ST. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

FACTORS AFFECTING NON-PERFORMING LOANS IN BANKING INDUSTRY IN ETHIOPIA: A CASE OF DASHEN BANK

BY:

NATNAEL TEFERA

June, 2017

ADDIS ABABA, ETHIOPIA

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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 **Asmamw Getie (Assistance Professor)**. 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.

Name: Natnael Tefera ***Signature*** ________________________

St. Mary's University, Addis Ababa **June, 2017**

ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a university advisor.

Asmamaw Getie (Assistance Professor)

Advisor	**Signature**

St. Mary's University, Addis Ababa **June, 2017**

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Natnael Tefera

Acronyms

CAR	Capital Asset Ratio
EAD	Exposure at Default
GDP	Gross Domestic Product
IMF	International Monetary Fund
LGD	Loss Given Default
NPLs	Non Performing Loans
PD	Probability of Default
SPSS	Statistical Package for Social Sciences

List of Tables, figures

ABSTRACT

The problem of non-performing loans is seen as a burden on any country's economy or financial institution and putting downward pressure on its growth. This is because the role of banks as financial intermediaries does not function properly due to the problem of non-performing loans (NPLs). In view of that, this study has been tried to examine the factors affecting non-performing loans in Dashen bank Sc. A quantitative research design were used in the methodology and using cross-sectional research design a sample size of 50 respondents of staff of Dashen Bank's credit department were used to collect data. Of which 42 questionnaires have returned; and the collected data has been processed through (SPSS) version 23 software and analyzed by descriptive statistical method. The findings indicated that diversion of funds for unnecessary expansion of business and speculations leading to investing in high risk assets to earn high income and legal environment which reflects the availability or non- availability of foreclosure laws and ownership rights for both domestic and foreign investors have been factors influencing NPLs. The study suggests that much attention should be given to proper credit assessment and risk management techniques, introducing and implementation of an aggressive debt collection policy, and strong loan follow-ups. Besides, the bank should exert additional effort to better manage its NPL position.

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

CHAPTER ONE
INTRODUCTION

1.1 Background of the study

Banking industry is a major sector of the economy that has achieved renewed focus after financial sector reforms and the entry of private sector banks. This sector is the foundation of modern economic development and linchpin of development strategy (Waweru and Kalani, 2009). It forms the core of the financial sector of an economy. Through mobilization of resources and their better allocation, commercial banks play an important role in the development process. Commercial banks improve the allocation of resources by lending money to priority sector of the economy. Loans are of the major outputs provided by the bank (Singh, 2005). However, the loan is a risk output. There is always an expected risk for a loan to finally become non- performing. Non-performing loans can be treated as undesirable outputs or costs to a loaning bank, which decrease the bank's performance (Chang, 1999). The risk of non-performing loans mainly arises as the external economic environment becomes worse off such as economic depressions (Sinkey and Greenawalt, 1991).

The return of loans is a bank's major source of revenues. Banks sometimes have to accept some risky loans because of the pressure of revenues (Singh, 2005). If banks can successfully diversify their sources of revenues, it should be able to ease the pressure of revenues from loans and thus, effectively reduce the rate of non- performing loans (Nobuo, 2005). Jin-Li Hu (2002) established a theoretical model to predict the relation between the government shareholding and the non-performing loans. Jin-Li Hu (2002) affirmed that, when both public and private sectors are corrupt (imperfect), the relation between the government shareholding and the non- performing loans rate can be either U-shaped or inverse U-shaped. That is, as the government shareholding arises, the non-performing loans rate will first go down (up) and then go up (down). Therefore, a mixed bank in average may have the lowest or highest loans non-performing rate.

McNulty *et al*, (2001) argues that non-performing loans are loans, especially mortgages that s lend to borrowers but do not capitalize on. In other words, the borrower cannot pay the loan back in full, or even enough for the bank to make a profit. When this happens, the bank can either work out a new payment option, or foreclose on what collateral the borrower has provided. Either option costs the bank money, so lenders try to avoid non-performing loans whenever possible (Yoonhee, 2006). Some of the factors influencing non-performing loans according to Yoonhee (2006) include; a) *Credit Culture* i.e. Most nonperforming loans are caused by borrower decisions. Sometimes borrowers decide to qualify for loans without thinking enough about the future and what else they need to buy with their income. When this occurs, a credit culture can develop where borrowers take out large loans not because it is financially wise but because they see others doing it. That can easily result in defaulted loans; b) *Sudden Market Changes* i.e. any sudden market change can change the loan market by affecting how much money people have to take out loans and make payments. If the market suddenly changes and the prices of objects increase due to shortages or greater demands, borrowers will have less money to pay off their loans, which can lead to greater overall nonperformance; c) *Real Estate Changes* i.e. the real estate industry and home loans--one of the staples of the loan industry--are closely connected. If prices in the real estate market fall--if houses sell for less and less--then lenders recoup less and less money from seizing properties in response to defaulted loans. This results in more loans becoming non-performing, losing the lender money instead of making it; d) *Bank Performance* i.e. bank performance also acts as a key cause of non-performing loans. An efficient and well- run bank should be able to adjust loan rates and terms to the current market in order to decrease the chance of nonperforming loans. Banks should also be selective as to which borrowers they accept. Banks that do poorly in these areas will create more nonperforming loans.

The problem of NPLs in the financial sector has been a matter of concern for all economies and resolution of NPLs has become synonymous to functional efficiency of financial intermediaries (Swamy, 2012). Counterparty risk, being an important risk in the financial system more particularly of the banking system, poses a bigger challenge in order to achieve financial stability (Nubuo, 2005). Counter-party risk is an outcome directly related to the Non-Performing Loans (NPLs) of a financial institution. Even though NPLs are permanent phenomenon in the balance sheets of the financial institutions, if not contained properly, they eventually lead to crisis that can pose big threats of contagion that can engulf the financial health of the system. As per the Global Financial Stability Report of International Monetary Fund, (IMF, 2009), identifying and dealing with distressed assets, and recapitalizing weak but viable institutions and resolving failed institutions are stated as the two of the three important priorities which directly relate to NPLs.

The Ethiopian banking system has undergone significant transformation following financial sector reforms. It is adopting international best practices with a vision to strengthen the banking sector. Several prudential and provisioning norms have been introduced, and these are pressurizing banks to improve efficiency and trim down NPLs to improve the financial health in the banking system. The immediate consequence of large amount of NPLs in the banking system is bank failure (URT, 2007). Many researches on the cause of bank failures find that asset quality is a statistically significant predictor of insolvency (Dermirgue-Kunt 1989, Barr and Siems 1994), and that failing banking institutions always have high level of non- performing loans prior to failure. In view of this, it is essential to examine the factors affecting non-performing loans in one of the private banks Dashen Bank, Ethiopia,Addis Ababa headquarter which is the motive for this study.

1.2 Statement of the problem

Any country or financial institution might suffer its own version of the financial crisis because non-performing loans have risen steadily. The problem of non- performing loans is seen as a burden on any country's economy or financial institution and putting downward pressure on its growth (Yoonhee, 2006).

With their profitability eroding and their capital depreciating due to the problem of non-performing loans, banks are not eager to take on new risks and invest in new customers or growth areas. Occupied with the backward-looking work of solving the problem of non-performing loans, banks are unable to spare enough personnel or management focus for the forward-looking work of establishing a new earnings base. First, the prolonged problem of non-performing loans has preserved inefficient corporations and industries and thus lowered the productivity of the banking industry as a whole. Second, concerns about the stability of the financial system cannot be dispelled due to the problem of non-performing loans and, as a result, corporations and households have become prudent in their investment and consumption behavior, which in turn serves to block economic recovery (Swamy, 2012).

Financial institutions such as banks are expected to maintain their credit management due to the increasing rate of non-performing loans. The increasing number of non- performing loans of different entities and individual creates a significant impact and negative values to the financial streams. In the long-run, this same impact will reach the entire economy and leads to increase the credit crisis (Swamy, 2012). Nobuo (2005) argues that, if the non-performing loans are kept existing and continuously rolled over, the resources are locked up in unprofitable sectors; thus, hindering the economic growth and impairing the economic efficiency.

Dashen Bank, as one of financial institution in Ethiopia, has been providing various loans and advances in the form of different types of credit facilities based on its eligibility criteria to various economic activities ranging from agricultural projects to manufacturing industries found in different parts of the country, hence playing its role in supporting the national development endeavors since its establishment. However, Due to prevalence of higher NPL amount, the profitability of the bank has not increased as expected that each NPL case is reviewed in tandem with the NBE's directive to accumulate provision which is the percentage of NPL amount to be deducted from annual profit of the Bank each year to give allowance for possible loan losses that arise due to various causes (NBE directive No.SBB/43/2008).

The most recent quarter of March 31, 2017 report indicates that the NPL percentage has exhibited 5.29% which exceeded the internal limit i.e. 3%, as well as the national bank of Ethiopia's required threshold 5%. Accordingly this NPL amount has its own contribution by reducing the income of the bank as reflected as expense in the bank's income statement and the provisional amount set by the bank each year (NBE directive No.SBB/43/2008).

Hence, as NPL is becoming more severe and hinders the banks growth and profitability, examining the factors affecting Non-performing is very important to manage the situation and should be given a higher attention.

1.3 Research questions

Based on the specific objectives, this study seeks to answer the following questions;

i. What are the factors influencing non-performing loans in in Dashen bank?

ii. What is the extent of non-performing loans in in Dashen bank ?

iii. What are the attempts made by Dashen bank to alleviate non- performing loans?

1.4 Objective of the study

The general objective of the study is to examine the factors affecting non-performing loans in one of the private banks in Ethiopia called Dashen bank, Addis Ababa. Based on this broad objective the specific objectives of this research paper are;

i. To identify the possible factors influencing non-performing loans in Dashen bank.

ii. To examine the extent of non-performing loans in Dashen bank,

iii. To identify attempts made by in Dashen bank, to alleviate non- performing loans

1.5 Significance of the study

This study examines the factors that affect non-performing loans in Dashen bank and will alert all stakeholders to take urgent steps to solve the problems. Furthermore, this study creates awareness regarding the factors that affect non-performing loans in banking industry in Ethiopia for the purpose of conducting further studies in order to curb the challenges associated with them. It also helps others who are interested in the area as a preliminary study.

