



**ST. MARY'S UNIVERSITY  
SCHOOL OF POST-GRADUATE STUDIES  
FACULTY OF BUSINESS AND ECONOMICS  
MASTER OF BUSINESS ADMINISTRATION PROGRAM**

**ASSESSMENT OF THE FACTORS AND PRACTICE OF NON-  
PERFORMING LOAN IN DEVELOPMENT BANK OF  
ETHIOPIA, ADDIS ABABA**

**BY:-**

**BETHLEHEM DESALEGN**

**JUNE, 2023**

**ADDIS ABABA, ETHIOPIA**



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**ID/NO/ SGS/0173/2014A**

A THESIS SUBMITTED TO THE SCHOOL OF GRADUATE STUDIES OF ST. MARRY  
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DEGREE OF MASTERS OF BUSINESS ADMINISTRATION

**ADVISOR:** DEMISSIE H / GEBREAL (PHD)

JUNE, 2023

ADDIS ABABA, ETHIOPIA

## DECLARATION

### Candidate's Declaration

I, **Bethlehem Desalegn**, the under signed, declare that this thesis entitled: that “**Assessment of the factors and practice of non-performing loan in Development Bank of Ethiopia, Addis Ababa**” is my original work. I have undertaken the research work independently with the guidance and support of the research supervisor. This study has not been submitted for any degree or diploma program in this or any other institutions and that all sources of materials used for the thesis has been duly acknowledged.

Candidate's Name: **Bethlehem Desalegn**

Signature: \_\_\_\_\_ Date: \_\_\_\_\_

### Supervisor's Declaration

I hereby declare this the preparation and presentation of the thesis were supervised in accordance with the guidelines on supervision of thesis laid down by ST. Marry university.

Supervisor's Name: Demissie H / Gebreal (PhD).

Signature:  Date: June 15, 2023

June, 2023

Addis Ababa, Ethiopia

**ST. MARY'S UNIVERSITY  
SCHOOL OF GRADUATE STUDIES  
MASTERS BUSINESS ADMINISTRATION**

**Assessment of the factors and practice of non-performing loan in  
development bank of Ethiopia, Addis Ababa**

**APPROVED BY BOARD OF EXAMINERS**

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**June, 2023**

**Addis Ababa, Ethiopia**

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## **LIST OF ACRONYMS**

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 was conducted assess the factors and practice of non-performing loan (NPL) in Development Bank of Ethiopia, more specifically assessed bank specific factors (Credit monitoring, Credit assessment) customers related factors (loan diversion, customers orientation or attitude towards non-performing loan) and external factors(macroeconomic, marketing factors and political instability) as 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, questionnaires from seventy nine staffs and customers of the bank at both head office and Addis Ababa district,. 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. Based on the findings of secondary data from DBE **the result** indicated that the Bank's NPLs stood at 24.1% by the end of June 2019/2020; the Bank's NPLs stood at 26.13% by the end of June 2020/2021; NPL of year 2021/2022 (G.C) (2014 E.C) was 19.27. 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 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 questionnaires and found poor credit monitoring, political instability, credit culture of customer's, macroeconomic factors and marketing factors causes accumulation of bad loan. The **study recommended** that DBE should reduce its high non-performing loans to blow 15% by working on factors identified by this study that cause NPL such as bank specific factors and customer's related factors that causes NPL.*

**Keywords:** Non-performing loan, Development Bank of Ethiopia, Factors



## CHAPTER ONE

### INTRODUCTION

#### Overview

This chapter presents the background of the study that gives some insight on the issues of nonperforming loans, 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.

#### ***1.1. Background of the study***

As worldwide, the banking business, compared to other types of business, is substantially exposed to risks, especially in this ever-changing competitive environment. The 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.

Banks no longer simply receive deposits and make loans. Instead, they are operating in a rapidly innovative industry with a lot of profit pressure that urges them to create more and more value-added services to offer to and better satisfy the customers. Risks are much more complex now since one single activity can involve several risks (Dam, 2010).

Providing loan is one of the main activities of a bank and interest income makes up the major source of profit. In the case of the Development Bank of Ethiopia (DBE), lending to manufacturing, agro-processing industries, mining or extractive industries and commercial agricultural projects constitute the major sources of its income. As a strategic government owned institution, DBE is uniquely positioned in the financial industry as it is empowered to extend both development finance and short-term working capital loans as a package (DBE, 2018)

But banks have to be careful about the safety of such advances cited as Mamuye, 2015 (Radha *et al*, 2010). 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.

