



**ST. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES**

**ASSESSMENT OF THE CAUSES OF NON-PERFORMING LOANS IN
DEVELOPMENT BANK OF ETHIOPIA**

BY

KALKIDAN ABEBE

SGS/0561/2010A

**JUNE, 2019
ADDIS ABABA, ETHIOPIA**

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**A THESIS SUBMITTED TO THE SCHOOL OF GRADUATE STUDIES OF ST MARY'S
UNIVERSITY IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE
DEGREE OF MASTERS OF BUSINESS ADMINISTRATION**

**JUNE, 2019
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DECLARATION

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

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St.Mary's University, Addis Ababa

June, 2019

ENDORSEMENT

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

Mesfin Tesfaye (PhD)

Advisor

Signature and Date

St. Mary's University, Addis Ababa

June, 2019

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ACKNOWLEDGEMENT

I would like to express my endless thanks to God and St Mary in every aspect of my journey to have delightful strength and to complete the project. My sincere thanks go to my advisor Mesfin Tesfaye (PhD) for his unreserved assistance and guidance. I extend my warm thanks to my husband Dr. Hailu Birara (PhD), my dear mother and rest of all families for their assistance and pray and all DBE staffs special thanks to Ato Yilkal Terefe and Shmendi Abrha, for their support and encouragement during my thesis work.

Finally, I would like to thank for my group members, our representative and all classmates who had coordinated, encouraged and helped me all time throughout our courses from the start to the end of the program.

KALKIDAN ABEBE

ADDIS ABABA

ETHIOPIA

LIST OF ABBREVIATIONS

CAR:-Capital Adequacy Ratio

DBE:-Development Bank of Ethiopia

GC: - Gregorian Calendar

GDP: - Gross Domestic Product

IMF: - International Monetary Fund

KYC:-Know Your Customer

NBE:-National Bank of Ethiopia

NPL:-Non-Performing Loan

OLS:-Ordinary Least Square

PLC:-Private Limited Company

PRLRD:-Project Rehabilitation and Loan Recovery Directorate

PRLRT: - Project Rehabilitation and Loan Recovery Team

ROA:-Return on Asset

ROE:-Return on Equity

SPSS:-Statistical Package for Social Science

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ABSTRACT

This research conducted to analyze the causes of nonperforming loan (NPL) in Development Bank of Ethiopia and assessed the major bank specific (Credit monitoring, Credit assessment) and non-bank specific (customers orientation or attitude towards non-performing loan and others like macroeconomic, marketing factors and political instability) causes towards NPLs in DBE. The data for the study was collected from primary and secondary sources. Primary data was collected using both structured and open ended, subjective questionnaires from seventy nine (79) staffs and customers of the bank from both head office and Addis Ababa district, census used to determine the sample and collect primary data as well as secondary data of five years NPL ratio collected from annual loan portfolio report and planning report of the bank to illustrate the incremental rate of non-performing loan of development bank of Ethiopia. Descriptive statistics were used to analyze and examine the collected data. The results indicated that among the bank specific factors that accounted for the incidence of NPLs, poor credit monitoring/follow up is the major cause of NPL in DBE and Inefficient/improper know your customer assessment of the bank, Poor credit appraisal, and poor credit advice and consultancy of customer ranked second, third, and fourth, respectively as the cause for the occurrence of the NPL in DBE. In addition customer's related causes that the result showed diversion of loan fund, knowledge and experience of customers about project management and weak project management capacity of the borrowers were the major factors of NPL in DBE. Moreover other factors discussed with respondents through open ended subjective questions and found poor credit monitoring, political instability, credit culture of customer's, macroeconomic factors and marketing factors causes accumulation of bad loan. Generally the researcher believes the conclusion and suggestion of the study will be essential for the Bank and its credit units, credit policy reviewers and credit decision makers and for other financial institutes.

Keywords:-NPL,DBE,Causes

CHAPTER ONE

INTRODUCTION

This chapter begins with the background of the study that gives some insight on the issues of nonperforming loans (NPLs), statement of the problem part which gives a clear description and justifies the reason to carry out this study, Following this, research questions, both general and specific objectives of the study, significance of the study, scope/delimitation, limitation of the study, organization of the paper, and finally ethical considerations are included respectively.

1.1 BACKGROUND OF THE STUDY

A certain amount of money that is given by one party to the other party with the expectation of it being fully repaid is called a loan. Loans and advances constitute the primary source of income by banks. As any business establishment a bank also seeks to maximize its profit. Since loans and advances are more profitable than any other assets, a bank is willing to lend as much of its funds as possible. But banks have to be careful about the safety of such advances cited as Mamuye, 2015 (Radha et al, 1980).

A bank loan is a form of credit that is often extended for a specified period of time, usually on fixed-interest terms related to the base interest rate, with the principal being repaid either on a regular installment basis or in full on the appointed recovery date.

The primary function of a bank is mobilizing deposits from surplus units to deficit units in the form of loan and advances to various sectors such as agricultural, industry, personal and governments. However, in recent times, the banks have become very cautious in extending loans due to non-performing assets (Sontakke & Tiwari, 2013).

The health of the development banks, and so as the financial sector as a whole is very important as failure in financial intermediation can critically disrupt the development process (Rajaraman & Vasishtha, 2002). Well-functioning development banks accelerate economic growth, while poorly functioning development banks impede economic progress and exacerbate poverty (Levine & Barth, 2001).

Bank problems, mostly failures and financial distress affect numerous banks, which results closed down by the regulatory authorities (Brown, 1998). This in turn led to contraction of activities, decline in output and the imposition of substantial costs on the economy (Chijoriga, et.al 1997). Observed that the cost of banking crises in terms of output loss has been high; typically a double digit percentage of Gross Domestic Product. Studies in other countries show that most of the bank failures have been caused by non-performing loans (NPLs) (Brown, 1998). National economic downturn, insider lending, political connection of bank owners, customer's failure to disclose vital information during the loan application process, lack of proper skills amongst loan officials were among major factors identified in other countries to cause non-performing loans (Waweru & Kalani, 2009).

Non-performing loans are one of the main reasons that cause insolvency of the financial institutions and ultimately hurt the whole economy (Hou, 2007). “A loan is nonperforming when payments of interest and/or principal are past due by 90 days or more, or interest payments equal to 90 days or more have been capitalized, refinanced, or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons such as a debtor filing for bankruptcy to doubt that payments will be made in full.” IMF’s Compilation Guide on Financial Soundness Indicators 2004.

“Non-Performing Loans (NPLs)” shall mean bad debts as defined by NBE for development financial institutions as per in the Directives No SBB/52/2012 of January 19, 2012.

The level of nonperforming loan in a Bank’s loan portfolio should be well managed in order to keep the quality of bank asset, to maintain or improve the efficiency and effectiveness of a bank. In general, to undertake sustainable and sound credit operation good non-performing loan management is among the crucial issues.

An optimal non-performing loan management mainly requires standardized and sustainable credit risk management and prudent pre and post credit administration practices which includes the following: undertaking due diligent assessment or know your customers (KYC) principles, standardized project appraisal, loan approval and continuous credit monitoring and evaluation, loan workout, taking timely and appropriate action before and after loan default.

Because of controllable or bank specific factors which are controlled by firm level and uncontrollable factors are external factors or macroeconomic factors which are difficult to control at firm level, it is unlikely to have 100% of collection of loan. (Tirsit, 2017)

Hence, Development Bank of Ethiopia, which is a specialized public financial institution, was expected to put its pivotal role in pushing forward the countries social and economic wellbeing via allocating efficiently the scarce resources which are gained from domestic and foreign sources. To achieve its vision and mission, the bank has undertaken a numerous simplest to more complex structural changes from its establishment to the current regime.

Regardless of the lessons has been obtained from these studies and previous experiences , Development Bank of Ethiopia, is still suffering from rise in Non-Performing Loans and accumulation of its Non-performing loan against the total outstanding loan is rising from time to time. Therefore, it is important and necessary to conduct a study on the major causes of non-performing loan in development bank of Ethiopia.

1.2 ORGANIZATION PROFILE

Development Bank of Ethiopia (DBE) was established with the objective of Promoting the overall economic development of the country. DBE is one of the financial institutions engaged in providing Short (working capital), Medium and Long term development credits. It is one of State/Policy bank that is highly engaged in lending for priority areas of the government with DBE's distinguishes feature is its "Project" based lending tradition. Projects financed by the bank are carefully selected and prepared through appraised, closely supervised and systematically evaluated. Within long years of existence, DBE has

established recognition at national and international level, nationally it is the sole bank with reputable experience in long term investment financing and internationally it is recognized as an important on leading channel for development program financed by bilateral and/or multilateral sources.

The vision of the bank was 100% success for all financed projects by 2020 but the accumulations of its bad loans hinder the bank's performance and protect from its vision achievement. Also the mission of the Development Bank of Ethiopia is to support the acceleration of the country's economic development through the provision of medium and long-term investment credit as well as short-term loans along with technical advice to viable projects in line with government priorities. In addition to this, it is also expected to maintain its sustainability by making reasonable profit.

Development Bank of Ethiopia has 110 branches and 13 districts across the country provides medium and long term loans for investment projects in the government priority areas such as commercial farming (agriculture), agro-processing, manufacturing and lease financing for small and medium enterprises.

1.3 STATEMENT OF THE PROBLEM

Banks exist to provide financial intermediation services while at the same time attempt to maximize profit and shareholders' value. Lending is considered the most important function of fund utilization of commercial banks as a major portion of their income is earned from loan and advances (Radha, 1980).