1.6 Scope of the study

The study examines the factors affecting non-performing loans in Dashen Bank S.co. The study focuses on Credit Director, Credit Analysts, credit administrative officers, Portfolio and recovery managers and officers at credit department of the bank.

1.7 Organization of the paper

The study is organized in to five chapters. The first chapter deals with Introduction and Background . The second chapter reviews literatures related with the study. The third chapter presents the Research design and Methodology. The fourth chapter, analysis of the collected data and interpretation of the data is presented. And finally, the fifth chapter presents summaries of major findings, Conclusion and Recommendations.

CHAPTER TWO

LITERATURE REVIEW

2.1 Theoretical literature review

2.1.1 An Over View of NPLs

Loans are classified as NPLs when they cannot be repaid according to the terms of the initial agreement or in an otherwise acceptable manner. Loans become problem credits as a result of many factors. The credit analysis may have been faulty because it was based on inadequate information or incomplete analytical procedures. Economic conditions may change adversely after the loan is granted so that the borrower cannot meet debt service requirements. Alternatively, a borrower may simply choose not to repay if circumstances permit. NPLs essentially reflect the default risk inherent in a borrower's willingness and ability to repay all obligations.

The lending process is, by its nature, imperfect. Credit analysis may be incomplete or based on faulty data, loan officers may ignore the true condition of a borrower with strong personal ties to the bank, and a borrower's ability to repay may simply change after a loan is granted. If management concentrates solely on minimizing losses, a bank will make virtually no loans, profits will shrink, and the legitimate credit needs of customers will not be met. Lenders cannot completely eliminate risk, so some loan losses are expected. The objective for a bank is that reach its optimal risk-return position. Reviews procedures help identify when loans start to deteriorate and how to institute corrective action. Most problem loans can be restructured to buy time until the borrower's financial condition improves. Problem loan analysis thus consists of detecting problem situations and modifying the initial terms to improve repayment prospects.

A default is not entirely an irrational decision. Rather a defaulter takes into account probabilistic assessment of various costs and benefits of his decision'. Mohan (2003) conceptualized 'lazy banking' while critically reflecting on banks' investment portfolio and lending policy. The Indian viewpoint alluding to the concepts of 'credit culture' owing to Reddy (2004) and 'lazy banking' owing to Mohan (2003) has an international perspective since several studies in the banking literature agree that banks' lending policy is a major driver of NPLs (McGoven, 1993, Christine 1995, Sergio, 1996, Bloem and Gorters, 2001).

Sergio (1996) in a study of NPLs in Italy found evidence that, an increase in the riskiness of loan assets is rooted in a bank's lending policy adducing to relatively unselective and inadequate assessment of sectoral prospects. Interestingly, this study refuted that business cycle could be a primary reason for banks' NPLs. The study emphasized that increase in bad debts as a consequence of recession alone is not empirically demonstrated. It was viewed that the bank-firm relationship will thus; prove effective not so much because it overcomes informational symmetry but because it recou`ps certain canons of appraisal. In a study of loan losses of US banks, McGoven (1993) argued that 'character' has historically been a paramount factor of credit and a major determinant in the decision to lend money.

Bloem and Gorter (2001) suggested that a more or less predictable level of NPLs, though it may vary slightly from year to year, is caused by an inevitable number of 'wrong economic decisions by individuals and plain bad luck (inclement weather, unexpected price changes for certain products, etc.). Under such circumstances, the holders of loans can make an allowance for a normal share of non-performance in the form of NPLs provisions, or they may spread the risk by taking out insurance.

Enterprises may well be able to pass a large portion of these costs to customers in the form of higher prices. For instance, the interest margin applied by financial institutions will include a premium for the risk of nonperformance on granted loans. At this time, banks' NPLs increase, profits decline and substantial losses to capital may become apparent. Eventually, the economy reaches a trough and turns towards a new expansionary phase, as a result the risk of future losses reaches a low point, even though banks may still appear relatively unhealthy at this stage in the cycle.

Loan officers constantly monitor each borrower's circumstances to detect loan problems before they become uncorrectable. Still, perceived loan quality often varies among those reviewers. Examiners from the regulatory agencies typically follow strict guidelines listed in review manuals. They appraise the quality of financial data, borrower's credit history as outlined in the credit file, the completeness of loan documentation, and the value of collateral. If weaknesses exist, examiners may grade the loan as substandard, doubtful, loss, and "other specially mentioned." Banks then must allocate reserves against potential losses in varying percentages relative to the loan grading. Many bankers feel that regulatory loan grading is too server and ignores important information. For example, fully collateralized loans with the collateral in the bank's possession may be classified as substandard if the borrower's cash flow from operations is insufficient to meet debt service requirements. A bank may thus have to allocate additional reserves even when it controls a guaranteed source of repayment (Chen, C.2009).

2.1.2 Classifications of Loans and Advances

Loans can be classified as performing and non-performing. Performing Loan is loan that payments of both principal and interest charges are up to date as agreed between the creditor and debtor. Generally, loans that are outstanding in both principal and interest for a long time contrary to the terms and conditions contained in the loan contract are considered as NPLs. This is because going by the description of performing loans above, it follows that any loan facility that is not up to date in terms of payment of both principal and interest contrary to the terms of the loan agreement, is non-performing.

According to directive number SBB/43/2007 All NPLs shall be placed on non-accrual status, unless the loans or advances are (i) well-secured and (ii) in process of collection and the definition for NPLs is loans or advances whose credit quality has deteriorated such that full collection of principal and/or interest in accordance with the contractual repayment terms of the loan or advance is in question. The time limit for the NPLs by the directives is outstanding for 90 consecutive days or more.

Table 1: Classification of loans

	Classifications	Criteria for Classification
	1. Pass	Loans or advances that are fully protected by the current financial and paying capacity of the borrower and are not subject to criticism.
	2. Special Mention	Past due for more than 30 days but less than 90 days
NPL	3. Substandard	Past due for more than 90 days but less than 180 days
	4. Doubtful	Past due for more than 180 days but less than 360 days
	Loss	Past due over 360 days

Source: directive no. SBB/43/2007

2.1.3 Provision for Doubtful

According to directive number SBB/43/2007, all bank shall maintain a provisions for loan losses account which shall be created by charge to provision expense in the income statement and shall be maintained at a level adequate to absorb potential losses in the loans or advances portfolio. In determining the adequacy of the provisions for loan losses account, provisions may be attributed to individual loans or advances or groups of loans or advances. The directive also mentions that this account shall always have a credit balance. Addition to or reductions of the provisions for loan losses account shall be made only through charges to provisions in the income statement at least every calendar quarter. Minimum Provision for Doubtful that the directive states mentioned below:

Table 2: Minimum percentage of loans provided to provision

Loan Classification	**Minimum Percentage**
Pass	1%
Special Mention	3%
Substandard	20%
Doubtful	50%
Loss	100%

Source: ***NBE directive no. SBB/43/2007***

Provisions for loan losses are reported on the income statement as a deduction in income statement from income and represent an allocation to the loan loss reserve. It is management's estimate of reported income that will note be received due to anticipated defaults. It is also a noncash expense. Foremost is the fact that provisions for loan losses involve a subjective estimate. It can be manipulated at management's discretion within certain bounds. If provisions are understated, the loss reserve will be too low relative to expected losses.

2.2 Controlling Loan Losses through Early Detection

Loan losses are a natural by-product of extending credit. Bank management cannot forecast with perfect accuracy which loans will be paid in a timely manner. Otherwise, no NPLs would be made without some form of fraud involved. Still, management can pursue policies that limit problem loans.

Problem loans and loan losses are cause by a variety of factors, some controllable and some uncontrollable. Controllable factors are those that reflect overall bank credit policy as well as inadequate credit analysis, loan structuring, and loan documentation. Uncontrollable factors typically reflect adverse economic conditions, adverse changes in regulation, environmental changes surrounding the borrower's operations, and catastrophic events. Problem loans and loan loses vary with the composition of a bank's loan portfolio. Retail loan losses are much more predictable that commercial loan losses. An individual's ability to repay is directly related to his or her employment stability and income level (Fofack, H. 2005),

In the aggregate, variations in employment and income follow the business cycle and local economic conditions, such that management can project losses from historical experience and incorporate the cost into its retail loan pricing. Commercial loan losses are less predictable, because a broader range of factors adversely affect a firm's performance. The major contributing factors include poor management quality, inadequate initial capitalization, high financial and operating leverage resulting from high growth, strong competitors capturing market share, and a general economic downturn (Ritchken et.al. 2003).

2.2.1 Preventing NPLs

It is virtually impossible to eliminate loan losses entirely. Adherence to sound credit analysis principles framed by a sound credit policy can, however, reduce the frequency and depth of loan problems. Two fundamental tenets of lending still hold: A bank should concentrate lending in fields where it possesses a demonstrated expertise, and a bank should not lend outside its trade area. Banks that emphasize loan growth do so at the expense of credit quality.

Loan officers often meet growth targets by lending to increasingly marginal borrowers, lending for purposes in which the officer has limited expertise, and lending in geographic areas where the bank has no permanent market presence. Lending difficulties can be reduced if management establishes and adheres to loan policy guidelines that restrict unacceptable activity. Such guidelines specify quantitative goals for loan production versus loan quality, and indicate procedures to attain these goals. The procedures document the format for obtaining loan applications, grading loans, approving loans, and systematically reviewing loan performance and quality (Chen, C.2009)..

2.2.2 Detecting NPLs

Once a loan is granted, the account officer is responsible for monitoring the borrower's performance. The purpose is to detect problems before they become too severe. This allows a bank to help the borrower take corrective action if necessary.

Most borrowers experience a severe cash crisis prior to defaulting on a loan. Unfortunately, banks that do not monitor borrower performance are often the last to know that such a crisis is pending. There are three distinct stages of cash problems. During

Stage 1, liquidity becomes strained. Inventory stats to accumulate, and receivables collection slows. Management reacts by slowing payment on trade credit and cutting expenses. In Stage 2, cash management becomes the top priority. Caps are imposed on expenses, employees are let go, capital outlays are eliminated, and the company attempts to liquidate nonessential assets. The firm's relationship with the bank deteriorates as it attempts to obtain additional credit while it violates existing loan covenants. Frequently, the company omits dividends to shore up equity reduced by operating by operating losses. During stage 3, the company teeters on the brink of bankruptcy. The company overdraws its deposit account, misses loan payments, and omits tax payments. The fundamental choice is to declare bankruptcy or find a merger/acquisition partner (Chen, C.2009)..