In the last three to four decades Non-Performing Loans (NPLs) have gained world's attention as these increasing non-performing loans are causing banking crisis which are turning into banking failures (Barr and Siems, 2014). One of the Main reasons that cause insolvency of the financial institutions is Non-performing loans and ultimately hurt the whole economy (Hou, 2007).

The phenomena and nature of non-performing loans has many connotations; as loan losses are fewer, it is an indicator of comparatively more solid financial system. However, high 2 level of non-performing loans will be seen as an indicator of unsecure and a worrying signal for financial system, bank management and regulatory authorities.

There is a relatively favorable environment for banking industry and other financial institutions in Ethiopia. As of June 30, 2011 the number of banks operating in the country were sixteen, of which thirteen were private and the remaining three state-owned (NBE, 2011). During the same period there were a total of 841 commercial bank branches in the country (NBE, 2011). One branch of a bank on the average is estimated to serve 95,124 people in Ethiopia as at December 2010 (NBE, 2011).

However, the high people to bank branch ratio indicates that Ethiopia still remains as one of the under banked economies even by Sub-Saharan Africa (SSA) countries standard (The World Bank, 2010). 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)

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.N"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. According to Nazanin and Kateryna (2015), one of the main causes of major failures at banks until now was the lack of attention to risk management in general and to operational risk management in particular. The relevance of this issue has grown in addition to operational risk management challenges concerning risk culture, internal control and risk governance (Schwartz and Garliste, 2013).

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. However, for the last many years the Bank's loan repayment performance has been very low due to various factors, these factors may explain among others the loan repayment behavior of borrowers and lending behavior of the Bank. This has an impact on the sustainable provision of credit to the potential investors and existence of the bank as a financial institution (DBE Annual Report, 2018).

According to directives of National Bank of Ethiopia "loans" or advances" means any financial asset of the bank arising from the direct or indirect advances by a bank to a person that are conditioned on the obligation of the person to repay the fund, either on a specified date or dates usually within interest (Directives of National Bank of Ethiopia SSB/43/2008).

Lending is not an easy task for banks because it involves risk of non-repayment which in banking terminology labeled as non-performing loans. The reason given by different banks vary according to their less quality asset performed, but in common, there are internal and external factors that cause it.

Knowing these factors will assist the Bank in its continuous efforts to recover its existing loans and to set ideals for forthcoming ones. Therefore, it is important to conduct a study on the major causes of non-performing loan in development bank of Ethiopia head office Addis Ababa

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. Back ground of the study organization***

According to the information obtained from public relation and communication department of 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 2030 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. Employees' in development bank Addis Ababa head office right now total (2400) staffs are presented.

### ***1.3. Statement of the problem***

The Development Bank of Ethiopia (DBE) is one of government owned financial institutions engaged in providing short, medium and long term development credits by financing viable projects from the priority areas of the government. Besides, it also provides credit to small scaled enterprises which are not capable of financing their projects. DBE's distinguished feature is its "project" based lending tradition. Project financed by the Bank are carefully selected and prepared through appraisal, closely supervised and systematically evaluated. It mobilizes funds from domestic and foreign sources (DBE, 2018).

Development Bank of Ethiopia is one of public investment banks in Ethiopia that deliver mainly medium (3-5 years) and long term (5-20 years) investment credit to borrowers in different sectors. Financing long term credit has high credit risk which in turn expose for high NPLs. Non-performing loans affect the bank's liquidity and profitability which are the main components for the overall efficiency of the bank.

The level of loan default increase in banking industry it reduces the possibility of generating income in order to maximize the profitability the banks. Again, mismatch of maturities between asset and liability create liquidity risk for the banks that deteriorate bank's overall credit rating including its image or goodwill (Badar and Yasmin, 2013). Therefore, the determinants of NPLs should be given a due consideration because of its argumentative effect on survival of banks.

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).

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).

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).

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.

Many studies have examined the causes of non-performing loans in several countries around the world; however, little research has gone to the study of the causes of NPLs in Africa (Onsarigo, et al., 2013). Like most Africa countries, in Ethiopia, to the knowledge of the researcher, there has not been much research which is conducted on determinants of loan defaults except for the study of Daniel (2010), Geletta (2012), Tesfaye (2015), Habtamu (2015), Anisa (2015) and Mesay (2017). The related studies conducted by Daniel (2010), Geletta (2012), Tesfaye(2015)

and Habtamu (2015) assessed the determinants of NPLs in Ethiopian commercial banks focusing on bank-specific variables.