Despite the fact that loan is the major source of banks' income and constitutes their major asset, it is the risky area of the industry. That is also why securing loan quality activities are carried out by firms in the financial services industry, cited by (Wondimagegnehu, 2012). One of the parameters by which bank's asset quality can be measured is the non-performing loan ratio (NPLs ratio) (Ahmed et al. 2012).

Loans and advances constitute the primary source of income by banks. As any business establishment a bank also seeks to maximize its profit. Since loans and advances are more profitable than any other assets, a bank is willing to lend as much of its funds as possible,

but banks have to be careful about the safety of such advances (Radhaet.al, 1980). Bankers naturally try to balance the issue of maximizing profit by lending at the same time manage the risk of loan default as it would harm profit. (Arega et.al, 2016)

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

In Ethiopia the banking environment has undergone many regulatory and financial reforms like other African countries with the aim of improving profitability, efficiency and productivity (Lelissa, 2007) cited as Tirsit, 2017).

Similarly Development Bank of Ethiopia (the only non-commercial bank), acts as a medium for providing sustainable credit facility for those projects which is believed to play pivot role from the country's economic development, such as project's engaged in the manufacturing sector and believed to create an employment opportunity, produce import substitute, generate an income for the government and other projects which has given priority as government's policy (Development Bank of Ethiopia Loan Manual revised on,2014).

The major sources of funds for the Bank to provide these credits and ensure its sustainability are mobilizing funds from foreign and domestic market either in the form of grant or loan. Besides the loan interest income is the major sources of income and ensuring the bank's sustainability and it is determined by the bank's loan recovery rate. So, in order to maintain this objective the bank needs to strengthen its liquidity position by enhancing and improving its loan recovery and bank asset quality.

In Ethiopian context, the Banks in the country are required to maintain a ratio of their nonperforming loans below five percent. Therefore Development Bank of Ethiopia's asset quality has to be regularly monitored and assessed whether it is within the acceptable standard or not that is 15% of the total outstanding loan, which is set by Association of

Africa Development Finance Institution and accepted by National Bank of Ethiopia. (NBE, 2008)

Before 2012/13 operational year the bank's asset quality in nonperforming loans was worsening issues, for instance the Bank's nonperforming loans ratio in 2008 & 2009 was around 28.11% to 37.04% respectively (DBE's Portfolio Report, May, 2019).

As shown in the literature parts of this paper the banks' NPL is at an increasing rate. Since the accumulation of arrears loan has been boomed through time to time and it makes the bank's nonperforming loans ratio to reach at its peak. At a press conference held on September 28 to review the past fiscal year's performance the management of the bank disclosed that the bank's NPL ratio grew to almost 40 percent for the year. In the 2016/17 fiscal year ratio of NPLs stood at 25 percent, which at the time was the worst performance the bank had experienced this fiscal year, however, NPLs escalated even more to 39.4 percent, according to a report presented by DBE management (DBE's Loan Portfolio Report May, 2019). Therefore, undertaking a deep diagnosis of the various aspects of loan defaults is more important for development bank of Ethiopia towards minimizing bad loans, to alter this negative reputation of the bank, for policy makers and other lending institutions.

The rate of nonperforming loans in development bank of Ethiopia had shown a great augmentation from 2016/17. However, the average NPL rate in 2018/19 rose to 39.63 percent which is awful as compared to previous years. Therefore, the focus of this study is for the assessment of major bank specific and customers'/borrowers' specific causes of NPL in DBE and to assess other factors like political instability, macroeconomic factors and marketing factors which causes of NPL to reduce non-performing loans accumulation, to alter the negative reputation and to achieve the banks' vision which is (100% successes in all financed projects by 2020); it is crucial to find out the root causes of NPLs in DBE. The researcher used both primary and secondary data to assess descriptive type of data analysis.

1.4 RESEARCH QUESTIONS

The following research questions related to non-performing loan (NPL) were developed and tried to answer in this study.

- 1) What are the bank specific causes of Non-performing Loans (NPLs) in DBE?
- 2) What are the customer's/borrower's related causes towards bad loan in DBE?
- 3) What are other causes of loan default in development bank of Ethiopia?

1.5 OBJECTIVE OF THE STUDY

1.5.1 General Objective

The general objective of the study is to assess the major causes of non-performing loans in the case of development bank of Ethiopia.

1.5.2 Specific Objective

The study attempted to achieve following specific objectives.

- To assess whether or not credit monitoring system of the bank causes NPL
- To examine whether or not the credit risk assessment method of the bank causes NPL
- To identify customers' effects towards Non-Performing Loan.
- To assess other factors of NPL in DBE

1.6 DEFINITION OF TERMS

A Non-performing loan:- A loan whose credit quality has deteriorated and the full collection of principal and/or interest as per the contractual repayment terms of the loan/advances is in question and delayed for more than 90 days (NBE, 2008).

Bank specific factors: - are factors affecting lending behavior of the Bank. And these factors are variables that are under the control of the bank management.

Borrower: The one who borrows money from the lender (Bank).

Customer's/Borrower's specific factors:-These are factors affecting loan repayment because of behavior of borrowers and these factors are not under the control of the bank.

Loan and advances: Any financial asset arranged by banks to borrower on a contract of an obligation to repay the principal amount with usually its interest either on due date or on demand.

1.7 SIGNIFICANCE OF THE STUDY

The researcher believes that the result of this study will be useful to obtain new knowledge about the causes for the rise in non-performing loans in development bank of Ethiopia, the result will be beneficial to identify major causes of Non-performing loan that affect the performance of the bank, to monitor and control non-performing loans and to distinguish mitigation measures to diminish NPL of the bank and also for different stakeholders specially in the banking industry of Ethiopia and other financial institutions in preparing and implementation of policy from the feedback.

Furthermore, the study will provide background information to other researchers and scholars who would like to investigate more on other factors causing loans default.

1.8 SCOPE (DELIMITATION) OF THE STUDY

This thesis work has been done for the objectives of assessment of the major causes of non-performing loan in Development Bank of Ethiopia. The study identified bank specific and customer's specific causes of non-performing loan in development bank of Ethiopia and assess other factors that causes bad loans accumulation. The focus area of the study was limited at the head office and Addis Ababa District. Generally, this research work looks at the various causes of bad loans. The period of assessment has also been delimited to 2014 to 2018. This is to ensure that the result illustrates the current trend and incremental ratio of DBE's NPL.

1.9 LIMITATIONS OF THE STUDY

The study has been undertaken specifically only on Development Bank of Ethiopia, due to the non-performing loans of the bank is an alarming issue, it is undermining the bank's operational performance, reputation and making the bank susceptible to risk of bankruptcy. Also the researcher focus areas of the study limited at the head office and Addis Ababa District of DBE selected projects under NPL which are under rehabilitation and loan recovery unit of the bank. The reason for limiting the study area at head office was that huge amount of loan projects financed and Addis Ababa district also near to the researcher in order to get needed information for the study as well as due to limited time, lack of enough literature and resources. In this study the researcher faced some difficulties like unwillingness of customers and a few staff members to provide reliable information, however the researcher tried a lot to undertake the study by taking the challenges like problems in collecting data and unwillingness of some respondents as an opportunity and support by discussing with advisor and colleagues.

1.10 ORGANIZATION OF THE PAPER

The study was organized into five chapters. The next four chapters presented as follows:-

The second chapter briefly reviewed both conceptual and theoretical literatures about Non-performing loans, definitions of terms, studies conducted on the bank specific and non-bank specific causes of non-performing loan, empirical studies made both in the country and elsewhere in the world and lastly conceptual framework developed by the researcher.

The third chapter presents a brief description of the study area, research design, target population, sample size, sampling technique of the study and methodology employed for data collection and analysis. The collected data analyzed, discussed and presented in the chapter four of this study.

The last chapter presents summary of the study, conclusion and the recommendation, drawn from findings of the data in addition n with implications for further research.

1.11 ETHICAL CONSIDERATION

This research has been conducted only for academic purpose. Therefore, before conducting and collecting data, permission is obtained from the management of both offices formally as well as undertakes the study freely and confidentially by keeping the confidentiality of the bank, employees and customers.

CHAPTER TWO

REVIEW OF RELATED LITERATURES

2.1 INTRODUCTION

This chapter starts with presenting the definition of terms related to the study. Additionally, concepts relating to nonperforming loans are discussed. Following this, empirical studies are reviewed by focusing on the major causes of NPLs of these bank related causes, non-bank (customer) related and other causes are presented. Then after, the knowledge gaps from the reviewed literatures are outlined finally conceptual framework developed by the researcher presented.

2.2 DEFINITIONS OF TERMS

2.2.1 Performing Loans

Credit facility is defined to mean a contractual promise between two parties where one party, the creditor (lender) agrees to provide a sum of money to a debtor (borrower), who in turn promises to return the said amount to the creditor either in one lump or in installments over a specified period of time. The agreement may include provision of additional payment of rental charges on the funds advanced to the borrower (debtor) for the time the funds are in the hands of the debtor. The additional payments that are in the form of interest charges, processing fees, commissions, monitoring fees, among others, are usually paid in addition to the principal sum lent.

A loan /credit facility may therefore be considered as performing if payment of both the principal and interest charges is up to date as agreed between the lender and the borrower. As Per the National Bank of Ethiopia (NBE) classification, loans are considered current if the payment of principal and interest are up to date. It can therefore be deduced that loans that are up to date in terms of principal and interest payment are described as performing loans and they constitute the healthy asset portfolio.(NBE, 2008)

2.2.2 Nonperforming Loans (NPLs)

The term Non-Performing Loans is used interchangeably with Bad loans and impaired loans as identified in (Fofack, 2005). (Berger & De young 1997) also describes these types of loans as “problem loans” In broad context, loans that are outstanding in both interest and principal for a period of time contrary to terms and conditions spelt out in the loan agreement are considered as non-performing loans.