While failed companies exhibit different traits, the three cash stages suggest that obvious signals of problems, such as overdrafts and missed loan payments, occur loan after corrective action is necessary. Early detection requires the account officer to understand the borrower's business, communicate regularly with the principals, and closely review the borrower's financial data.

2.3 The Five C's of Credit

The credit analysis process, traditionally employed by the first banks, does not differ fundamentally from the processes used today (Rose, 2002). The five C's are considered the fundamentals of successful lending and have been around for approximately 50 years. Initially only character, capacity and capital were considered. However, over the years collateral and conditions were added.

These provided an even more comprehensive view and clearer understanding of the underlying risk and resulting lending decision (Sinkey, 2002). According to Murphy (2004) these principles should be the cornerstone of every lending decision. The five C's are discussed as follows.

Character

Character refers to the borrower's reputation and the borrower's willingness to settle debt obligations. In evaluating character, the borrower's honesty, integrity and trustworthiness are assessed. The borrower's credit history and the commitment of the owners are also evaluated (Rose, 2000). A company's reputation, referring specifically to credit, is based on past performance. A borrower has built up a good reputation or credit record if past commitments were promptly met (observed behavior) and repaid timely. Character is considered the most important and yet the most difficult to assess (Koch and MacDonald, 2003).

Bankers recognize the essential role management plays in a company's success. Critically analyzing quality of management has been one of the ways of assessing character. The history of the business and experience of its management are critical factors in assessing a company's ability to satisfy its financial obligations. The quality of management in the specific business is evaluated by taking reputation, integrity, qualifications, experience and management ability of various business disciplines such as finance, marketing and labor relations into consideration (Sinkey, 2002). These factors can be regarded as a risk mitigants if a banker views these positively. Much of its success can in fact be attributed to competent leadership. Companies with strong and competent management teams tend to survive in an economic downturn. On the other hand privately owned companies are generally managed by its owners. In this instance, succession planning must be in place, as the role of management remains vital to the success of the company (Koch and MacDonald, 2003).

Capacity

Capacity refers to the business's ability to generate sufficient cash to repay the debt. An analysis of the applicant's businesses plan, management accounts and cash flow forecasts (demonstrating the need and ability to repay the commitments) will give a good indication of the capacity to repay (Sinkey). To get a good understanding of a company's capacity evaluating the type of business and the industry in which it operates is also vital. It plays a significant role since each industry is influenced by various internal and external factors. The factors that form the basis of this analysis includes; Type of industry, Market share, Quality of products and life cycle, whether the business is labor or capital intensive, the current economic conditions, seasonal trends, the bargaining power of buyers and sellers, competition and legislative changes (Koch and MacDonald, 2003).

These factors lead the banker to form a view of the specific company and industry. The banker would regard this as a potential risk mitigate if he/she is confident about the company and industry and prospects for both appear to be positive. Besides, the financial position is also a critical indication of a business' capacity. The company's financial position is evaluated by assessing past financial performance and projected financial performance. A company's past financial performance is reflected in their audited financial statements. Financial projections consist of projected cash flows demonstrating the need for the facility and the ability to repay the facility (Sinkey, 2002).

In this regard at least three years audited financial statements (balance sheet and income statement) are required for data analysis. A financial spreadsheet is used to undertake the analysis. Commercial banks utilize the financial spread sheet (i.e. audited financial statement analysis and ratio calculations - DuPont) and it is applied through the Moody's Risk Advisor. The model also performs a peer comparison and calculates the probability of default (Koch and MacDonald, 2003). The following financial ratio analyses are very critical in assessing business' position. a) *Liquidity ratios* - reflect the company's ability to meet its short-term obligations. According to Conradie and Fourie (2002), the current ratio is calculated by dividing the current assets by the current liabilities; b) *Activity ratios*- indicate whether assets are efficiently used to generate sales; c) *Leverage ratios*- indicate the company's financial mix between equity and debt and potential volatility of earnings. High volatility of earnings increases the probability that the borrower will be unable to meet the interest and capital repayments; d) *Profitability ratios*- supply about the company's sales and earnings performance.

The cash flow analysis need to be done once the ratio analysis has been evaluated. The cash flow analysis allows the banker to distinguish between reported accounting profits (net income) and cash flow from operations (cash net income). Cash flow from operations gives an indication of how much cash is generated from normal business activities. The cash flow generated must be sufficient to service the banking facilities (Sinkey, 2002).

These assumptions are evaluated against the company's past performance, industry averages and expected economic trends. An assessment of the financial capacity of a company should always include an evaluation of trends. Evaluating trends over a three to five year period gives a clear picture of the direction a firm is heading. Ratio results should always be compared to a peer group of or an industry comparison. Is the firm collecting faster or slower than the rest of the industry? Is this company more profitable than other companies just like them? In this regard making a maximum use of ratios by comparing the firm to its peers using established benchmarks is so vital. Comparison of the company to firms in the same line of business, geographic area and employee size provides a more accurate comparison (Harris, 2003).

The projections also reveal the purpose, amount and type of finance required. It also provides insight into the company's ability to generate sufficient cash flow to service the debt (Murphy, 2004). Banks must ensure that the type of financing is aligned to the purposed of finance. Analysis of the financial capacity of the should also be carried out in order to determine a borrower's ability to meet financial obligations in a timely fashion. Its ability to pay may be much more important. It is critical to understand the difference. Watching customer payment habits over time is an excellent indication of cash flow. Also, checking bank and trade references, as well as any pending litigation or contingent liabilities are pivotal.

Further checking for a parent company relationship is important as a parent company's guarantee may be available. Intercompany loans might affect financial solvency. Agency ratings that predict slow payment or default should be carried out before completion of investigating capacity of a borrower (Rose, 2000).

Capital

Capital refers to the owner's level of investment in the business (Sinkey, 2002). Banks prefer owners to take a proportionate share of the risk. Although there are no hard and fast rules, a debt/equity ratio of 50:50 would be sufficient to mitigate the bank's risk where funding (unsecured) is based on the business's cash flow to service the funding (Harris, 2003). Lenders prefer significant equity (own contribution), as it demonstrates an owner's commitment and confidence in the business venture.

Conditions

Conditions are external circumstances that could affect the borrower's ability to repay the amount financed. Lenders consider the overall economic and industry trends, regulatory, legal and liability issues before a decision is made (Sinkey, 2002). Once finance is approved, it is normally subject to terms and covenants and conditions, which are specifically related to the compliance of the approved facility. Banks normally include covenants along with conditions when credit facilities are granted to protect the bank's interest. The primary role of covenants is to serve as an early warning system. Covenants can either be negative or positive.

Negative covenants stipulate financial limitations and prohibited events (Koch and MacDonald, 2003). Some examples of negative covenants are: a) Cash dividends cannot exceed 50% of the net profit after tax (financial limitation); b) No additional debt may be obtained without the bank's prior approval (prohibited event). Positive or affirmative covenants stipulate the provisions the borrower must adhere to (Rose, 2000). Some examples of positive covenants are;

Audited financial statements must be provided within 90 days of the company's financial year-end;

The borrower must maintain the following financial ratios: Interest cover ratio of 4:1 (defined as earnings before interest and tax divided by interest paid), Gearing ratio of 2:1 (defined as total liabilities divided by owners' equity). Conditions normally stipulate that all the security relevant to the loan should be in order before any funds will be advanced.

Collateral

Collateral (also called security) is the assets that the borrower pledges to the bank to mitigate the bank's risk in event of default (Sinkey, 2002) .It is something valuable which is pledged to the bank by the borrower to support the borrower's intention to repay the money advanced. Security is taken to mitigate the bank's risk in the event of default and is considered a secondary source of repayment (Koch and MacDonald, 2003). Supporting of the aforementioned, Rose and Hudgins (2005) define secured lending in banks as the business where the secured loans have a pledge of some of the borrower's property (such as home or vehicles) behind them as collateral that may have to be sold if the borrower defaults and has no other way to repay the lender.

The purpose of security is to reduce the risk of giving credit by increasing the chances of the lender recovering the amounts that become due to the borrower. Security increases the availability of credit and improves the terms on which credit is available. The offer of security influences the lender's decision whether or not to lend, and it also changes the terms on which he is prepared to lend, typically by increasing the amount of the loan, by extending the period for which the loan is granted and by lowering the interest rate (Harris, 2003). According to De Lucia and Peters (1998), in the banking environment, security is required for the following three reasons; a) to ensure the full commitment of the borrower to its operations; b) to provide protection should the borrower deviate from the planned course of action outlined at the time credit is extended, and c) to provide insurance should the borrower default.

The security value of an asset is based on the estimated re-sale value of the assets at the time of disposing of it (McManus, 2000). The specific type of property is valued by the bank to determine the property’s market value for security purposes (Rose, 2000). Besides the physical collateral a third party can provide a suretyship for the debt of the borrower. Should the borrower not be in a position to repay the debt, the bank will then call on the surety for repayment (Koch and MacDonald, 2003). It is normal banking practice for the banks to take the suretyships of the shareholders/directors when funds are advanced to a company (Rose, 2000). C’s” are well-known credit assessment principles, commercial banks have developed their own qualitative credit risk assessment models to assess whether the bank will agree to lend to a specific business (Sinkey, 2002). Based on the credit obtained about the borrower and credit assessment carried out, either by quantitative or qualitative model (through the use of the five C’s) or combination of both, credit sanctioning is done.

2.3.1 Credit Approval process

Extending credit is the careful balance of limiting risk and maximizing profitability while maintaining a competitive edge in a complex, global marketplace. Banks go through a thorough process in approving credit to hit the balance. Credit approval is the process of deciding whether or not to extend credit to a particular customer. It involves two steps: gathering relevant and determining credit worthiness (Goosen *et al,* 1999). As has been discussed in the preceding section, the credit analysis process consists of a subjective analysis of the borrower’s request and a quantitative analysis of the financial provided.

The individual steps in the credit approval process and their implementation have a considerable impact on the risks associated with credit approval. The quality of credit approval processes depends on two factors, i.e. a transparent and comprehensive presentation of the risks when granting the loan on the one hand and an adequate assessment of these risks on the other. Furthermore, the level of efficiency of the credit approval processes is an important rating element. Due to the considerable differences in the nature of various borrowers and the assets to be financed as well the large number of products and their complexity, there cannot be a uniform process to assess credit risks (Khemraj and Pasha, 2009).

