyze the data.

CHAPTER FOUR

4 DATA ANALYSIS AND DISCUSSION

This chapter presents the result the study is aimed at exploring bank specific factors determinants of non-performing loans.

4.1 Survey Result

The questionnaire was distributed to credit related professionals (including relationship managers, credit analysts, recovery officers, credit managers, loan officers and risk officers in six private commercial banks that are operational in Ethiopia.

The questionnaire was physically distributed to 100 employees whose positions are related to bank lending, out of 100 questionnaire 96 were completed and collected, as a result the response rate is 96 percent. According to Fowler (1986) researcher survey organization differ considerably in the extent to which they devote time and money to improve response rate; thus, there is no agreed upon standard for a minimum acceptable response rate.

Table-4.1.2 **Respondent position in the banking industry**

Position		Frequency	Percent
	Loan Officer	20	20.3
	Credit Analyst	20	20.8
	Credit Director	12	12.8
	Relationship Manager	16	16.7
	Recovery/Monitoring Officer	28	29.2
	Vice President	4	4.2
	Total	96	100.0

Looking at to the positions of the survey respondents 16.7 percent were bank relationship managers while 29 percent were recovery /monitoring officers 20.8 percent were credit directors and credit analysts each and 4.2 percent and 8.3 percents were Vice presidents and loan officers,

Table 4.1.3 Respondent experience in the banking industry

Exprince		Frequency	Percent
	1-5 years	12	12.5
	11-15 years	12	12.5
	6-10 years	60	62.5
	Above 15 years	12	12.5
	Total	96	100.0

Interns of experience 62.5 percent of survey respondents indicated that they had 6-10 years of banking experience 12.5 percent of the respondents had banking experience of 1-5 years, 11-15 years and above 15 years each, this clearly depicts that respondents had reach experience in providing response that naturally contributed to the data quality of the survey

Table-4.1.4 Respondent experience in the banking Credit Process

Experience in criedt process		Frequency	Percent
	Less than 1 year	4	4.2
	1-5 years	16	16.7
	6-10 years	68	70.8
	Above 15 years	8	8.3
	Total	96	100.0

On the other hand 70.8 percent of the respondents had 6-10 years of experience in bank lending, 16.7 percent had 1-5 years of banking lending experience 8.3 & 4.2 percents had banking lending experience of above 15 years and less than one year respectively, the fact that majority of the respondents had many years experience in bank credit operations helped capture good quality of data.

4.2 Discussion of the Result

Table-4.2.1 Relation between collateralizing loans and occurrence of Nonperforming loans

Relationship	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Collateralized loan perform well	8.3	4.2	4.2	37.5	45.8
Collateralized loan help protect loan default		4.2	12.5	50.0	33.3
Most of the time non collateralized loans are defaulted	4.2	16.7	8.3	33.3	37.5

With regard to relation between collateralizing loans and occurrence of non-performing loans the respondents were asked three questions. Accordingly, 83.3 percent agree with the fact that collateralized loan perform well, on the other hand, 4.2 percent of the respondent have neutral insight that collateralized loan perform well or not. The remaining 12.5 percent of the respondents believed collateralized loan don’t perform well.

When asked of whether collateralized loan help protect loan default or not 83.3 percent of the respondents agree that collateralized loan help protect loan default. The remaining 4.2 percent of the respondents disagree while 12.5 percent of the sampled participants responded neutral.

Out of the total respondents 70.8 percent agree on the fact that non-collateralized loans mostly default. On the contrary, 20.9 percent of the respondents disagree that non-collateralized loans mostly default. The remaining 8.3 percent replied neutral.

Table-4.2.2 **Relation between borrowers' orientation and occurrence of Nonperforming loans**

		Agreement Level		
Relation	Disagree	Neutral	Agree	Strongly Agree
Borrowers Orientation/culture is related to loan performance	4.2		45.8	50.0
There is r/ship b/n loan default & borrowers culture Percent		4.2	62.5	33.3
Default in some area is ascribed to the culture of the borrowers		8.3	45.8	45.8
Society culture development leads to good loan performance		4.2	54.2	41.7

With regard to the relation between borrower's orientation and culture and loan performance 95.8 percent of the respondents agree on the fact that there is a relationship between borrowers' orientation and culture with that of loan performance.