According to the International Monetary Funds (IMF) Compilation Guide on Financial Soundness Indicators (IMF,2005), non-performing loans is defined as” A loan is nonperforming when payments of interest and/or principal are past due by 90 days or more, or interest payments equal to 90 days or more have been capitalized, refinanced, or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons such as a debtor filing for bankruptcy to doubt that payments will be made in full (IMF, 2005).

Besides, the Ethiopian banking regulation also defines NPL as follows:”Non-performing Loans: -means 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".(NBE, Directive No.SBB/69/2018).

The classifications of loan based on the national bank of Ethiopia directives issued on November 2018, are:-

Pass: -Loans or advances which are fully protected by the current financial and paying capacity of the borrower and are not subject to criticism.

Special mention: - Loans or advances with pre-established repayment programs past due 30(thirty) days or more, but less than 90 (ninety) days.

Substandard: - Loans or advances with reestablished repayment programs past due 90 (ninety) days or more, but less than 180 (one hundred eighty) days.

Doubtful: - Loans or advances with pre-established repayment programs past due 180 (one hundred eighty) days or more, but less than 360 (three hundred sixty) days.

Loss: - Loans or advances with pre-established repayment programs past due 360 (three hundred sixty) days or more.

A non-performing loan is a loan that is in default or close to being in default. A loan is said to be in default when it fails to make the repayments of principal and /or interest specified in its loan contract and has no intention of repaying in the future (Pilbeam, 1998).

Generally, NPLs are loans that are outstanding both in its principal and interest for a long period of time contrary to the terms and conditions under the loan contract. Any loan facility that is not up to date in terms of payment of principal and interest contrary to the terms of the loan agreement is NPLs. Thus, the amount of non-performing loan measures the quality of a bank's assets (Tseganesh, 2012).

2.2.3 Credit Risk

Credit risk means the potential that a bank's borrower or counterparty will fail to meet its obligations in accordance with agreed terms. (DBE's Risk Management Policy, Jan., 2011)

2.2.4 Credit Risk Management

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

Mean the process of ensuring the systematic application of establishing the context, identifying, assessing, treating, monitoring and communicating risks with the objective of maintaining risk within the risk appetite of the Bank. (DBE's Risk Management Policy, Jan, 2011)

2.2.5 Follow up/Credit Monitoring

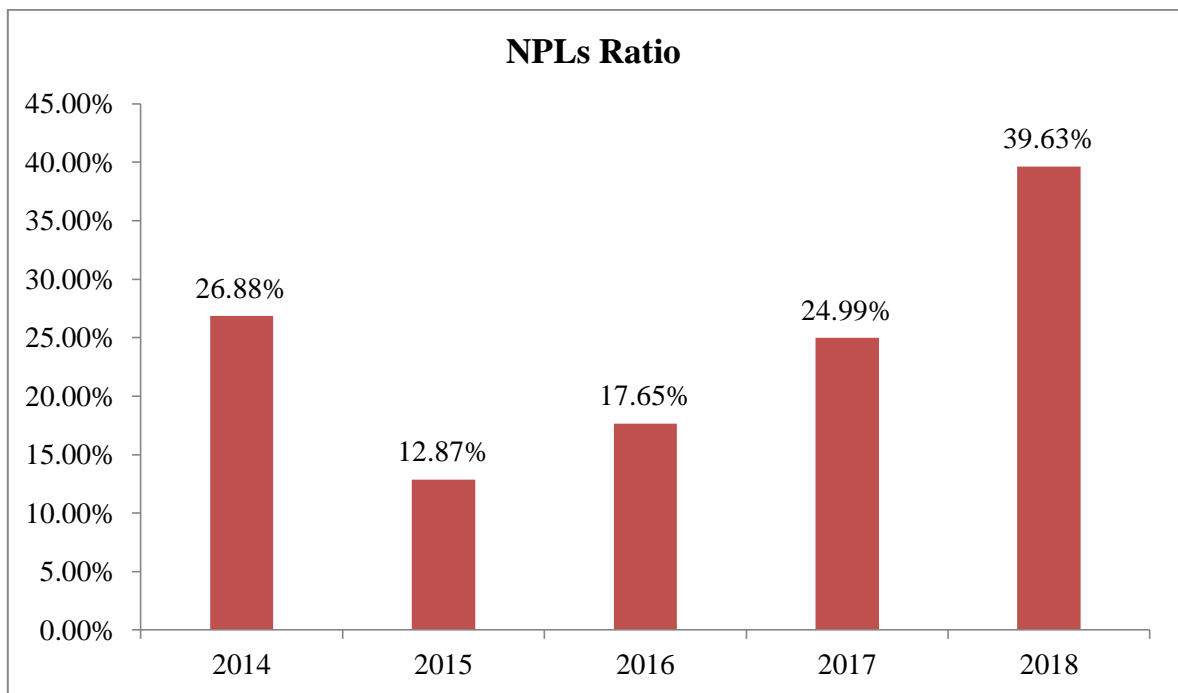
Follow-up or credit monitoring means bank officers checks the borrower's behavior of turnover, the information regarding the profitability, liquidity, cash flow situation, level of

security offered, insurance coverage of security and trend in sales in maintaining various ratios of the borrower to meet its timely obligation.

2.3 TREND OF DBE'S NPLs AS a WHOLE

In DBE loans are transferred to non-performing loans and categorized as substandard, doubtful and loss loans based on NBE Directive, No SBB/52/2012. The trend of NPLs in DBE shows has boosted from 2016/17 fiscal year ratio of NPLs stood at 25 percent the Bank's NPLs reached (NPL) ratio raised to 40 percent in 2017/18 from 12.8 percent in 2015. Figure 1 below illustrates trends of NPL ratio from 2014-2018 (Annual portfolio report of the bank, 2019).

Figure 2.1: Trend of DBE's NPLs from 2014 to 2018 G.C



Source: - DBE's Loan Portfolio Annual Reports, 2019

2.4 THEORETICAL REVIEW

The banking system may vary in different parts of the world; the reason for the variation may be due to features like social banking, low degree of technological sophistication and cumbersome legal system (Venugopal & Raghu, 2010).

Default culture is not a new dimension in the arena of investment. Rather in the present economic structure, it is an established culture. The redundancy of unusual happening becomes so frequent that it seems people prefer to be declared as defaulters (Sonali, 2001) cited by (Esayas, 2015).

In the last years the growing level of the NPLs in major banking system all over the world, especially in the Balkans countries, has encouraged different researchers to analyze the factors that influence the NPLs ratio. It is to mention that the high level of NPLs is translated into higher levels of credit risk and in some cases has lead to bankruptcies of the whole banking system or even the collapse of the financial system like: Asian crises of 1997 and Sub-Sahara African countries in the 1990'.

Non-Performing Loans (NPLs) are regressed on three sets of factors in terms of credit, banks size induced risk preference and macroeconomic shocks. The panel regression models show the terms of credit variables to be significant. The estimated coefficient on changes in the cost of credit because of expectations of higher interest rate is positive. On the contrary, a horizon of maturity of credit, better credit culture, and favorable macroeconomic and business conditions decrease the NPLs (Ranjan & Dhal, 2003).

2.4.1 Causes of non-performing loan

There are various reasons for loan default, and various researchers concluded different reasons behind default of loan-performing loan. The researcher reviewed major causes of non-performing loan concentrated on bank specific, customer specific and other causes of NPL.

2.4.1.1 Bank Specific Factors of Non-performing Loan

The following are some of the factors described bank specific causes as the following.

❖ Credit Monitoring or Follow-up

There are evidences in literature about poor monitoring, on the part of the banks, to be the main bank-specific factors behind creating NPLs.

Salas and Saurina (2002) are of the view that inefficient bank management causes NPLs. The loans are more secure if the banks keep a continuous check on the borrowers. The banks need to give their borrowers full attention, so they are not relaxed at any stage about repayment of their loans. It has been seen that less monitoring of borrowers leads to NPLs (Agresti et al, 2008).

❖ Credit Assessment

Making periodic assessment of the health of the loans and advances by noting 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.

Credit assessment is the most important safeguard to ensure the underlying quality of the credit being granted and is considered an essential element of credit risk management (Cade, 1999).

A credit analysis is used by the credit official to evaluate a borrower's character, capital, capacity, collateral and the cyclical aspect of the economy, or generally referred to as the five C's (Striscek, 2000).

2.4.1.2 Non-Bank/Customer specific factors of NPL

❖ Credit culture/orientation

A Study conducted by (Rajan & Dhal (2003) in India indicated that credit orientation significantly affects loan default. (Wondmagegnehu, 2012) in his study found out that due to underdevelopment of credit orientation /culture borrowers engaged in business that they

had no depth knowledge, diverted loans advanced for unintended purpose and at times made a willful default.

The socio economic underdevelopment of the country which is also associated with poor access to the formal banking, as depicted by higher bank branch to population ratio (NBE, 2011) meant that credit culture is yet to develop in Ethiopia. That was also why Ethiopian banks had a comparatively big NPL ratio. There is an Ethiopian proverb “either a borrower or a lender might die” indicating a borrower shouldn’t bother to repay borrowings. Thus cultural development has got a huge bearing on loan performance.

Customers related factors-: These are factors affecting loan repayment behavior of borrowers. Customer’s failure to disclose vital information during the application process leads to occurrence of non-performing loans (Brown, 1998).

❖ **Diversification of funds**

Diversification of funds occurs when the funds borrowed have to be used only for a particular or the purpose it was intended for Ashiq (2003) cited in Martha, 2017. Not using the funds for the primary purpose they were intended for and as such, many projects become halfway completed, in such case the funds were meant for an income generating project but the borrower decides to divert into a different business thus leading to loan default.