The quality of the credit approval process from a risk perspective is determined by the best possible identification and evaluation of the credit risk resulting from a possible exposure. The credit risk can be distributed among the following risk components; i) Probability of default (PD), ii) Loss given default (LGD) and iii) Exposure at default (EAD) according to Saunders and Cornett (2003).

Probability of default (PD)

Default probability is the likelihood that the business will default on its repayment over the term of the facility. Reviewing a borrower’s probability of default is basically done by evaluating the borrower’s current and future ability to fulfill its interest and principal repayment obligations.

Loss given default (LGD)

Exposure at default is the magnitude or exposure that would be materialized in the event of a default. It addresses what fraction of the exposure may be recovered through bankruptcy proceedings or through some other form of settlement in the event of a default. The loss given default is affected by the collateralized portion as well as the cost of selling the collateral. Therefore, the calculated value and type of collateral also have to be taken into account in designing the credit approval processes.

Exposure at default (EAD)

The exposure at default corresponds to the amount owed to the institution. Thus, besides the type of claim; the amount of the claim is another important element in the credit approval process. Once has been gathered, the firm faces the hard choice of either granting or refusing credit. Many financial managers use the "five C's of Credit" as their guide to identify and evaluate the credit risk resulting from a possible exposure to sanction the credit.

2.3.2 Loan Follow Up or Credit Monitoring Process

Lending decision is made on sound credit risk analysis/appraisal and assessment of creditworthiness of borrowers. But past records of satisfactory performance and integrity are no guarantee future, though they serve as useful guide to project trend in performance. A loan granted on the basis of sound analysis might go bad because of the borrower may not meet obligations per the terms and conditions of the loan contract. It is for this reason that proper follow up and monitoring is essential. Monitoring or follow-up deals with the following vital aspects;

- Ensuring compliance with terms and conditions;
- Monitoring end use of approved funds;
- Monitoring performance to check continued viability of operations;
- Detecting deviations from terms of decision;

Making periodic assessment of the health of the loans and advances by nothing some of the key indicators of performance that might include: profitability, activity level and management of the unit and ensure that the assets created are effectively utilized for productive purposes and are well maintained;

Ensuring recovery of the installments of the principal and interest in case of term loan as per the scheduled repayment program; vii) Identify early warning signals, if any, and initiate remedial measures thereby averting from possible default (Harris, 2006).

Basically there are three types of loan follow up systems. These are: Physical follow up, financial follow up and legal follow up.

- **Physical Follow -up***;* helps to ensure existence and operation of the business, status of collateral properties, correctness of declared financial data, quality of goods, conformity of financial data with other records (such as taxes, register books), availability of raw materials, labor situation, marketing difficulties observed, undue turnover of key operating personnel and change in management set up among others.

- **Financial Follow- up**; is required to verify whether the assumptions on which lending decisions was taken continues to hold good both in regard to borrowers' operation and environment, and whether the end use is according to the purpose for which the loan was given.

- **Legal Follow- up**; The purpose of legal follow up is to ensure that the legal recourse available to the Bank is kept alive at all times. It consists of obtaining proper documentation and keeping them alive, registration, proper follow up of insurances.

Specific issues pertaining to legal follow up include: ascertaining whether contracts are proper executed by appropriate persons and documents are complete in all aspects, obtaining revival letters in time (revival letters refer to renewal letter for registration of security contracts that have passed the statutory period as laid down by the law), ensuring loan/mortgage contracts are updated timely and examining the regulatory directives, laws, third party claims among others.

2.3.3 Credit Risk Management

Loan is a major asset, income source for banks, and risky area of the industry. Moreover, its contribution to the growth of any country is very clear. Bank credit is the primary source of debt financing available for most customers in the personal, business or corporate market. The underlying need for credit varies across these markets. Banks generally also want to increase the base of their income and use credit extension as an opportunity to cross sell other fee generating services when a customer applies for credit facilities (Koch and MacDonald, 2003). Any successful business must meet its customer needs and make a profit. Likewise, successful financial institutions must meet the desperate needs of depositors and borrowers. Depositors look for high rates, short terms and no risk, while borrowers seek low rates and long terms. Financial institutions are therefore, in the risk intermediation business. To be successful, financial institutions, banks in particular, must properly underwrite risk, manage and monitor the risk assumed (Rose, 2002).

Credit risk can be defined as the potential for a borrower or counter party to fail to meet their obligations in accordance with the terms of an obligation's loan agreement, contract or indenture (Sanders and Cornett, 2003). Credit risk is considered the oldest form of risk in the financial markets. Beck *et al* (2005) stated that "credit risk is as old as lending itself", dating back as far as 1800 B.C. The first banks, which started in Florence seven hundred years ago, faced very similar challenges that banks face today. Although managing credit risk is their core competency, many banks failed due to over-extension of credit.

The most prominent risk assumed by banks is credit risk. This is due to the various factors that influence a borrower's ability to repay the credit facility. The borrower's ability to repay is closely linked to the general economic conditions of a country. In favorable economic conditions the ability to repay increases, which could be due to a favorable interest rate environment, low inflation, increased income levels or a combination of these factors. The opposite is however true in poor economic conditions. The borrower's ability to repay is adversely effected under these conditions due to a reduction in disposable income (Koch and MacDonald, 2003).

Credit risk arises from uncertainty in a given counterparty's ability to meet its obligations. The increasing variety in the types of counterparties (from individuals to sovereign governments) and the ever-expanding variety in the forms of obligations (from auto loans to complex derivatives transactions) has meant that credit risk management has jumped to the forefront of risk management activities carried out by firms in the financial services industry (Jentzsch, 2008)). The risk profile of banks is fundamentally different from that of other financial institutions, like stockbrokers and insurance industry.

An integral part of banking is the management of credit risk and it is done through well-diversified portfolios of exposure. Most banks fail because of poorly managed credit risk (Rose, 2002). Credit risk management primarily focuses on loss avoidance and the optimization of return on risk. Financial institutions in the world are facing two major challenges. Firstly, they need to deliver increasing returns and value to shareholders and secondly, they need to determine how to capitalize on the New Capital Accord's (Basel II) minimal capital requirements (Belmont, 2004). The need to put a strong credit risk management in place cannot overemphasized as failure which lead loan default and thereby crisis on banks.

2.3.4 Causes of non-performing loans

Non-Performing Loans arise due to a number of causes according to Yoonhee (2006) like;

- **Speculation**: Investing in high risk assets to earn high income;
- **Default**: Willful default by the borrowers;
- **Fraudulent practices**: Fraudulent Practices like advancing loans to ineligible persons, advances without security or references;
- **Diversion of funds**: Most of the funds are diverted for unnecessary expansion and diversion of business;
- **Internal reasons**: Many internal reasons like inefficient management, inappropriate technology, labour problems, marketing failure, etc. resulting in poor performance of the companies; and
- **External reasons**: External reasons like a recession in the economy, infrastructural problems, price rise, delay in release of sanctioned limits by banks, delays in settlements of payments by government and natural calamities.

On the other hand, Rajan *et al* (2003) provide causes of non-performing loans such as interest rate, inflation rate, economic growth and unemployment rate. These are further elaborated as follows.

Interest rate

Interest is a fee paid on borrowed assets. It is the price paid for the use of borrowed money or money earned by deposited funds. As for banks, their main profits come from interest rate (i.e. interest rate differed according to years of payment). The longer it takes to make settlement, the higher it will be for the interest rate. At a time when interest rate is at its lowest, demand for financing is high by customers. This shows negative relationship between interest rate and demand for loan, whereas when interest rate is high, demand for financing is low. People choose to save their money when interest rate is high, and only apply for financing when the rate is decreasing.

By doing so, the amount that needed to pay for bank as a result for making a loan is slightly lower compared to when the time when interest rate is high. When the interest rate is low, net NPLs is also low. And when interest rate is high, the amount of NPLs will also be increased. High credit growth in the past could generate higher NPLs in the future. According to all models, NPLs are very persistent, which would suggest that the response of credit losses to the macroeconomic cycle could take time to materialize, although it would also imply that NPLs would then cumulate to high levels (Arthur, 2003). An increase in interest rate weakens loan payment capacity of the borrower therefore non-performing loans and bad loans are positively correlated with the interest rates.

Inflation rate

The higher the inflation rate objective, the lower the probability of hitting the zero bound. Under inflation targeting regime, the policy interest rate is generally a single instrument to signal policy stance towards various economic variables with an ultimate goal of price stability and sustainable economic growth. Recently, nonetheless, continued increases in the world prices of oil and other commodities, due to leapfrog expansion of emerging economies in particular China and India, exerted upwards pressure on global inflation. The increase in inflation ultimately forces interest rates upwards. It means that inflation rates is only profound the impact on the interest rate and not other factors. The level of output permanently falls as the inflation rate increases. An increase in inflation can result into higher output or lower output or no change in output.

There is an empirical evidence of positive relationship between the inflation in the economy and non-performing loans (Fofack, 2005). While Nkusu (2011) has explained that this relationship can be positive or negative according to the author inflation affects loan payment capacity of borrowers positively or negatively, higher inflation can enhance the loan payment capacity of borrower by reducing the real value of outstanding debt; moreover increased inflation can also weaken the loan payment capacity of the borrowers by reducing the real income when salaries/wages are sticky, moreover by highlighting the role of inflation in the presence of variable interest rate. Nkusu (2011) further explains that in this scenario inflation reduces the debt servicing capacity of the loan holders as lenders adjust the lending interest rates to adjust their real return. So according to literature relationship between inflation and non-performing loans can be positive or negative depending on the economy of operations.

Economic growth

Non-performing loans can lead to efficiency problem for banking sector. It is found by a number of economists that failing banks tend to be located far from the most- efficient frontier. Because banks don’t optimize their portfolio decisions by lending less than demanded. What’s more, there are evidences that even among banks that do not fail; there is a negative relationship between the non-performing loans and performance efficiency. The phenomena that banks are reluctant to take new risks and commit new loans is described as the ‘”credit crunch” problem. According to the United States Council of Economic Advisors (1991), credit crunch is “a situation in which the supply of credit is restricted below the range usually identified with prevailing market interest rates and the profitability of investment projects”. A “credit crunch” is a disequilibrium phenomenon. It is present when banks are unwilling to lend, especially when a firm with profitable projects cannot obtain credit in spite of low interest rates (lower than the expected marginal products). Credit crunch results in excess demand for credit and hence credit rationing, where loans are allocated via non-price mechanism. Eventually, it imposes additional pressure on the performance of the monetary policy.