To the opposite,4.2 percent of the respondents do not agree on the fact that there is a relationship between borrowers' orientation and loan performance.

When asked of whether default in some area is ascribed of the culture of the borrowers or not 91.6 percent of the participants agreed that default in some area come as a result of culture of the borrowers while 8.4 percent of the respondents answered neutral.

Almost all that 95.8 percent of the respondents agree that society cultural development leads to good loan performance. The other 4.2 percent of the respondents, however, responded neutral.

Tabe-4.2.3 Relation between cost of loan and Loan default

Relation	Agreement Level			
	Disagree	Neutral	Agree	Strongly Agree
Lenient credit term cause loan default	4.2	12.5	50.0	33.3
Loans with big interest rate tend to turn NPL		60	19	21
Charging big interest rate leads to loan default	16.7	37.5	8.3	37.5
Loan price affects loan performance	4.2	50	12.5	33.3

Out of the total respondents 83.3 percent agree that lenient credit terms cause loan default. On the other hand 12.5 and 4.2 percent of theme responded neutral and disagree respectively.

For 45.8 percent of the respondents charging big interest rate leads to loan default. Quite the opposite 16.7 percent of the respondents do not agree that charging big interest rate leads to loan default. The remaining 37.5percent of the participants responded neutral.

When asked of whether loan price affects loan performance or not, 45.8 percent of the respondents replied that loan price affect loan performance. . Half of the respondents answered neutral while 4.2 percent of the respondents replied loan performance does not affect loan performance

Table-4.2.4 **Credit growth relation with Nonperforming loans**

Relation	Agreement Level				
	xxx	Disagree	Neutral	Agree	Strongly Agree
Aggressive lending leads to large NPL volume/ratio		4.2		45.8	50.0
Banks whose credit growth is rapid experiences huge NL level		16.7	8.3	29.2	45.8
Banks great risk appetite is cause for NPL		4.2	4.2	41.7	50.0
Compromised			8.3	37.5	54.2

integrity in lending leads to loan default					
Having large number of borrowers causes loan default	4.2	16.7	4.2	25.0	50.0

When we see to the response on the relation between credit growth and occurrence of non-performing loans almost 90 percent of them agreed to assertion that aggressive lending leads to occurrence of large magnitude of NPLs. The response on the relation between compromised integrity and NPL reveals that almost 82.5 percent are in agreement so it can be stated that when banks pursue aggressive lending strategy and thereby experience rapid credit growth they might heap up large volume of nonperforming loans. Not only this but also compromised integrity in sanctioning credit is also believed to be cause for occurrence of loan default by respondents.

In relation to the impact of aggressive lending on NPLs volume, 95.8 percent replied that aggressive lending to large NPL volume/ratio .The remaining 4.2 percent disagree that aggressive lending leads to increasing NPL volume.

In relation to the question banks great appetite is cause of NPL, 91.6 percent of the respondents agree that banks greater risk appetite causes in NPLs of banks. The remaining 4.2 percent replied neutral.

For 91.7 percent of the sampled respondents compromised integrity in lending leads to loan default. The remaining 8.3 percent, on the other hand, replied neutral ,similarly,75 percent of the respondents agreed that having large number of borrowers causes loan default. While 20.9 percent of them disagree and 4.2 percent neutral. Therefore, it can be stated that when banks pursue aggressive lending strategy and thereby experience rapid credit growth they might heap up large volume of non-performing loans. Not only this but also compromised integrity in sanctioning credit is also beloved to be cause for occurrence of loan default by respondents.