2.4.1.3 Other factors of Non-performing loan

❖ **Economic (Macroeconomic) Determinants of Non-performing Loans**

Several Studies have been conducted on the relation between macroeconomic determinants such as inflation, unemployment and interest rate and loan defaults. Some of the studies are the following.

(Farhan *et al.* 2012) on the title of “Economic Determinants of Non-Performing Loans: Perception of Pakistani Bankers” employed both primary and secondary data. The data was collected from 201 bankers who are involved in the lending decisions or handling nonperforming loans portfolio. Correlation and regression analysis was carried out to analyze the impact of selected independent variables. The variables included were interest

rate, energy crisis, unemployment, inflation, GDP growth, and exchange rate. The study found that, interest rate, energy crisis, unemployment, inflation and exchange rate has a significant positive relationship, Whereas GDP growth has insignificant negative relationship with the non-performing loans.

Similarly, (Shingjergji, 2013) on the study of “impact of bank specific factors on NPLs in Albanian banking system” concluded that, capital adequacy ratio, loan to asset ratio, net interest margin, and return on equity were considered as determinant factors of NPLs. The study has used simple regression model for the panel data from 2002 to 2012 period. The researcher found that capital adequacy ratio has negative but insignificant impact, whereas return on equity (ROE) and loan to asset ratio has a negative significant impact on NPLs. beside, total loan and net interest margin has positive significant relation with NPLs. The study justifies that an increase of the capital adequacy ratio (CAR) will cause a reduction of the NPLs ratio. Besides, an increase of ROE will determine a reduction of NPLs ratio.

Mileris (2012) studied on the title “Macroeconomic determinants of loan portfolio credit risk in banks” The study used multiple and polynomial regression models with cluster analysis, logistic regression and factor analysis for the prediction. The finding indicates that NPLs are highly dependent on macroeconomic factors.

❖ Marketing factors of Non-performing Loans

Bank marketing is the aggregate of functions, directed at providing services to satisfy customers’ financial (and other related) needs and wants, more effectively and efficiently than the competitor keeping in view the organizational objective (Uppal , 2010)

(Girma Seifu, 2017) in his study on the title of Impact of Bank Marketing Factors on Nonperforming Loans in Ethiopian Banking Industry validate that the bank marketing factors, namely: bank size, interest lending rate, loan size and unfair competition have direct influence on nonperforming loans in Ethiopian banking industry. Increase in these variables has direct relationship leading to an increase in nonperforming loan. Among these factors, bank size alone demonstrated highest influence while unfair competition showed lower influence on nonperforming loan in Ethiopian banking industry.

Those remaining bank marketing factors; knowledge and experience, customer relationship management and communication have exhibited inverse influence on nonperforming loans. Increase in these variables leads to decrease in nonperforming loans. Of these three factors; customer relationship management has significant influence on nonperforming loans in Ethiopian banking industry.

❖ **Political Causes of Non-performing Loans**

The researcher had not gotten yet handy study about political impacts towards non-performing loan in and outside the country. However, there was political instability from 2007 EC in different places of the country in Ethiopia. Most projects financed by the bank burned, stolen, and left without owner and forced to turn into non-performing loan. This concern commenced the researcher to assess political causes on non-performing loan. Furthermore the researcher tried to assess the political causes of NPL on open ended questions and included the respondents thought on result and discussion part of the study.

2.5 EMPIRICAL REVIEW

There are numerous numbers of empirical literatures on the study of determinants of nonperforming loan with external and bank specific analysis. Some of important studies that are relevant for this study are reviewed as follows:-

Jimenez & Saurina (2005) studied on the Spanish banking sector from 1984 to 2003 nonperforming loans are determined by lenient credit terms. The authors indicated that the causes for the leniency were attributed to disaster myopia, herd behavior, moral hazard and agency problems that may entice bank managers to take risk and lend excessively during boom periods.

In addition, Ahmed & Bashir (2013) study on the “Macroeconomic Determinants of Nonperforming Loan of Banking Sectors in Pakistan”: The study was conducted on 30 commercial banks from total of 34 banks. The major aspire of the study was to investigate the macroeconomic determinants impact of bad loan like inflation, credit growth, GDP growth rate, unemployment rate, consumer price index and lending/interest rate, on nonperforming loan. The study found out that negative effect of lending/interest rate and

GDP rate on NPLs. Their justification for negative association between lending rates and NPLs implies that as lending rate increase, individuals with funds starts saving with the banks to earn on their funds but investors with the profitable projects feel reluctant to borrow and invest. In the same way, their study on banks specific factor of NPLs of banking sectors in Pakistan, they found positive significant effect of ROA but insignificant effect of ROE on NPLs. Their justification for positive significant association between ROA and NPLs implies that in order to increase the short term earnings, banks management expose wrong picture to the investors relating the future profitability and positive return prospects. Consequently, investors start borrowing from the banks and invest in the less profitable projects. These results, in the current good performance and profitability of the banks, but because of the wrong forecasting, returns on the investments are not according to the investors' expectation, resulting in the inability of the investors in repayment of loans thus leading to the growth in NPLs.

Nzambi (2010) conducted a study on the significance of factors contributing to non-performing loans in commercial banks in Kenya, (A census of commercial banks in Nairobi), Kenyatta University. The study found out that other factors which lead to non-performing loans were; Know Your Customer (KYC), Security issues, Company mergers and interbank competition also from the study, the factor identified to have the highest contribution to NPLs problem was the borrower's company dissolution.

Martha N, (2017) Factors Affecting Non-Performing Loans:-A case study of KCB Bank Kenya Limited Nairobi Region. The study found out that the interest rates offered by the bank caused the non-performing loans in KCB bank, but bank size and credit size did not influence non-performing loans statistically. The study also concluded that customer related factors, gender and age did not significantly influence non-performing loans.

(Wondimagegnehu, 2012) in his study "determinants of NPLs on commercial banks of Ethiopia" exposed that underdeveloped credit culture, poor credit assessment, aggressive lending, botched loan monitoring, lenient credit terms and conditions, compromised integrity, weak institutional capacity, unfair competition among banks, willful defaults by borrowers and their knowledge limitation, fund diversion for unexpected purposes and overdue financing has a significant effect on NPLs. Conversely, the study indicated that

interest rate has no significant impact on the level of commercial banks loan delinquencies in Ethiopia.

(Gadise, 2014) in her explanatory study on the title of “determinants of nonperforming loans: an empirical study in case of commercial banks in Ethiopia” shows a descending slope of nonperforming loans for commercial banks in Ethiopia. The finding also discovered as loan to deposit ratio had positive, whereas inflation rate had negative, but insignificant effect on NPLs of commercial banks in Ethiopia. However, bank profitability measured in terms of return on equity, banks capital adequacy ratio and lending rate had negative and statistically significant effect whereas bank profitability measured in terms of return on asset (ROA) and effective tax rates had positive and statistically significant effect on NPLs of commercial banks in Ethiopia. And finally the researcher recommended as bank managers should emphasize the management of current assets and loans than fixed assets in order to reduce the level of nonperforming loans. Besides, it is better for the loan officers to provide financial counseling to the borrowers on the wise use of loan and also to make decision on timely fashion to meet their needs.

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

(Yetimgeta Abera, 2011) in his study indicates that, the impact of non-performing loans on the performance of financial institutions a case study in Development Bank of Ethiopia, the researcher used econometric models to make inference about some variables that explains non-performing loans. It is found that the effect of the amount of loan in arrear is significant and positively related with NPL and in addition, the variables, net income and

collection are negatively related to non-performing loans where as doubtful debt expenses and disbursements are positively related with nonperforming loans.

“Factors affecting non-performing loan to Development Bank of Ethiopia Dilla Branch” studied by (Kassahun Fiseha , 2013) found out that non-performing loans were caused by both internal and external factors. Internal factors such as poor credit policy, Weak credit analysis, poor credit monitoring and inadequate risk management. The researcher finding highlighted; external factor, namely natural disaster, market failure and integrity of the borrowers. Findings further indicated that non-performing loans have negatively affected the performance of the bank interims of profitability and liquidity. In addition to the above factors most of the borrowers do not use the loan for the intended purpose. As a result, diversion of fund or debt occurs. This diversion of fund might be used for non-productive purpose; the debtor will not be able to repay the loan, but from their analysis the researcher's does not exhaustively analyze the effects of institutional capacity, macro-economic instability, political turmoil, exchange rate devaluation, having a policy prone to loan default risk and, loan diversion to nonperforming loans rate

All these information can give clues in the area for users of this study. As indicated in the above, there are a number of empirical studies which has been undertaken about nonperforming loans in other commercial bank's including Development Bank of Ethiopia.

As a result, this attempted to examine exhaustively the major causes of the nonperforming loans in Development Bank of Ethiopia from both banks specific, customer’s specific causes of NPL and other factors causing NPL perspective using descriptive statistics. By doing so, it will fill the literature gap in the area and provides possible mitigation mechanisms for rise in nonperforming loans at Development Bank of Ethiopia.

2.6 SUMMARY OF LITERATURE REVIEW

Insight of the above discussions, numerous studies has been conducted on the determinants of non-performing loans. Most of these studies focused on bank specific and macro-economic determinants of NPLs. However, in the previous empirical analysis little study has been conducted on customer-specific factors influencing non-performing loans. Besides, most of the empirical studies reviewed and discussed in the above sections were

conducted in other countries; however very few studies have been carried out in Ethiopia as reviewed in the previous section.