Unemployment rate

Like any other market, the labour market consists of a supply side and a demand side. The labour supply of the population referred to as the economically active population or labour force, has two components; employed persons and unemployed persons. The labour demand of enterprises and other production units too, can be broken down in two components; jobs (filled posts) and job vacancies (unfilled posts). Due to the existence of multiple jobholding, the number of jobs tends to be larger than the number of employed persons. In most countries, statistics on the supply of labour are far better developed than statistics on the demand of labour.

As a result, current international recommendations on labour market statistics deal almost exclusively with statistics on labour supply. Unemployment occurs when people are without jobs and they have actively looked for work within the past four weeks (International Labour , 2007). The unemployment rate is a measure of the prevalence of unemployment and it is calculated as a percentage by dividing the number of unemployed individuals by all individuals currently in the labour force. During unemployment, those who make loan from bank are unable to pay back to bank as the effect of losing their jobs. Without salary, they cannot pay their loan. So, when the unemployment rate is high, so does it go with NPLs amount.

An increase in the unemployment in the country negatively affects the incomes of the individuals which increases their debt burden. It is obvious when a person losses his source of income it becomes difficult to return his loan, similarly an increased unemployment in the economy also negatively affects the demand of the products of firms which ultimately affects the production/sales of the firms, this ultimately leads to decline in revenues of the firms and a fragile debt conditions.

Most of the empirical evidence suggests that banks' NPLs as closely linked to the economic activity. In other words, macroeconomic factors matter: downturns/slowdowns in the economy, recessions, low rate of savings, weak markets, depressions in industrial production, and reduction in per capita income levels and most importantly the inflation levels in the economy. A fair amount of the academic literature has dealt with determinants of banking crisis, which is the most severe of the consequences of bad loans in a banking system which is of valuable understanding as a backdrop for the study of NPLs (Demirguc-Kunt and Levine, 2005). The immediate consequence of large amount of NPLs in the banking system is bank failure. Many researches on the cause of bank failures find that asset quality is a statistically significant predictor of insolvency (Dermirgue-Kunt 1989, Barr and Siems 1994), and that failing banking institutions always have high level of non- performing loans prior to failure.

Lending as a global concept

Lending practices in the world could be traced to the period of industrial revolution which increased the pace of commercial and production activities thereby bringing about the need for large capital outlays for projects. Many captains of industry at this period were unable to meet up with the sudden upturn in the financial requirements and therefore turn to the banks for assistance (Sergio, 1996). Lending which may be on short, medium or long-term basis is one of the services that commercial banks do render to their customers.

In other words, banks do grant loans and advances to individuals, business s as well as government in order to enable them embark on investment and development activities as a mean of aiding their growth in particular or contributing toward the economic development of a country in general (Yoonhee, 2006).

Commercial banks are the most important savings, mobilization and financial resource allocation institutions. Consequently, these roles make them an important phenomenon in economic growth and development. In performing this role, it must be realized that banks have the potential, scope and prospects for mobilizing financial resources and allocating them to productive investments. Therefore, no matter the sources of the generation of income or the economic policies of the country, commercial banks would be interested in giving out loans and advances to their numerous customers bearing in mind, the three principles guiding their operations which are, profitability, liquidity and solvency (Waweru and Kalani, 2009). However, commercial banks decisions to lend out loans are influenced by a lot of factors such as the prevailing interest rate, the volume of deposits, the level of their domestic and foreign investment, banks liquidity ratio, prestige and public recognition to mention a few.

2.4 Non-Performing Loans in the Banking Industry

Financial institutions such as banks are expected to maintain their credit management due to the increasing rate of non-performing loans. The increasing number of non- performing loans of different entities and individual creates a significant impact and negative values to the financial streams. In the long-run, this same impact will reach the entire economy and leads to increase the credit crisis (Harrison, 2006). There is an interest drawn by the researcher/s regarding the reason or several reasons that lead to non-performing loans. The major reason lies on the failures in management. Banks are absolutely strong to hold the financial crisis. But in the recent years, this characteristic of bank changed due to the various economic changes and challenges offered by the globalization (Waweru and Kalani, 2009). Added to this disadvantage is the growing numbers of non-performing loans that affects the financial stream and operations of the bank.

The main objective of the bank in offering the financial credit and loans for the entities and small individuals can be viewed in the noble mission "to lessen the poverty". The procedures and operations of the banks are tested through their model country. However, there are instances that the loan performance fails to follow its original plan and fail to produce the expected outcome because of the two aspects – the credit management of the financial institution and the failure of the individual or entities to wisely use the loans (Harrison, 2006).

2.5 Strategies for recovery of non-performing loans

Masoom (2013) contended that under the present overall socio economic dynamics the banks should prioritize to extend purpose-oriented credit facilities with required security/collateral support as their policy priority since diversion of fund is one of the identified causes of loan default. So it becomes of imperative need to keep a close watch on the borrower's business operations and the movement of its financial indicators in an empirical manner. Banks have to play the role of business partner rather than a conventional lender.

A bank has to ensure that utilization of credit is in accordance with the purpose for which it is lent i.e. end use of the lending has to be ensured. The bank has to monitor the performance of the borrowing unit to verify whether the assumptions on which the loan was sanctioned continue to hold good with regard to operation and environment. It is also to be observed whether the promoters are adhering to the terms and conditions of sanction and this is done by devising a mechanism for obtaining at regular intervals from the borrowing units.

The bank will review the performance of the unit from the broader perspective for having better insight, so that they can extend meaningful advice to the promoters for overcoming any business hurdles. It is an admitted fact that a bank's financial health is largely dependent upon the extent and size of performing assets. Credit losses are equivalent to capital losses. An increase in non-performing loan (NPL) has the multi- pronged adverse impacts on bank's balance sheet having consequential effect of erosion of capital impairing earning streams, profitability, liquidity and solvency.

2.6 Literatures from various scholars

Das and Ghosh (2003) argue that in addition to the standardized system, efforts have been made to improve the classification of loans. For example, more countries are shortening the period when unpaid loans become past due, intending to put loans on lenders' timetable sooner and require them to address these loans before losses start to escalate. The International Accounting Standard 39 revised in 2003 focuses on recognition and measurement of financial instruments and, most importantly, defines and establishes the measurement and evaluation of impaired loans. Singh (2005) contend that, as lenders usually make little or no loss provision for impaired loans, they are at risk to be suddenly forced to reclassify such loans as a loss and take a full write-down if the borrowers go bankrupt. The initiation of this standard is to prevent lenders from being caught off-guard. In addition, many global economists, rating agencies, and s such as the World Bank and the Asian Development Bank have begun to evaluate the effects of NPLs on GDP growth. They reduce growth estimates to reflect the time and cost of resolving large non-performing loan issues.

Stronger performance of real economy led by healthy competition among financial institutions result in lower NPLs. Boyd and Nicolo (2005) found that banks charge more rents on their lent assets in declining competition scenarios. In such situations higher lending rates augment the chances of borrower's bankruptcy. Khemraj and Pasha (2009) studied the relationship of various bank specific and macroeconomic variables as determinants of NPLs in Guyanese banking sector. Based on empirical evidence, they argued that banks charging relative higher lending rates with excessive lending strategy are exposed to higher risk of incurring NPLs..

Increase in non-performing loan portfolios of banks is common in all those economies where economic monitors including regulators and banking professionals lack understanding of systemic risks and macroeconomic effects pertaining to NPLs. Reddy (2002) stressed the importance of issues related to systemic risk and effects of macroeconomic variables faced by the economy specifically the banks by comparing India with other countries including China, Japan, Korea and Thailand for effectively solving critical problem of non-performing loans. As per their analysis, steep rise in the interest rates was the root cause of majority NPLs in Thailand. Research conducted by Asari, *et al*. (2011) was also on the same lines and concluded that NPLs and interest rates have significant relations. Their study suggested that increase in the non-performing loans result in deterioration of bank assets and subsequently capital erosion. Interest rates and their volatility are among the most critical and closely watched variables in the economy. Paper by Adela and Iulia (2010) demonstrated the connection between average interest rate and nonperforming loans.

2.7 Empirical Literature Review

There are many internal and external factors affecting NPLs while the internal factors might be taking up new projects, promoting associate concerns, business failure, cost overruns during the project implementation stage, strained labour relations, inefficient management, technology related problems, product obsolescence etc., the external factors include GDP growth, default in other countries, high inflation, accidents and natural calamities.

Das and Ghosh (2003) established relationship between nonperforming loans of India's public sector banks in terms of various indicators such as; asset size, credit growth and macroeconomic condition and operating efficiency indicators. Bercoff, Giovanniz and Grimardx (2002) in their study of Argentinean banks tried to measure NPLs by using the various bank related parameters as well as macroeconomic parameters. Bank specific parameters in their study were Ratio of Networth to Net Assets, Bank's exposure to peso loans, and type of banks such as foreign, private or public. Macroeconomic factors in this study were credit growth, reserves adequacy, foreign interest rate and monetary expansion.

They established that variables such as operating cost, exposure to peso loans, credit growth, and foreign interest rate had a negative effect on NPLs. The macroeconomic variables such as money multiplier and reserve adequacy had a positive impact on NPLs. However, their researches could not examine the extent of non-performing loans in banking industry. Chen *et al.* (1998) study the relationship between the risks and the ownership structure, and it appears that a negative correlation exists between the managers' shareholdings and the risks faced by the financial institution. That means if the managers' shareholding percentage increases, the financial institution will reduce its own risk behavior.