Table-4.2.5 **Relationship credit terms and price on loan performance**

Relation	Agreement Level			
	Disagree	Neutral	Agree	Strongly Agree
Lenient/lax credit terms cause loan default	16.7	37.5	37.5	37.5
Borrowers default b/c they don't understand credit terms well	16.7		45.8	37.5
Poorly negotiated credit terms lead to non performance load		4.2	62.5	33.3

From the total respondents,83.3 percent agree that borrowers default because they don't understand credit terms well. Opposite to this, 16.7 percent of the respondents disagree that borrower's default b/c they don't understand credit terms well.

In the mean time, When asked of the relationship between poor negotiation in credit terms and the occurrence of respondents,95.8 percent expressed their agreement by indicating that poorly negotiated credit terms lead to non performance loan. The remaining 4.2 percent, however, expressed their disagreement to same question..

4.3. Discussion on Collateral and NPLs

Security is taken to mitigate the banks' risk in the event of default and is considered a secondary source of repayment (Koch & Macdolad,2003).According to De Lucia & 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 the planned course of action outlined at the time credit is extended and to provide insurance the borrower default .similarly the survey respondents agreed on the relation between collateralized loan & NPLs.

4.4. Discussion on Credit Orientation/Culture and NPLs

Study conducted by Rajan and Dhal(2003)in India indicated that credit orientation significantly affects loan default response to four of the questions posed to assertion the relationship 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)meant that credit culture is yet to develop in Ethiopia, that was also why Ethiopian banks had comparatively big NPL ratio. There is an Ethiopian proverb "either a borrower or a lender might die" indicating a borrower shouldn't bother to repay borrowing that cultural development has got huge bearing on loan performance

4.5 Discussion on Credit Terms & price

Credit terms & Price and NPL 77.3 percent of the respondents agree that lenient/lax credit terms cause loan default ,limitation in capacity of credit apparatus is the cause for poor assessment ,shallow assessment would fail to indicate terms and conditions of loan properly, among others, 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 either of this or related lead to poor loan performance ,thus the failure to put appropriate terms and conditions would lead to loan default, Rajan and Dhal (2003) who studied the Indian commercial banks also found that terms of their credit determines occurrence of nonperforming loans ,Jimenez and Saurina (2005) also indicated that NPLs by lenient Credit terms.

Study by Sinkey and Greenwal(1991)Rajanand Dhal(2003)indicated that high interest rate charged by banks is associated with loan defaults ,the study failed to support this finding in that average response to the assertion that loans with big interest rate would turn to defaulted was neutral ,none the survey participants believed that interest rate is related to occurrence of loan default in the Ethiopian private commercial banks context. One line of argument could be that the interest rate charged is comparatively smaller, for example according to NBE (2011) the price index for non energy commodity was 29 percent higher than a year before at the beginning of the year 2011, and where as the average lending rate was only 12.25 percent for the year 2010/11. On the other hand, business might also have a big profit margin that interest they pay for loans could not be an issue to cause loan default.

4.6 Discussion on Rapid credit Growth & NPLs

Salas and Saurina (2002) who studied Spanish banks found out that credit growth is associated with nonperforming loan o f the survey participant more than 70 percent support this.

CHAPTER FIVE

5. CONCLUSION AND RECOMMENDATIONS

The broad objective of the research was to asses factors of non-performing loans; based on the broad objective a number of specific research questions were developed.

To achieve this broad objective the study used descriptive research approach ,more specifically ,the study used survey of employees of banks, the result showed that based on the respondents view it was evident that most likely factors that affect occurrence of nonperforming loans in Ethiopian commercial private banks are presented in the paragraph that follow.

5.1 Conclusion

The study found out that due to underdeveloped of credit orientation/culture borrowers engaged in business that they had no depth knowledge diverted loans advanced for unintended purpose and at made a willful default.

The study also depicted that unfair competition among the banks along with aggressive lending pursued added to poor customers selection made in motive to maximize profit by the banks or due to the moral hazard or compromised integrity were the other causes for loan default besides, despite the fact that credit monitoring follow up plays pivotal rule to ensure loan collection, failure to do this properly was also found to be cause of sick loans ,moreover collateralized loan should be major part of a loan rather than granting loans in clean base it also revealed that compromised integrity of credit operators were cause for incidences of NPLs

On the other hand the study did not support the existing literature that state occurrence of NPL is related to interest rate banks charge.