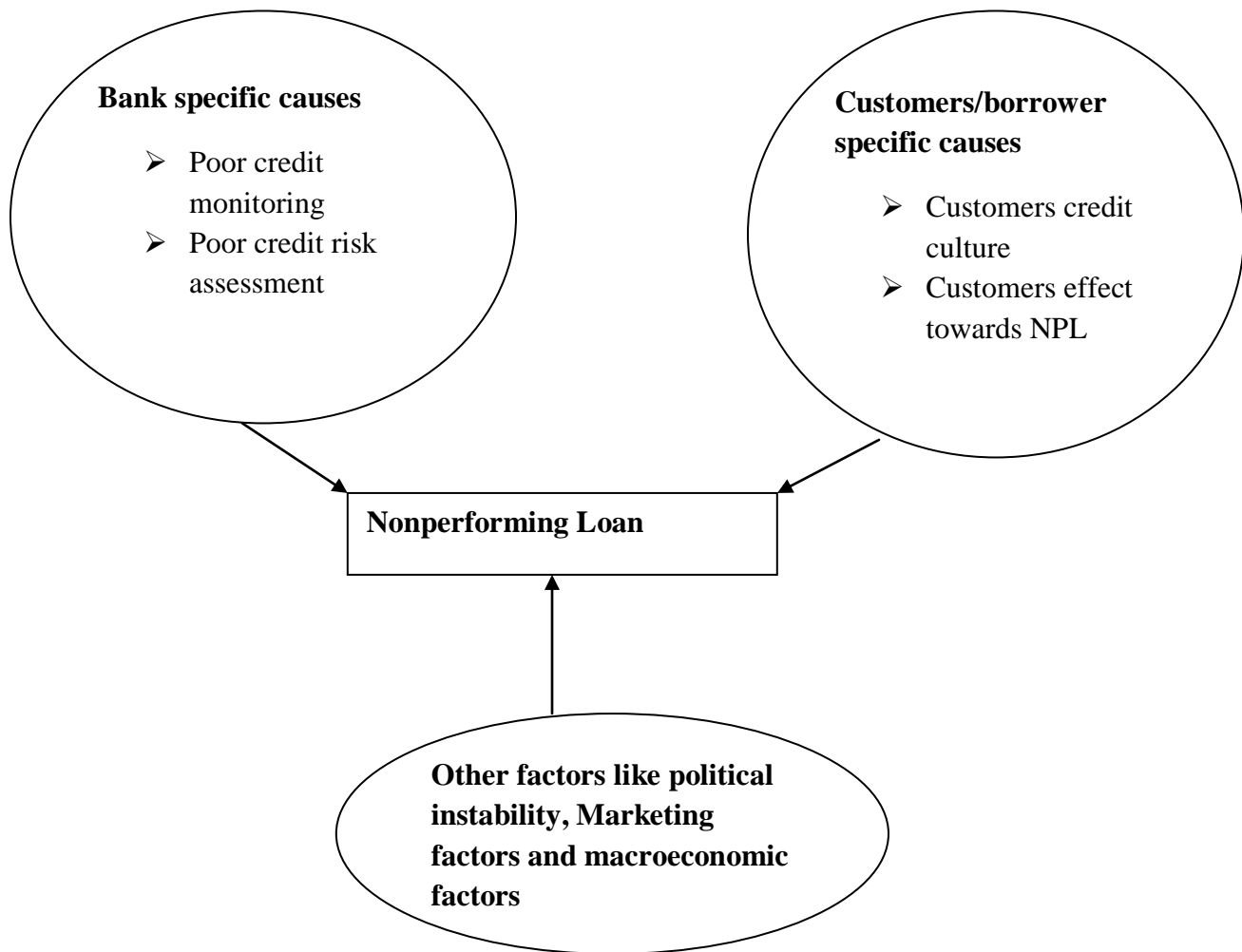
2.7 KNOWLEDGE GAP

Numerous researchers have done various research studies and most of them concentrated on the macroeconomic determinants and bank specific factors of NPLs. Since these factors, not only causing bad debt the fundamental nature of this study is to fill the knowledge gap by assessing the bank specific, customer-specific and other factors effects on non-performing loans (NPLs).

2.8 CONCEPTUAL FRAMEWORK

As emphasized previously, the main objective of the study is to assess the major bank specific, customer (borrower) specific and other causes contributes to the loan defaults in development bank of Ethiopia. In the literature review section, various concepts and aspects of non-performing loan have been addressed. Non-performing loans are affected by bank specific, customer specific and other factors as discussed in the literature review section above. Bank specific factors include the following: - Poor credit monitoring, poor credit risk assessment and customer/borrower specific factors are poor credit culture of customers and diversion of fund as mentioned above are concern of researcher. Therefore, the following conceptual model summarizes as the main focus of this study: - (Creswell, 2009) suggests that after summarizing and assembling the literature review, structuring it thematically or organizing it by important concepts to end the literature review is commendable. Accordingly, in observation of the various literatures reviewed in the foregoing section, the following conceptual framework is developed to provide a justification for the study.

Figure 2.2 Conceptual framework of the research



Source: - Developed by the researcher for this study, 2019

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3.1 INTRODUCTION

The following chapter describes the research methodology used to conduct the study of cause of non-performing loan and identified the knowledge gap in development bank of Ethiopia. It includes a study area, research design, sampling method, and sample size, method of data collection and analysis technique.

3.1.1 Description of the Study Area

The particular study area of this paper is on development bank of Ethiopia, which is one of public bank to identify the causes for the rise in non-performing loans. There are two classes selected for this study, these are Project Rehabilitation and Loan Recovery Directorate at head office and PRLR team at Addis Ababa District since projects under NPL entertained in this work units and customers also available on this work unit to acquire sufficient information.

3.2 RESEARCH DESIGN

The choice of research design depends on objectives that the researchers want to achieve (John, 2007) cited in (Wondim, 2015). The main objective of the study is to assess major causes of non-performing loan in DBE. To achieve the objective of the study the researcher used descriptive research design and both qualitative and quantitative data has been collected and analysis method used based on the degree of requirement. Thus the study utilized primary data through researcher self-administered structured questionnaires and secondary data from 2014 to 2018 period gained from annual banks' report.

3.3 POPULATION AND SAMPLING TECHNIQUE

The population is the complete set of individuals (subjects), objects or events having common observable characteristics in which the researcher is interested (Agyedu *et al.*,

1999). The target populations for primary data collection for this study were employees and project customers/borrowers from both head office and Addis Ababa district.

From the total population (both employees and customers) the researcher uses census to determine sample size for the study since the study focus on causes of NPL. That means the selection of the study area conducted on, from the perspectives of employees who are doing in loan process and borrower of the bank's whose projects under NPL which are approached for questioners to identify the major causes for the rise in nonperforming loans at development bank of Ethiopia. Therefore the researcher asked customers whose project under NPL and employees close to non-performing loan projects. Furthermore the selected projects in the bank were grouped under NPL status, but operational projects, whereas foreclosed, written-off and taken over projects not included for this study because it is difficult to acquire customers in this regard.

Table 3.1: The total customer population and employees were 34 and 45 respectively

Sample of employee respondents	Quantity	Sample of customer respondents	Quantity
Rehabilitation officers	27	Project manager	6
loan officers	6	Marketing managers of the project	9
Senior loan officers	7	Employees of the project	11
Team manager	4	Production managers	8
Attorney	1	Total	34
Total	45		

Source: - Survey result and researcher own computation, 2019

3.4 TYPE OF DATA AND INSTRUMENTS OF DATA COLLECTION

The data used for this study were both primary and secondary data. In order to collect the primary data, the researcher used self-administered and more close-ended and some open-ended structured questionnaires from staffs and the Bank's borrower/customers whose projects under NPL thus the researcher distributed totally seventy nine (79) questionnaires to employees and customers to collect primary data. A secondary data is less expensive in terms of time and money while collecting and also of its high quality data (Saunders et al, 2007) cited in (Martha, 2017). Moreover, secondary data gathered from the Bank's loan portfolio reports, from the banks different compiled documents (Planning report), and unpublished materials to examine how significantly increasing the bank's NPL ratio. There are twenty projects under rehabilitation work unit at head office and thirty seven credit officers, portfolio management staffs and legal affairs close to NPL and also fourteen projects (customers) and eight credit staffs/rehabilitation officers at Addis Ababa District, since non- performing loans of the bank is mainly entertain by the PRLR credit staffs rather than others. Therefore the researcher collected primary data from head office and Addis Ababa district since the population was a small population and implied that a census was more applicable and secondary data showing the five years NPL trends of the bank collected from Bank portfolio management annual report.

3.5 PROCEDURES OF DATA COLLECTION

Questionnaires sent to respondents and it explained briefly the purpose of the survey, the importance of the respondents' participation which encourages their responsibility for the survey, and a statement guaranteeing confidentiality finally expressed gratitude to the respondents at the end.

Questionnaires were self-administered. The self-administered questionnaires were easy to manage and answer by the respondents. It preserved the confidentiality of respondents and requested the respondent's willingness. The questionnaire has been administered in a standard manner.

3.6 DATA ANALYSIS

The raw data obtained from a study is useless unless it is transformed into information for the purpose of decision making (Emery & Couper, 2003). Information that collected from the respondents includes the socioeconomic characteristics such as gender, educational background of respondents and years of experience.

To assess and identify bank specific, customer specific and neither of the two factors of NPLs in DBE, the researcher employed descriptive statistics for the analysis by using tables, frequency, percentage and mean. The researcher used quantitative data analysis technique, the data collected from questionnaire survey were carefully coded and checked and entered into the statistical package for social studies (SPSS) spreadsheet. Open-ended questions also briefly analyzed and described in the discussion part of the study and secondary data were also collected from the bank's annual portfolio report for five years and illustrated to show how significantly increased the bank's bad loan ration.