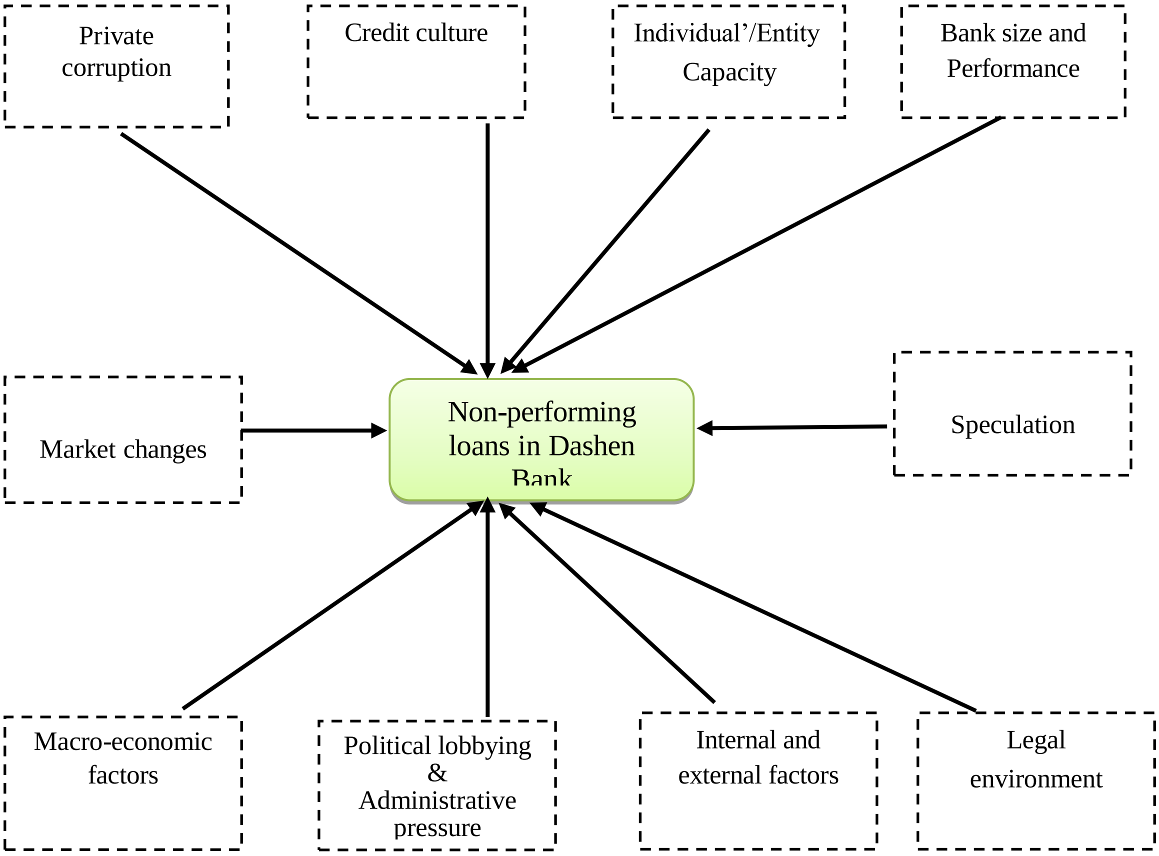
While Berger and De Young (1995) mention that a management team with poor operating capability is unable to correctly appraise the value of collateral, which means that it is difficult for it to follow up on its supervision of the borrower, its poor credit-rating technology will result in management being unable to control and supervise the operating expenses efficiently, thus leading to a significant increase in NPLs. Accordingly, banks face a number of challenges such as; worrying level of NPLs, stringent prudential norms, increasing competition, growing customer expectations, increasing pressure on profitability, liquidity and credit risk management, assets-liability management, shrinking size of spread, rising operating expenditure and so on.

2.8 Conceptual Framework Model

Figure 2.1 provides the conceptual framework model. This is defined as an abstract idea or a theory used to develop new concepts or to reinterpret existing ones (Kothari, 2004). It gives the relationship between the independent and dependent variables. From the figure the dependent variable is the factors affecting non- performing loans while the independent variables include; political lobbying and administrative pressure, private corruption/fraudulent practices, bank size and performance, credit culture, market changes, legal environment, individual's/entity's capacity, speculation, macro-economic factors and internal and external factors.

Theoretically there exists a relationship among them (i.e. dependent and independent variables). The relationship can be expressed as factors affecting non-performing loans (Y) are the function of political lobbying and administrative pressure, private corruption/fraudulent practices, bank size and performance, credit culture, market changes, legal environment, individual's/entity's capacity, speculation, macro- economic factors and internal and external factors (x_1,x_2........x_n).

This is expressed mathematically as; Y = f(political lobbying and administrative pressure, private corruption/fraudulent practices, bank size and performance, credit culture, market changes, legal environment, individual's/entity's capacity, speculation, macro-economic factors and internal and external factors)



Source: adopted from Msigwa, (2013)

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3.1 Research Methodology

The methodology that have been adopted to investigate the research questions are described and outlined below.

3.1.1 Study Area

Dashen Bank coined its name from the highest peak in the Country, mount Dashen, and aspires to be unparalleled in banking. Headquartered in Addis Ababa, the Bank is the biggest private Bank in Ethiopia. It operates through a network of 300 Branches, nine dedicated Forex Bureaus, 220 ATMs and 958 plus Point-of-Sale (POS) terminals spread across the length and breadth of the nation. It has established correspondent banking relationship with 464 banks covering 71 countries and 175 cities across the world. Wherever business takes customers around the world, Dashen Bank is already there. Dashen is the most reputable brand in the domestic banking market; a reputation earned through consistent delivery of values and preeminence unmatched by its competitors. The Bank also works in partnership with leading brands in the electronic payments industry (American Express, VISA, MasterCard & UnionPay cards) and prominent money transfer operators (Western Union, Money Gram, Express Money, Dahabshiil, TransFast, EzRemit , FloCash , Dawit Money Transfer & Ria).

3.1.2 Research Design

Descriptive research analysis method has been implemented so as to identify factors affecting non-performing loans since the design enables descriptions of phenomena or characteristics associated with a subject population and estimates of the proportions of a population that have these characteristics by studying a sample of that population. The study implements a cross-sectional study using questionnaires for data collection with the intent of generalizing from a sample to a population (Fowler, 2008). Cross-sectional research has been used in which questionnaires (self-administered questionnaire) and interviews were utilized to obtain the data from the field. The reason for using cross-sectional research design is that, it allows the collection of data at one point in time (in a short time as it is feasible).

With cross-sectional research design the quantitative and qualitative methods were also employed i.e. the quantitative method employed questionnaires while the qualitative method incorporated through interview with top management of the credit department of Dashen Bank Sc. Finally, the collected data from a number of cases or units of inquiry under investigation and only a sample of cases was analysed and examined.

3.2 Population and Sampling Techniques

Subsequent to the justification of the research methodology, a sample design has been chosen to collect relevant information for the research problem. In selecting a valid sample credit department employees of the bank at head quarter is essential to define the target population, selection of sampling method, and determination of sample size.

3.2.1 Population and sample size

The population of the study comprised respondents who are Dashen bank employees under credit department which includes; Directors, credit administration officers, customer relationship officers, and portfolio & recovery officers since they have a direct knowledge of the subject matter under study who can be able to assist providing feedback.

Table 1 size of the study population

SN	Department	Population size
1	Credit Analysis, and Appraisal	18
2	Customer Relationship Management	14
3	Risk and compliance	9
4	Portfolio Management	12
	Total population size	**53**

Source; Dashen bank's human resources report 2015/16

3.2.2 Sampling frame

The ideal sampling frame as in many research methodology literatures is based on the notion of its accessibility to the researcher. And so, in the case of this research, two sampling procedures namely; purposive and stratification sampling were used. Purposive sampling method is used as it is a non-random sampling procedure in which personal experience regarding non-performing loans will be considered to be a key derived from the position one held or the roles s/he played in relation to that particular activity. Thus respondents are selected purposively in order to attain the study objectives.

Similarly stratification sampling method was also used to focus on different work unit of the credit department including Credit Analysis, and Appraisal, Risk and compliance, and Customer Relationship Management. The reason according to Yin (1994) is that, stratification serves the distribution among heterogeneous population which need to be incorporated for the purpose of gaining insights from it (i.e. opinions from working experience and different departments were highly needed).

3.2.3 Sample size

If a sample is to be drawn does not constitute a homogeneous group, stratified sampling technique is to be applied to obtain representation sample. Since we have to get representative sample from employees under credit department at head quarter, the population divided in to four strata that individually be more homogeneous than the total population and then select item from each stratum.

The sample size was comprised of the total population of 53 respondents who are working in different work unit of credit department of Dashen Bank Sc. The sample size of 100% population was taken in the study. Table 1 shows the distribution of respondents.

Table 2 Sample size of the study population

S/N	Category	Population	Sample size
1	Credit Analysis and Appraisal	18	**18**
2	Customer Relationship Management	14	**14**
3	Risk and Compliance	9	**9**
4	Portfolio Management	12	**12**
	Total	**50**	**50**

Source; analyzed data, 2017

3.3 Types of Data and Tools/Instruments of Data Collection

Data collection is the process of gathering and measuring information on variables of interest, in an established systematic fashion that enables one to answer the stated research questions, and evaluate out comes whereas the study uses a self-administered paper-based questionnaire (the survey method) which is designed according to the aims of the research. The qualitative data is obtained from open ended questions provided on the survey instrument and the questionnaire uses a five-point Likert scale to measure the variables employed to obtain quantitative data. The questionnaire has three parts; the first part of the questionnaire is used to screen prospective of respondents they are credit analysts, customer relationship managers, credit administration officers, portfolio officers, and recovery officers. This section also asks the respondents for their demographic information (gender, age, Academic qualification and years of experience).

Both primary and secondary data collection methods were used to get data's from respondents and other sources. The Primary data collection method was used by the researcher to collect data from the field whereby interviews and questionnaires being employed. Both open ended and closed ended questions have been used.

The researcher also used different documents in order to access accurate and reliable data. The study uses the latest available published secondary data and other available data from Dashen Bank for the years 2013/14-2016/17 which is compiled from financial Reports of the Bank and other inside available on Trends and Progress of Bank (i.e. The Bank quarterly reports on lending from year 2013/14-2016/17). The scope of the study was limited to four years data from Dashen bank Credit Department However, other documents comprised of company profiles, guidelines, directives, policies, regulations, books, journals, and Dashen bank management performance reports.

The interviews has been conducted with the credit department work unit Directors and managers were used in order to solicit information's regarding the non-performing loans.

Table 3 sample size of the interview population

S/N	**Category**	**Expected population**	**Actual interviewees**
1	Credit Analysis, and Appraisal	1	**1**
2	Customer Relationship Management,	1	**1**
3	Risk and compliance	1	**1**
4	Portfolio Management	1	**1**
	Total	**4**	4
	Actual percentage		100%

Source: Analyzed data, 2017

The interview tool was expected to unveil from these respondents views/opinions regarding the matter. As Yin (1994) affirms that the interview tool is very important source of getting helpful in handling cross-sectional related matters as the research design indicates.