5.2 Recommendation

After close examination and analysis of the research findings, the following recommendations are suggested:

Banks should put in place a vibrant credit process that would encompass issues of proper customer selection, robust credit analysis, proactive monitoring and recovery strategies for sick loans.

Banks should pursue a balanced approach of profit maximization and risk management lest they engage in aggressive lending and unhealthy competition that would lead to selecting borrowers that would default.

Banks should give due emphasis it takes to developing the competency of credit operators, information system management pertaining to credit and efficiency of, information credit and efficiency of credit process.

As loans would contribute to the development of an economy and its default leads to episode of huge loss on banks and a country, deliberate effort should be exerted in developing culture of public towards credit and its management.

Presence of policies that govern bank loans should continuously be ensured in light of international best practices, continuous revision of procedures based on practical situation.

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APPENDIXES

QUESTIONAIRE

(Please tick appropriate boxes)

SECTION ONE – BACKGROUND INFORMATION

1. **Your current position in the Banking industry**

Loan Officer 1 Relationship manager 4

Credit analyst 2 Recovery/ monitoring officer 5

Credit Director 3 Vice president 6

Other, please specify ____________________________

2. **Indicate your experience in the banking industry**

Less than 1 year 1 6-10 years 4

1-5 years 2 Above 15 years 5

11-15 years 3

3. **Indicate your experience in bank credit processes**

Less than one year 1 6-10 years 4

1-5 years 2 Above 15 years 5

1-6 11-15 years 3

SECTION TWO – QUESTIONS ON THE DETERMINANTS OF NON PERFORMING LOANS

4. Please rank the factors that cause occurrence of nonperforming loans in Ethiopian Private Banks

N.B Rank the factors in order of their importance in contributing to the occurrence of nonperforming loans from 1-3

Factor that causes occurrence of nonperforming loans	**Rank 1=Lowest ……. 3=Highest**
Rapid Loan growth by banks	
Poor credit monitoring/follow-up	
Poor risk assessment	
Poor collateral management	
Others, Please specify ______________ ________________________________ ________________________________ ________________________________ __________________________	

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

		Strongly Agree (5)	**Agree (4)**	**Neutral (3)**	**Disagree (2)**	**Strongly Disagree (1)**
5	Collateralized loan perform well					
6	Collateralizing loan help protect loan default					

7	Most of the time non collateralized loans are defaulted					

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

		Strongly Agree (5)	Agree (4)	Neutral (3)	Disagree (2)	Strongly Disagree (1)
8.	Borrowers Orientation /Culture is related to loan performance					
10	There is r/ship b/n loan default & borrowers culture					
11	Default in some area is ascribed to the culture of the borrowers					
12.	Society culture development leads to good loan performance					

Please indicate your degree of agreement or disagreement to the statements pertaining to Credit terms and price the occurrence of NPL

		Strongly Agree (5)	Agree (4)	Neutral (3)	Disagree (2)	Strongly Disagree (1)
13.	Lenient credit term cause loan default					
14	Loans with big interest rate tend to turn NPL					
15	Charging big interest rate leads to loan default					
16.	Loan price affects loan performance					
17	Lenient /tax credit terms cause loan default					
18	Borrowers default because they don't understand credit terms well.					

19.	Poorly negotiated credit terms lead to non performance loan					

Please indicate your degree of agreement or disagreement to the statements pertaining to Rapid credit growth and greater risk appetite and price the occurrence of NPL

20.	Aggressive lending leads to large NPL volume/ratio					
21.	Banks whose credit growth is rapid experiences huge NPL level					
22.	Bank's great risk appetite is cause for NPL					
23.	Compromised integrity in lending leads to loan default					
24.	Having large number of borrowers causes loan default.					

25 If you have furtherther comments on the bank specific factors affecting nonperforming loans of Ethiopian Private Banks please use the space below.

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End of the questionnaire

Thank you for your participation