CHAPTER FOUR

DATA ANALYSIS, RESULT AND DISCUSSION

4.1 INTRODUCTION

This chapter consists of data analysis and discussion of results in order to meet the research objectives and to enclose conclusion and recommendation. The aim of the study was the assessment of the major causes of non-performing loan in development bank of Ethiopia. Descriptive statistic for the study considered were minimum, maximum, mean, standard deviation.

4.2 ANALYSES ON THE RESPONSES OF RESPONDENTS

4.2.1 Survey response rate

Structured questionnaire (Appendix I) was distributed to thirty four customers whose projects under project rehabilitation and loan recovery and their status under NPL in both head office and Addis Ababa district and forty five employees these are rehabilitation officers, loan officers (loan portfolio officers), team managers and attorney officers. For the sake of simplifying the analyses and discussion the data from both respondent groups is presented sequentially.

Table 4.1:- Seventy nine questionnaires distributed to customers and employees and out of total distributed questionnaires the whole completed and collected (See table 4.1 below). Therefore, in this study response rate of respondents is 100% and it is more significant.

Table 4.1: Response rate survey

No	Respondents	Percent %
1	Sample size	79
2	Completed & returned questionnaires	79
	Response rate	100%

Source: - Survey result and researcher own computation, 2019

4.2.2 Profile of the respondents

As shown in the table 4.2 below the gender distribution of the respondents, 84.8% of the respondents are male while the remaining 15% are females. This distribution is consistent with the fact that women are represented poorly in both job and business as the ones this researcher has conducted to obtain the data from. As well as educational qualification of respondents are 62% are first degree holders, 36.7% are master's holders, 1.3% of respondent's diploma holders, and none of respondents hold doctorate degree (PhD). This figure explains that the majority of respondents of both employees and customers are educated. So these improve their excellence in order to execute their activity efficiently and effectively.

Table 4.2: Gender and Educational Background of Respondents

	Gender	Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Female	12	15.2	15.2	15.2
	Male	67	84.8	84.8	100.0
	Total	79	100.0	100.0	
	Educational Background	Frequency	Percent	Valid Percent	Cumulative Percent
	Diploma	1	1.3	1.3	1.3
	Degree	49	62.0	62.0	63.3
	Masters	29	36.7	36.7	100.0
	Total	79	100.0	100.0	

Source:-Survey result and researcher own computation, 2019

Table 4.3 below presented in terms of respondents work experience on the Bank, the survey indicates that the minimum and maximum working experiences of the respondents were 2 and 19 years, respectively. From this, 27 of the respondents or 34.2% had 3-5 years of banking experience, 14 of them which are 17.7% had 6-8 years' experience, and the rest 37 or 46.8% had more than eight years of experience in both bank and business this clearly shows that respondents had sufficient experience and opportunity to identify the major bank specific and non-bank specific causes of non-performing loan in development bank of Ethiopia.

Table 4.3: Working experience of respondents

	Working Experience	Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Less than two	1	1.3	1.3	1.3
	3-5	27	34.2	34.2	35.4
	6-8	14	17.7	17.7	53.2
	Greater than 8	37	46.8	46.8	100.0
	Total	79	100.0	100.0	

Source: - Survey outcome and own computation, 2019

The respondent's position in the table 4.4 below indicates that out of the total 79 respondents, 45 are employees of these, 27 of the employees 60% were project rehabilitation and loan recovery officers, 6 loan officers, which is 13.3%, 7 were senior loan officers 15.6%, 4 team managers which is 8.9%, and 1 legal attorney 1% which is 2.2% from the bank employees. This shows that respondents had sufficient information related to the objective of the study and this definitely helps the researcher to obtain more interrelated and reliable data for the study.

Table 4.4: Position of employee respondents

	Position of employees	Frequency	Percent	Valid Percent
Valid	Rehab officers	27	60.0	60.0
	Loan officers	6	13.3	13.3
	Senior loan officers	7	15.6	15.6
	Team manager	4	8.9	8.9
	Attorney	1	2.2	2.2
Total		45	100.0	100.0

Source: - Survey outcome and own computation, 2019

Table 4.5 below shows that from the total 34 customers respondents 6 are project managers of which 17.6%, 8 production managers from the total 23.5%, of 11 employees of project that hold 32.4% and 9 marketing managers which is 26.5% of the projects. This indicates that customers had sufficient experience in business and it's believed that they collaborate by providing reliable data towards causes of bad loan.

Table 4.5: Position of customer respondent

		Frequency	Percent	Valid Percent
Valid	Project managers	6	17.6	17.6
	Production managers	8	23.5	23.5
	Employees of the Project	11	32.4	32.4
	Marketing managers of the project	9	26.5	26.5
	Total	34	100.0	100.0

Source: - Survey outcome and own computation, 2019

4.3 RESPONSES TO FACTORS THAT CAUSE NONPERFORMING LOAN IN DEVELOPMENT BANK OF ETHIOPIA

According to the Table 4.6 above respondents were expected to rank above listed factors in order of their role contributing for the occurrence of nonperforming loan in development bank of Ethiopia? Hence the finding of the result for factors that contribution for the increasing rate of NPL in DBE listed below.

Therefore, out of the total respondents 87.5% of respondents shared poor credit monitoring of the bank contributing highest level as a factor for nonperforming loan of DBE 48 respondents which is 60% of respondents agreed gave political instability that occurred in different parts of the country contributing the second major cause of nonperforming loan in DBE next to poor credit monitoring, 62 of respondents which is 77.5% shared poor credit risk assessment of the bank contributing third level for the major cause, 63 respondents

78.8% of respondents gave Customers credit attitude/culture contributing for the fourth major cause, 65 respondents, 81.3% of respondents agreed macroeconomic factors less contributed to NPL and Finally 56 respondents 36.7 of respondents 70% from the total shared marketing factors has low contribution factor for the cause of nonperforming loan in DBE.

Table 4.6: Rank the factors of NPL

S/N	Factors which causes Non-performing Loan	1=Highest.....6=Lowest
1	Poor credit monitoring of the bank	87.5% ranked 1 st
2	Macroeconomic factors	81.3% ranked 5 th
3	Customers credit attitude/culture	78.8% ranked 4 th
4	Poor credit risk assessment	77.5% ranked 3 rd
5	Political Instability	60% ranked 2 nd
6	Marketing Factors	70% ranked 6 th

Source: - Survey outcome and own computation, 2019

Besides, the respondents were asked to rank the factors causing NPLs in DBE. Accordingly, poor monitoring/follow-up was considered by the majority as the primary factor causing for the occurrences of nonperforming loans while political instability was ranked second. Poor credit risk assessment was ranked as the third influential factor. On the other hand, Customers credit attitude/culture was ranked as the fourth important factor to cause occurrence of nonperforming loans. Whereas, Macroeconomic factor mentioned in the table was ranked as the fifth relevant factors causing for NPL. Finally, marketing factors have been ranked as the sixth and final influential factor to cause for loan default. (See table 7 below). Hence the bank should adjust its monitoring/follow-up assessment, its credit risk assessment and customer related causes by strictly following the default loan and defaulters of credit to keep the health of the bank.

The descriptive statistics of the mean scores and standard deviation of 79 attribute were discussed in the following subsequent tables in each categories. The interpretation was made based on the following measurement scale intervals or ranges., Means value 1.31 strongly agreed that Poor credit monitoring of the bank usually cause loan default, Mean value 3.16 agreed Political instability the second major cause to NPL, Mean value 3.24 agreed Poor credit risk assessment causes loan default, Customers credit attitude/culture with mean value 3.69 agree the fourth factor to bad loans, and Macroeconomic factors with 4.5696 mean value and finally Marketing factors 5.08 mean value agreed fifth and six factors to nonperforming loan in development bank of Ethiopia.

Table 4.7: Factors which cause NPL in DBE

	Minimum	Maximum	Mean	Std. Deviation	Rank
Poor credit monitoring of the bank	1.00	6.00	1.3165	1.00695	1
Macroeconomic factors	1.00	6.00	4.5696	1.13999	5
Customers credit attitude/culture	1.00	6.00	3.6962	.70446	4
Poor credit risk assessment	1.00	6.00	3.2405	.86551	3
Political instability	1.00	6.00	3.1646	1.65971	2
Marketing factors	1.00	6.00	5.0886	1.58672	6

Source: - Survey outcome and own computation, 2019

The study tried to compute the rate of the nonperforming loan ratio of development bank of Ethiopia. The study required respondents to show their agreement or disagreement with certain statements dealing with rate of nonperforming loan of development bank of Ethiopia. Examining the results of the study, 75.9% of respondents strongly agreed to the statement “rate of nonperforming loan ratio of development bank of Ethiopia is high”, 15.2% the respondents agreed and the rest 8.9% were neutral about it and this enable the researcher to proceed the study since the NPL of the bank obvious and an alarming issue and to obtain sufficient and reliable data from the respondents to assess the major cause of DBE’s arrears loan.