3.3.1 Procedures of Data Collection

Data was gathered from a sample of respondents by hand after the respondents done filling for self-administered and email for structured questionnaire that is distributed through the organizations e-mail (outlook) to the respondents. The screening question ensured those credit departments employees of the bank.

3.3.2 Methods of Data Analysis

Data collected were analysed both qualitatively and quantitatively. These were summarized, coded and analysed by Statistical Package for Social Science (SPSS). Frequency distribution and percentages were used to describe major variables. Qualitative data from interviews have been analysed using content analysis.

The collected data from the field were prepared through coding and editing of the data involves checking of data collection forms for omission, legibility and consistency as well as discarding the incomplete responses which had missing data. Thereafter, identified potential errors in data collection were d iscussed for their implications.

3.3.3 Ethical Consideration

In order to keep the confidentiality of the data given by respondents, the respondents were not required to write their name and assured that their responses has been treated in strict confidentiality. The purpose of the study and a reasonably expected possible benefit to the respondents and Ethiopian Revenues and Customs Authority was disclosed in the introductory part of the questionnaire. Furthermore, the researcher tried to avoid misleading or deceptive statements to be incorporated in the study. Lastly, the questionnaires were distributed only to voluntary participants.

CHAPTER FOUR

RESULTS AND DISCUSSION

In this chapter, a brief overview of the respondents' information will be presented then a statistical analysis of the data collected will proceed. In the analysis, the data will be compared with the theories presented in the theoretical research frame, all derived from the literature review. The analysis will follow in the same structure as the research questions.

4.1 Data Analysis

A total of 50 paper based questionnaires were administered to customers of the relevant bank who were willing to take part in the study. Only 42 usable responses were obtained representing an effective response rate of 83.33%. However, this sample size is considered adequate according to statistical methods and requirements used in this study. For the purpose of data analysis, the required statistical procedures were applied using SPSS 23 package. Descriptive statistics is used to summarize means of key dimensions and demographic characteristics of the respondents.

4.2 Factors influencing non-performing loans in Dashen Bank

The first objective of this study was to identify the factors that influenced non-performing loans in Dashen Bank. These factors included; political lobbying and administrative pressure, private corruption/fraudulent practices, bank size and performance, credit culture, market changes, legal environment, individual/entity's capacity, speculation, macro-economic factors, internal and external factors, higher interest rates and diversion of funds. The respondents' opinions were therefore sought on how they perceived and being able to identify these factors. The summary of findings is given in Table 4. The results in Table 4. show the factors which influenced non-performing loans in Dashen Bank from the respondents' opinions. The diversion of funds for unnecessary expansion of business and speculation which focuses on investing in high risk assets to earn high income were reported by (70%) of respondents as factors influencing NPLs.

Moreover, bank size and performance influenced NPLs from the fact that the larger the bank size, the more resources to evaluate and process loans while focusing on selective borrowers as well as legal environment which reflects the availability or non-availability of foreclosure laws, bankruptcy laws, creditor rights and ownership rights for both domestic and foreign investors due to the prevailing legal environment were reported by respondents.

Table 4 Factors influencing non-performing loans

Factor	Mean	Standard Deviation
Political lobbying and administrative pressure	4.10	0.19
Private corruption/fraudulent practices	3.54	0.10
Bank size and performance	3.85	0.13
Credit culture	4.15	0.19
Market changes	4.00	0.17
Legal environment	3.51	0.10
Individual/entity's capacity	3.90	0.15
Speculation	3.67	0.11
Macro-economic factors	4.08	0.18
Internal and external factors	4.21	0.20
Higher interest rates	4.49	0.25
Diversion of funds	3.46	0.08

Source: Researchers Analyzed data, 2017

On the other hand, private corruption or fraudulent practices influenced NPLs through the practices such as advancing loans to ineligible persons, advances without security or references as affirmed by mean 3.54 of respondents. Yet, market changes which focus on the deviation from the supply and demand of market process lending to non-performance and macro-economic factors which reflect issues concerning with downturns and slowdowns in the economy, recession, low rate of savings, weak markets, depression in industrial products and inflation levels were reported by mean 4.00 and 4.08 score of respondents. However, political lobbying and administrative pressures as reported by respondents with mean score 4.10 influenced NPLs by allowing domestic and foreign investment along with valid decisions.

Finally, individual or entity's capacity which reflects the success or failure of the individual or entity to wisely use the loans indicated by mean 3.90, internal and external factors which focus on issues concerning taking up projects, promoting associate concerns, business failure, costs of overruns during the performance, capital adequacy, credit growth, operational efficiency and branch spread indicated by a mean score 4.21 were factors which influenced NPLs as attested by the mentioned respondents. Moreover, credit culture which focuses on the borrower's decision to take a loan without thinking of the future results to defaulted loan and higher interest rates as indicated by high mean score 4.15 and 4.49 respectively, put by various commercial banks have been factors influencing non-performing loans as reported by respondents.

In general the findings imply that, with mean score 3.46 diversion of funds for unnecessary expansion of business and speculations on investing in high risk assets to earn high income, bank size and performance from the fact that the larger the bank size, the more resources to evaluate and process loans and legal environment which reflects the availability or non-availability of foreclosure laws, bankruptcy laws, creditor rights and ownership rights for both domestic and foreign investors were reported by mean score of 3.51 and 3.85 by respondents.

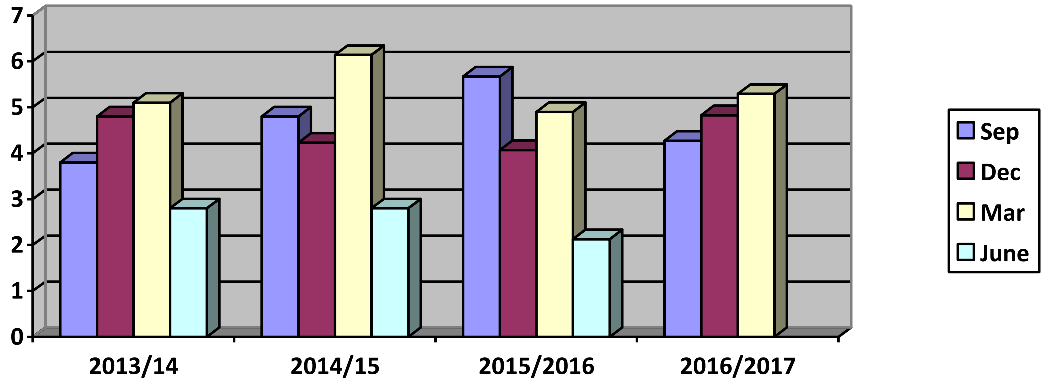
Yet, political lobbying and administrative pressures as reported by respondents with mean score 4.10, individual or entity's capacity which reflects the success or failure of the individual or entity to wisely use the loans indicated by mean 3.90 internal and external factors which focus on issues concerning taking up projects, promoting associate concerns, business failure, costs of overruns during the performance, capital adequacy, credit growth, operational efficiency and branch spread (mean 4.15) were factors which influenced NPLs. Moreover, credit culture which focuses on the borrower's decision to take a loan without thinking of the future results to defaulted loan (mean 4.21) and higher interest rates (mean 4.90) put by commercial bank have been factors influencing non-performing loans as reported by respondents.

The results present the factors which influence NPLs because increased non- performing loans can cause the decline in Dashen bank credits, as banks with high level of non-performing loans in their portfolio may become increasingly reluctant to take up new risks and commit new loans. However, their impact is vital which need to be reflected for better bank performance, as without keen reflection renders the performance of the Dashen bank to be poor.

4.3 Extent of non-performing loans in Dashen bank

The second objective of this study was to examine the extent of non-performing loans in Dashen bank. To obtain on the extent of non-performing loans, the researcher has been used secondary data which was gathered though quarter report of the credit department which is being made by the portfolio management work unit of the bank.

Figure 1. **Extent of non-performing loans**



Source: from Dashen Bank Quarterly NPL reports

The results in above figure shows the extent of non-performing loans which are supported with testimonies from the quarter report of Credit Department. More specifically, the results shows that Dashen bank have different results regarding the extent of non-performing loans. Dashen banks has NPLs ranging from 2.8% to 5.1 % in 2013/14; from 2.8% to 6.14% in 2014/15; from 2.13% to 5.67 in 2015/16 and from 4.27% to 5.29% in 2016/17. These results reflect that Dashen Bank exhibited lowest NPL percentage at annual report of the month of June. This indicates that the management of the bank exerts its maximum effort on loan collection at the end of the fiscal year of the bank. Besides the banks exhibited higher NPL percentage at third quarter report in all sample report period.

However, banks with better risk position (lower non-performing loans) have higher inclination to extend loans. Yet, when bank have higher non-performing loans in the portfolio, may be more concerned about the risky, and hence, have lower tendency to grant loans. As a whole, some evidences show that non-performing loans reduce the incentive to increase lending when banks have non-performing loan rate above the threshold level.

4.4 Attempts made by the bank to alleviate non-performing loans

The study identified the attempts made by Dashen bank to alleviate non- performing loans by seeking opinions from the respondents. These attempts included; enhancement of credit risk management practices for bank lending; estimating the non-performing loans and allocating them to the corresponding borrowers (but considering how unpaid loans are recorded in the accounts in such a way as to increment principal outstanding); estimate the interest received rather than the receivable on the interest payable so that the performing loans are not affected by the non-performing loans; introduction and implementation of an aggressive debt collection policy; enhancing training and development options to prevent the failure in assessing the capabilities of the individuals or entities to generate the interests in their loans and enhancement of proper credit assessment and risk management mechanism. The summary of findings is indicated in Table 4.

Table 5 Attempts made by the bank to alleviate non-performing loans

Attempt	**Percentage %**	
	Yes	**No**
Enhancement of credit risk management practices for bank lending	80	20
Estimating the non-performing loans of the corresponding borrowers	84	16
Introduction and implementation of an aggressive debt collection policy	90	10
Enhancing training and development options to prevent the failure	85	15
Enhancement of proper credit assessment and risk management mechanism	81	19

Source: Researchers Analysed data, 2017

The results in Table 5 show the attempts made by Dashen bank to alleviate the non-performing loans which were attested by respondents.

More specifically, results in Table 5 show that estimating the interest received rather than the receivable on the interest payable was an attempt utilized by Dashen bank for the reduction of NPLs as supported by (70%) of respondents. However, the enhancement of credit risk management practices for bank lending was supported by (80%) and enhancement of proper credit assessment and risk management mechanism for the reduction of NPLs being supported by (81%) of respondents.