4.4 RESPONSES TO THE CAUSES OF NPL IN DEVELOPMENT BANK OF ETHIOPIA

4.4.1 Bank related factors of NPL

The study tries to examine the factors that affect NPLs in DBE. Based on different studies held in the different countries about the major factors of bank bad loan, factors that influence NPL can be categorized into two major causes: these are bank specific causes (on the bank side) and customer related causes. The researcher asked respondents to show their level of agreement or disagreement to certain statements dealing with bank specific factors affecting occurrences of nonperforming loans. Therefore, the study required respondents (both employees and customers) to provide their experience and view about bank specific causes towards the occurrence of nonperforming loans. Thus the respondent provided their opinion as percent of agreement and disagreement regarding the factors affecting the occurrence of NPL in DBE as illustrated in table 4.9. Accordingly, 96.1 percent of the respondents agreed with the mean score of 1.43 agreed with the fact that poor follow up and monitoring of a project play a major role in the occurrence of nonperforming loans in DBE while 85 percent of them with mean of 1.82 agreed that insufficient or improper know your customer (KYC) influence the occurrence of nonperforming loans in DBE on the second rank and poor credit appraisal ranks third level which is 73.3 percent with mean of 1.91 by the respondents and poor credit advice and consultancy of customers ranked fourth level by 59 percent of agreement mean 2.41. The respondents also agreed that under/over financing of projects would lead to NPL in DBE by 51.85 percent agreements and the mean 2.67. On the other hand, 3.79 percent of the respondents have neutral insight regarding the impact of poor follow up for NPL; whereas none of them selects neutral about the influence of improper know your customer (KYC) to NPL in DBE (Table 4.9).

On the contrary, inefficient knowledge/experience of credit service employees is perceived to not to cause as NPL as evidenced by above average number, 73.4% of respondents disagree and strongly disagree with the mean value of 3.87.

Whereas, 13.9% and 32.9% of respondents agreed neutral regarding inefficient knowledge/experience of credit service employees & loan manual and policy of the bank as a cause of NPL in DBE respectively. Therefore, it can be stated that poor follow-up/monitoring and Inefficient knowledge and experience of credit service employees 1st and 2nd as a major bank specific cause for nonperforming loan in development bank of Ethiopia. Bank related factors as described in literature part of the study are internal factors which can be controlled under firm level and as the survey above indicated the major cause of DBE's bad loan accumulation is because of the bank's poor credit monitoring/follow-up assessment , inefficient/improper KYC study and credit assessment policies of the bank plays a great role. The bank should review its credit monitoring/follow-up, KYC and credit assessment to collect its arrears loan, to rehabilitate NPL projects and turn into performing loan.

Table 4.9: Bank specific causes of NPL in DBE

No	Bank specific factors that causes the occurrence of NPL	Strongly agree		Agree		Neutral		Disagree		Strongly disagree		Mean	St.Dev
		freq.	%	freq.	%	freq.	%	freq.	%	freq.	%		
1	Poor follow-up/monitoring is directly related to occurrence of NPL	48	60.75	28	35.44	3	3.79	0	0	0	0	1.43	0.67
2	Poor credit appraisal are the cause of NPL in DBE	37	46.9	21	26.5	12	15.1	9	11.4	0	0	1.91	1.04
3	Inefficient knowledge and experience of credit service employees	5	6.3	5	6.3	11	13.9	32	40.5	26	32.9	3.87	1.13
4	Inefficient/improper know your customer(KYC) study of the bank	39	49.3	29	36.7	0	0	8	10.2	3	3.79	1.82	1.1
5	Poor credit advice and consultancy of customer	20	25.3	27	34.17	17	21.5	10	12.6	5	6.3	2.41	1.16
6	Under/over financing of projects	16	20.25	25	31.64	15	18.98	15	18.98	8	10.12	2.67	1.2
7	Loan manual and policy of the bank	11	13.9	12	15.8	26	32.9	21	26.5	9	11.4	3.06	1.04

Source: - Survey outcome and own computation, 2019

4.4.2 Customer Specific causes of nonperforming loan

In addition to bank related factors for the occurrence of NPL in DBE, respondents were asked to identify the cause customer/borrower related factors of NPL in DBE. The responses of respondents in this regard are summarized in Table 4.10. Among this factors for the occurrence of NPL in DBE, the response indicates that there is a highly relationship between NPL and Diversion of loan fund, knowledge and experience of customers about project management. About 80.95 and 70.1% of the respondent agreed that diversion of granted loan and used it for unintended purpose and insufficient knowledge and experience of customers about project management could be the result of loan default in DBE with the mean value of 2.01 and 2.07, respectively. Weak project management capacity of the borrowers ranked third by 67.3% of the respondents' agreement mean 2.22. On the other hand, only less than 20 % of respondents agreed that having a large number of borrowers and Carelessness and dishonest of customers about credit could influence for the occurrence NPL in DBE. This indicates the influence of large number of borrowers and Carelessness and dishonest of customers about credit on NPL is very small. Customers related are factors affecting loan repayment behavior of borrowers. Customer's failure to disclose vital information during the application process leads to occurrence of non-performing loans as the study found customer related causes like diverting the approved loan for unintended purpose, insufficient knowledge and experience of customers and weak project management capacity of borrowers were the major customer related causes to the bank's bad loan accumulation, and incremental of defaulter customers and unconvinced to collect the disbursed loan. So this indicates the bank should strictly monitor its loan and borrowers, should revise its follow-up assessment policy, strictly assess the know your customer study during customers apply to a loan, should identify the customers commitment and experience in-depth, should take immediate legal action on borrowers who divert the loan for another business and teach other from this and finally collaborate with borrowers to collect the arrears loan and keep the bank from bankruptcy.

Table 4.10:- Customer specific causes of NPL in DBE

No	Customer related causes of NPL in DBE	Strongly agree		Agree		Neutral		Disagree		Strongly disagree		Mean	St.Dev
		freq	%	freq	%	freq	%	freq	%	freq	%		
1	Carelessness and dishonest of customers about credit	12	15.8	5	6.32	40	50.6	22	27.8	0	0	2.9	0.97
2	Insufficient knowledge and experience of customers about project management	24	30.7	32	40.4	16	20.2	7	8.8	0	0	2.07	0.93
3	Diversion of loan fund	19	24.05	45	56.9	11	13.9	4	5.06	0	0	2.01	0.76
4	Easily admitted borrowers	11	13.9	16	20.25	29	36.7	16	20.2	7	8.8	2.89	1.15
5	Customers negative attitude towards credit	16	20.25	15	18.9	21	26.5	19	24.05	8	10.2	2.88	1.3
6	Weak project management capacity of borrowers	21	25.5	33	41.7	14	17.7	8	10.2	3	3.79	2.22	1.07
7	Having large number of borrowers	5	6.32	9	11.4	49	62	4	5.06	12	15.18	3.11	1.02
8	Exaggerated feasibility study	12	12.6	26	7.59	24	36.7	12	26.5	5	16.4	2.64	1.1
9	Uncomfortable working conditions of customers/borrowers	10	12.6	6	7.59	29	36.73	21	26.5	13	16.4	3.31	1.19

Source: - Survey outcome and own computation, 2019

4.5 RESPONSES TO OPEN ENDED QUESTIONS

In order to get a deep understanding about banks specific, borrowers specific and other factors causing non-performing loans in DBE, open ended questions were also included. According to the respondents' reflection, there are many factors described that contributing to the occurrence of NPLs in DBE. But it is classified by major three factors viz., Bank related, borrowers (customer) related and other general factors. Similarly, different studies (Bercoff et al 2002) concludes that, among many other factors affecting NPL in different banks, Bank specific and borrowers related are the major influencing factor influencing NPL. Though some of the factors that already ranked as major factors of NPL by structured questions by the respondents, there are still other factors for the occurrence of NPLs in DBE presented by the respondents as the following.

4.5.1 Bank specific factors

The following are the factors raised frequently by the respondents as the bank specific factors:

- ✓ Poor follow-up/monitoring is the first determinant factors of NPL
- ✓ Lack/improper of in depth know your customer (KYC) study of the bank
- ✓ Poor credit advice and consultancy, customer
- ✓ Outdated loan manual policy of the bank
- ✓ Project implementation delays

4.5.2 Customer related factors

These are factors that come from borrowers/customers which have a strong relation with the occurrence of the NPL or loan default in DBE. The following are some of the factors commonly given by more than 50% of the respondents with open ended questions.

- ✓ Diversion of funds: 80% of the respondents strongly believe that the use of funds for unplanned purpose is one of the major reasons for the occurrence of the NPL in DBE. Using the granted fund for other unintended purpose leads cash flow fail and in turn results loan default.

- ✓ Business management problems/weak project management of the borrowers- most of the projects with family owned businesses faced inexperienced and untrained project managers that may leads project failure
- ✓ Poor awareness of customers about the Bank's credit terms, policy and other credit related issues
- ✓ Exaggerated feasibility study by customers to obtain over planned finance or loan.
- ✓ Market problem due to poor linkage of borrowers with different stakeholders, dealers and international market agents.

4.5.3 Other/external factors

The study also assessed other factors of nonperforming loans in DBE and to have bottomless understanding about NPL. Therefore, subjective/ open ended questions were provided for Respondents indicated that several factors contribute to loan default and occurrence of NPLs in DBE; based on outcome of the analysis of the respondents, the factors have been summarized and presented as follows

- ✓ Poor credit culture of the community play a great role for the accumulations of bad loans.
- ✓ Macroeconomic factors like inflation, interest rate, market problems.
- ✓ Political instability: most of the respondents (84%) provide attention for political instability as the factors for the occurrence of NPL in DBE. Most of them explained that, political instability becomes one of the major external factors of NPL in DBE specially the last four years.
- ✓ Loan default due to poor weather condition: as some of the respondents explained that, poor weather condition like drought, excessive rain or less rain and others could lead to project fail of agricultural based projects

A number of projects were burned by protestors during the time of unrest held in different part of the country in the last four years. Therefore, the owners of the project were forced to leave the country rather than settling the loan. These factors distress highly the projects/borrowers of the bank, protect them from performing well and paying the loan based on repayment schedule contract and finally turned to nonperforming loans.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5 INTRODUCTION

These chapters summarize the study and formulate conclusions based on the findings. The recommendations of the study and areas for further research are also presented. This section presents the findings from other studies in comparison to what other scholars have said as noted under literature review. Finally, this chapter is organized into the following sub-sections; Introduction, The summary of the findings, conclusion, recommendations and Suggestions for further studies.