Yet, enhancing training and development options to prevent the failure in assessing the capabilities of the individuals or entities to generate the interests in their loans was supported by (85%) of respondents and introduction and implementation of an aggressive debt collection policy (90%) have been the attempts made to alleviate NPLs.

In general, the results in this part imply that estimating the interest received rather than the receivable on the interest payable (70%), the enhancement of credit risk management practices for bank lending (80%) and enhancement of proper credit assessment and risk management mechanism (81%) for the reduction of NPLs have been attempts to alleviate NPLs. Moreover, estimating the non-performing loans and allocating them to the corresponding borrowers (84%) while considering how unpaid loans are recorded in the accounts in such a way as to increment principal outstanding; enhancing training and development options to prevent the failure in assessing the capabilities of the individuals or entities to generate the interests in their loans (85%) and introduction and implementation of an aggressive debt collection policy (90%) have been the attempts made to alleviate NPLs.

The results highlights the attempts made to alleviate NPLs. As financial intermediations, commercial banks' main function is to receive deposits and make loans to facilitate the flow of capitals. For most of the commercial banks, deposits are the main funding sources for commercial banks' assets. And loans take up the biggest proportion in the asset portfolio. With the expansion of the asset size, banks will expand the volume of the loans to re-balance the asset portfolio. However, proper assessment of individual's or entity's capability is essential for the reduction of these non-performing loans to the extent of making Dashen bank to continue with its operations in profit making manner.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This chapter gives the summary of findings; conclusions and policy implications, recommendations and areas for further research which result from the study findings. It starts with the summary; then provides the conclusion and policy implications; recommendations and areas for further research are given..

5.1 summary of findings

The findings from the study showed that, diversion of funds for unnecessary expansion of business and speculations leading to investing in high risk assets to earn high income (70%), bank size and performance for both domestic and foreign investors as reported by (75%) of respondents have been factors influencing NPLs in Dashen bank. However, private corruption or fraudulent practices (78%), market changes which focus on the deviation from the supply and demand of market process lending to non-performance; and macro-economic factors which reflect issues concerning with downturns and slowdowns in the economy as reported by (80%) of respondents influenced NPLs in Dashen bank.

Yet, political lobbying and administrative pressures as reported by (81%) of respondents, individual or entity's capacity which reflects the success or failure of the individual or entity to wisely use the loans (82%), internal and external factors which focus on issues concerning taking up projects, costs of overruns during the performance and branch spread (85%) were factors which influenced NPLs in Dashen bank. Moreover, credit culture which focuses on the borrower's decision to take a loan without thinking of the future results to defaulted loan (89%) and higher interest rates (90%) put by respondents in Dashen bank have been factors influencing non- performing loans as reported by respondents.

The results showed that estimating the interest received rather than the receivable on the interest payable (70%), the enhancement of credit risk management practices for Dashen bank lending (80%) and enhancement of proper credit assessment and risk management mechanism (81%) for the reduction of NPLs have been attempts to alleviate NPLs in unite bank. Moreover, estimating the non-performing loans and allocating them to the corresponding borrowers (84%) while considering how unpaid loans are recorded in the accounts in such a way as to increment principal outstanding; enhancing training and development options to prevent the failure in assessing the capabilities of the individuals or entities to generate the interests in their loans (85%) and introduction and implementation of an aggressive debt collection policy (90%) have been the attempts made to alleviate NPLs in Dashen bank.

5.2 Conclusions

Although making loans are still the most important function for Dashen bank; with the innovation of financial instruments and less activity restriction, banks are expanding their business scope other than lending in order to obtain higher profitability and larger market power. Especially when banks have less risk constraints, i.e., less non-performing loans, they have more freedom to engage in various businesses. Banks' capital declines as non-performing loans grow, lower capitalization reduces banks' capacity for lending (Demirgüç et.al., 2000). If the banks are not immediately recapitalized or if they do not have excess of capital, credit supply will be affected. And also the result of the bank failure to take proper credit assessment and risk management the bank may expose itself to a higher NPL

The results indicate that Dashen bank need to put emphasis on reserving adequate amount of capital to improve the risk position by reducing the amount of NPLs from the Bank book of account . As a whole, some evidences show that non-performing loans reduce the incentive to increase lending when banks have non-performing loan rate above the threshold level. The growth in NPLs influences significantly credit supply. Due to the psychological effect, banks are reluctant to extend new loans when they see that old loans are in default. Moreover, NPLs influence a decline in loans due to growing financing costs, interest margin growth, and reduction in free capital (Diwan, and Rodrik, 1992).

The research adds to the argument for enhancing training and development options to prevent the failure in assessing the capabilities of the individuals or entities to generate the interests in their loans in order to alleviate NPLs to the minimum required threshold.

5.3 Recommendations

In light of the above findings, the researcher has proposed the following recommendations;

Individual or entity's capacity which reflects the success or failure of the individual or entity to wisely use the loans in line with the credit culture which focuses on the borrowers decision to give loans with analysing the probability that future results turn to default loans which enhanced the betterment of the bank performance.

Enhancing training and development options to prevent the failure in assessing the capabilities of the individuals or entities to generate interests in their loans and to properly follow-up diversion of funds for unnecessary expansion.

In addition to this, the bank should take proper credit assessment and risk management techniques' to minimize the bank expose to a higher NPL and tries to minimize the extent of NPL within the Banks internal rate limit over all the banks fiscal year.

The bank also needs to identify unfavorable situations of market changes and microeconomic factors that could probability turn loans to NPL.

While developing NPL resolution strategies, the bank should clearly identify those non-performing loans that can be easily turned to performing status or using enforced resolution for those that cannot be turned to performing status. By doing so, the bank can mitigate the extent of NPL.

5.4 Limitations of the study

The limitations of the study will be as follows;

Response rate; and response quality tough even the researcher is a current employee of the bank ,the response quality would be low since some respondents may be in a hurry, very busy with their daily activities and/or others may be absent at their working places sometimes due to different reasons ,

Lack of co-operation; some respondents showed a minimal co-operation to be able to reveal what may be needed.

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Appendix 1 : Questionnaires for respondents

St. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

MASTER OF BUSINESS ADMINISTRATION PROGRAM

Dear respondent,

The purpose of this questionnaire is to collect data from employees of Ethiopian airlines for conducting Masters of business administration (MBA) thesis on the title **" *Factors affecting non-performing loans in banking industry: A case of Dashen Bank*"**. Please be honest and objective while filling the questionnaire. The information you give is used only for academic purpose and will be kept confidential.

Thank you, for your cooperation and timely response in advance

Thank you!!

Natnael Tefera

PART A: Factors influencing non-performing loans in *Dashen Bank*

.Please indicate your agreement or disagreement regarding the factors influencing non- performing loans as follows; 1) SA=Strongly Agree 2) A=Agree 3) U=Uncertain 4) D=Disagree 5) SD=Strongly Disagree.

Factor	Choice				
	Strongly	**Agree**	**Uncertain**	**Disagree**	**Strongly**
1.Political lobbying and administrative pressure (allowing domestic and foreign investment along with valid decisions)					
2.Private corruption/fraudulent practices (practices such as advancing loans to ineligible persons, advances without security or references)					
3.Bank size and performance (the larger the bank size, the more resources to evaluate and process loans while focusing on selective borrowers)					
4. Credit culture (the borrower decision to take a loan without thinking of the future results to defaulted loan)					
5. Market changes (the deviation from the supply and demand of market process lending to non- performance)					
6. Legal environment (the availability or non-availability of foreclosure laws, bankruptcy laws, creditor rights and ownership rights for both domestic and foreign investors)					
7. Individual's/Entity's capacity (the success or failure of the individual or entity to wisely use the loans)					
8. Speculation (investing in high risk assets to earn high income)					
9. Macroeconomic factors (issues concerning with downturns and slowdowns in the economy, recession, low rate of savings, weak markets, depression in industrial products, inflation levels)					

10. Internal and external factors (issues concerning taking up projects, promoting associate concerns, business failure, costs of overruns during the performance, capital adequacy, credit growth, operational efficiency and branch spread)					
11. Higher interest rates					
12. Diversion of funds (funds diverted for unnecessary expansion and diversion of business)					

PART B: The extent of non-performing loans in Dashen Bank

1. What is the extent of non-performing loans in Dashen Bank at present (elaborate)

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2. Why is that extent attained? (elaborate)

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3. What are the reasons which facilitated that extent of non-performing loans in Dashen Bank? (elaborate)

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4. How have you managed these non-performing loans in Dashen Bank? (elaborate)

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PART C: Attempts made in Dashen Bank to alleviate non-performing loans

5. Do think that the following attempts have been incorporated by Dashen Bank? (Tick where appropriate).

No	Attempt	Yes	No
1	Enhancement of credit risk management practices for bank lending		
2	Estimating the non-performing loans and allocating them to the corresponding borrowers but considering how unpaid loans are recorded in the accounts in such a way as to increment principal outstanding		
3	Estimate the interest received rather than the receivable and on the interest payable so that the performing loans are not affected by the non-performing loans		
4	Introduction and implementation of an aggressive debt collection policy		
5	Enhancing training and development options to prevent the failure in accessing the capabilities of the individuals or entities to generate the interests in their loans		
6	Enhancement of proper credit assessment and risk management mechanism		

6. What other attempts do you incorporate other than the mentioned (Specify)

i)……………………………………………..…….ii)……………………………….……

iii)……………………………………………..…..iv)……………………………….…..

v)…………………………………………….…vi)……………………………….…….

Appendix 2: Interview Guide questions for Dashen Bank credit Director, portfolio and recovery managers and relation Managers

St. Mary University

School Graduate Studies

Masters of Business Administration

Dear Respondent,

The objective of this interview is to gather and analyze relevant and in-depth information that will provide insights about factors affecting Non-performing loans of Dashen Bank .This study is undertaken as a partial requirement for the completion of Masters in Business Administration.

1. In your opinion ,what are the factors influencing non-performing loans in Dashen Bank?
2. In your opinion ,what is the extent of non-performing loans in Dashen Bank at present (please elaborate)
3. In your opinion, what are the reasons which facilitated that extent of non-performing loans in Dashen Bank? (please elaborate)
4. What strategy did your Dashen Bank used to manage non-performing loans? (please elaborate).

Thank you for your valuable response and time