5.1 SUMMARY OF FINDINGS

The main objective of the study was to assess the major causes affecting non-performing loans of DBE in Ethiopia. The study used both primary and secondary data. Primary collected data using a structured questionnaire including open-ended questions. Secondary data covered for the period from 2014-2018. Credit monitoring/follow up and credit risk assessment were found as bank specific causes and customers credit culture & diversion of loan as customer specific causes and other causes assessed were like macroeconomic, marketing and political instability effects towards NPL in DBE. The study used descriptive statistics techniques to analyze the data obtained.

The results indicated that among the bank specific factors that accounted for the incidence of NPLs, poor credit monitoring/follow up is the major cause of NPL in DBE and Inefficient/improper know your customer assessment of the bank, Poor credit appraisal, and poor credit advice and consultancy of customer ranked second, third, and forth, respectively as the cause for the occurrence of NPL in DBE.

In addition customer's related causes that the result showed diversion of loan fund, knowledge and experience of customers about project management and weak project management capacity of the borrowers were the major factors of NPL in DBE.

5.2 CONCLUSIONS

Based on the findings from secondary data, the average ratio of non-performing loans in the bank for the last five years (2014-2018) was high as 39.43%, which is very high compared to the acceptable standard of 15% of the total loan outstanding set by the Association of African Development Finance Institutions. Evidences from the different study shows that NPL is found to be one of the major critical factors that adversely affect the overall performance of the bank.

Assessing the causes of NPLs is very important for planning appropriate measures to enhance the bank asset quality. Therefore, the aim of this study was to assess the causes of nonperforming loans related to bank specific causes, customer related causes and other factors. For this study data was collected from both primary and secondary sources. Structured and open ended questionnaires were the main source of primary data collection from sample respondents. Descriptive analysis using SPSS were used to analyze the data. Hence, the following conclusions are presented.

Among the bank specific factors that accounted for the incidence of NPLs, it was found out from the study conducted that poor credit monitoring/follow up (96.1%) is the major cause of NPL in DBE. The result also shows that Inefficient/improper know your customer assessment of the bank, Poor credit appraisal, and poor credit advice and consultancy of customer ranked second, third, and fourth, respectively as the cause for the occurrence of NPL in DBE. This implies that the bank should modify credit monitoring or follow up system to creditworthiness and project capacity to repay a loan and the risk associated with the loan. The result is in line with the study carried out by Arega et al (2016), entitle "factors affecting non-performing loans: Case Study on Development Bank of Ethiopia Central Region" concluded that factors such as; weak monitoring and follow up the project and inadequate risk management have influence towards non-performing loans.

Regarding customer's related factors, the result also shows that diversion of loan fund, knowledge and experience of customers about project management and weak project management capacity of the borrowers were the major factors of NPL in DBE. This finding is also consistent with the result of Wondimagegnehu (2012) concluded that willful defaults by borrower insufficient knowledge and experience of the borrowers about project management, fund diversion for unintended purposes and overdue financing has a significant effect on NPLs. This indicates that like to bank specific factor, customers' specific factors has a significant impact on NPL. From the study it is also concluded that political instability, macroeconomic factors, poor credit culture of the community and loan default due to poor weather condition are the main external factors that found out as the cause of NPL.

From the result of open ended subjective question also concluded that Poor project follow up activities in the bank, poor credit appraisal (analysis), less know your customer study of the bank (KYC) assessment on credit applicants, Poor credit advice and consultancy to customers, outdated loan manual policy of the bank and over/under financing found as major bank specific factors for occurrence of nonperforming loan DBE whereas diversion of funds, weak business/project management of the borrowers and exaggerated feasibility study during establishment of the business were among the non-bank (borrowers related) causes of NPL.

Analysis of open ended subjective question also concluded that the following factors as major factors for occurrence of NPLs in DBE: Poor credit monitoring/follow up system of the bank, outdated loan manual policy of the bank ,political instability occurred in most parts of the country for the last three years main reason behind for failure of projects and turned to NPL, customers credit culture towards loan, poor credit risk assessment of the bank, unfortunate know your customer (KYC) assessment during credit application, lack of willingness of borrowers to pay the loan until they get 30 days reminder letter are major findings for the occurrence of NPL in DBE that discussed in open-ended questions. The major bank specific and customer specific causes of NPLs especially borrowers related factors identified by responses of open ended question are similar to findings of structured questioners.

5.3 RECOMMENDATIONS

Based on the findings mentioned above, the following recommendations are suggested to identify the cause of nonperforming loans in Development bank of Ethiopia.

- Bank should have adequate and reliable information about clients, should update its credit loan manual & policy, and conduct appropriate credit appraisal study before loan disbursed, and train their customers on business, management and financial, entrepreneurships and handling.
- The bank should put proper credit evaluations process, and this should be based on evaluation objective and the project also should be economically viable and technically feasible and environmental friendly.
- Banks should develop regularly review and monitor their performance and policies related to the NPL management framework. The management body should review these policies and processes at least annually and proceed with any necessary amendments.
- The impact of external factors such as natural disasters, political instability and market failure should be considered seriously during the credit assessment process.
- The bank needs to make physically powerful follow-up whether the disbursed funds are being used for the intended purpose or not through enhanced timely credit monitoring after the loan is being released.
- The bank should attempt a lot in improving its loan quality by strengthening its loan follow up/monitoring system, undertaking regular and continuous project follow up on active projects in order to identify defaulters and to take timely action based on the follow up report.
- Future researchers may be interested to asses other influencing factors for the occurrence of NPL that were not included in this study.

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V. APPENDIX I



St Mary University

School of Master's program

Master of Business Administration

Dear Respondent,

Greetings for the day,

This questionnaire is prepared to conduct research for the title "Assessment of the causes of non-performing loan in the case of Development Bank of Ethiopia, at Head office and Addis Ababa District". The main objective of this paper is for the partial fulfillment of master's degree from St Mary University.

Thank you very much for your willingness by taking time to respond all information given by you will be kept confidential and will be used for research. Your cooperation will be highly appreciated.

Instruction

- ❖ No need of writing your name
- ❖ Your confidentiality maintained sincerely
- ❖ Use √ up on given choices alternatives.

Kalkidan Abebe

09-15-86-09-56

Questionnaire

Section One:-Background of the respondent

1. Please indicate your Gender

Male

Female

2. What is your level of education background that you have attained?

Diploma

Degree

Masters

Doctorate

If others -----

3. For how long you have been working in DBE? **(For staffs only)**

0-2 years

3-5 years

6-8 years

More than 8 years

4. For how long you have been working on this business? **(For customers only)**

0-2 years

3-5 years

6-8 years

More than 8 years

5. Where are you working now? (For staff only)

A. Head office

B. Addis Ababa District

6. In which position you are working now?

Section Two: - Questions on the CAUSES OF NON PERFORMING LOANS

7. Rank below listed factors in order of their role in contributing for the occurrence of Non-performing loan?

S/N	Factors which causes Non-performing Loan	1=Highest.....6=Lowest
1	Poor credit monitoring of the bank	
2	Macroeconomic factors	
3	Customers credit attitude/culture	
4	Poor credit risk assessment	
5	Political Instability	
6	Marketing Factors	

Discuss briefly how the following factors influencing NPL?

A. Poor Credit Monitoring of the bank?

B. Macroeconomic factors

C. Customers Credit attitude/culture?

D. Political Instability?

E. Marketing Factors?

F. Poor Credit risk assessment?

G. Discuss if others?

8. Please indicate your degree of agreement or disagreement to the statements pertaining to Non-performing loan ratio in DBE is high?

S/N	Causes of NPL	Strongly Agree (1)	Agree (2)	Neutral (3)	Disagree (4)	Strongly Disagree (5)
1	Non-performing loan ratio in DBE is High					

- 9 What Bank specific factors do you think are causing the occurrence of nonperforming loans in DBE?
-
-

- 10 Please indicate your degree of agreement or disagreement to the statements pertaining to bank related causes of Non-performing loan?

S/N	Causes of NPL	Strongly Agree (1)	Agree (2)	Neutral (3)	Disagree (4)	Strongly Disagree (5)
1	Poor follow up/monitoring is directly related to occurrence of nonperforming loans					
2	Poor credit appraisal are the causes of NPL in DBE					
3	Insufficient knowledge and experience of credit service employees					
4	Inefficient/improper know your customer (KYC) study of the bank					
5	Poor credit advice and consultancy of customers					
6	Under/over financing of projects					
7	Loan manual policy of the bank					

11 What customer's/borrowers specific causes do you think are causing the occurrence of Nonperforming loans in DBE?

12 Please indicate your degree of agreement or disagreement to the statements pertaining to customer specific factors and the occurrence of NPL

S/N	Causes of NPL in DBE	Strongly Agree (1)	Agree (2)	Neutral (3)	Disagree (4)	Strongly Disagree (5)
1	Carelessness and dishonesty of customers for credit					
2	Insufficient knowledge and experience of customers about credit					
3	Diversion of fund for unintended purpose					
4	Easily admitted borrowers are defaulter					
5	Customers negative attitude towards credit					
6	Weak project management capacity of borrowers					
7	Having large number of borrowers					
8	Exaggerated feasibility study					
9	Uncomfortable working condition of customers/borrowers					

13 Please state other causes neither bank specific nor customer's related causes for the occurrence of NPL on DBE's loan portfolio.

End of the questionnaire

Thank You