The study by Anisa (2015) and Mesay (2017) combined both the macroeconomic and bank specific factors but both the studies utilize the same macroeconomic variables. Accordingly, as per the knowledge of the researcher, the macroeconomic determinants of NPLs in Ethiopian banking sector are not addressed.

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.

#### ***1.4. Research questions:-***

- What is the credit monitoring system of the bank?
- What is the credit risk assessment method of the bank?
- What are causes of NPL in DBE?
- What are the customer's/borrower's related causes towards bad loan in DBE?

#### ***1.5. Objectives of the study:-***

##### **1.5.1. General Objective of the study**

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

##### **1.5.2. Specific Objectives of the study**

- To assess the credit monitoring system of the bank causes NPL
- To describe the credit risk assessment method of the bank
- To examine the customer's/borrower's related causes towards bad loan in DBE
- To identify others supplementary causes of NPL in DBE

#### **1.6. Significance of the study**

The researcher believes that the result of this study was useful to obtain new knowledge about the causes for the rise in non-performing loans in development bank of Ethiopia, the result was 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 was providing background information to other researchers and scholars who would like to investigate more on other factors causing loans default.

### ***1.7. Scope of the study***

**Geographically** the scope of the study was limited to Addis Ababa; **conceptually** the scope of the study was to identify NPL and factors that cause NPL such as The bank related factors such as credit monitoring system, credit risk assessment method and the customer's/borrower's related causes towards NPL and external factors. **Methodologically** the study used mixed approach which makes data collection and analysis cumbersome. Unit of analysis was customers and bank employees.

### ***1.8. Limitation of the study***

Important limitations are inherent in a research of this kind. Firstly, 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 limit time, lack of enough literature and resources.

Secondly, even with the high level of participation in this study, there is a possibility that responses of individuals who do not participate may have differed in some manner from those who do in fact participate.

### ***1.9. Organization of the study***

The study was organized into five chapters. The first chapter deals with introduction of the study, the second chapter was 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 was analyze, 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 study along with implications for further research.

## **CHAPTER TWO**

### **REVIEW OF RELATED LITERATURE**

Overview of the chapter; This section mainly focused in the four (4) major sub sections: theoretical literature, empirical findings and Conceptual framework. The theoretical literature sub section explores the theories; concepts and definitions related to main issues includes concepts and ideas, definitions; Determinants of public property disposal effectiveness, Conceptual framework of the research and empirical evidences are also included.

#### **2.1. Theoretical review**

##### **2.1.1 Performing Loans**

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).

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).

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’.

### **2.1.2 Non-performing Loans (NPLs)**

The term Non-Performing Loans is used interchangeably with Bad loans and impaired loans as identified in (Fofack, 2005). (Berger & De young 2017) 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.

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 (Wondimagegnehu, 2012). However the bank should consider the credit risk that arises because the possibility that the expected cash flows from advances and securities held, might not be paid in full.

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

Saba et al. (2012) defined NPL in US banking sector as a sum of borrowed money upon which the debtor has not made his or her scheduled payments for at least 90 days. A NPL is either in default or close to being in default. Once a loan is non-performing, the odds that it will be repaid in full are considered to be substantially lower. If the debtor starts making payments again on a NPL, it becomes a re-performing loan, even if the debtor has not caught up on all the missed payments 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). Non-Performing Loans (NPLs) are regressed on three sets of factors in terms of credit, banks size induced risk preference and macroeconomic shocks(Ranjan & Dhal, 2003)

### **2.1.3 Credit Risk**

According to Eastern Caribbean, (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. In order to maintain successful credit risk management, the lending institution should develop Page 10 and implement all-inclusive credit risk management in line with its credit risk strategy. The credit risk strategy should reflect the institution's tolerance for risk and the desired level of profitability for incurring various credit risks.

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)

### **2.1.4 Credit Risk Management**

Quality of credit risk management process is one of the most determinant factors for the efficiency, impact and profitability of the institutions. Thus getting the credit process and product mix right is therefore one of the most demanding as well as rewarding challenges of every financial institutions (banks). The sections that follow discuss major issues in credit management process that include credit information, credit analysis process, credit approval and credit monitoring processes. Getting these well significantly affect loan performance (Wondimagegnehu, 2012).

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, and 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).

Credit assessment thus involves assessing the risks involved in financing and thereby anticipating the probability of default and recovery rate. A credit analysis is used by the credit official to evaluate a borrower's character, capital, capacity, conditions, collateral, common sense, and control and the cyclical aspect of the economy, or generally referred to as the seven C's (Strischek, 2000).

### **2.1.5 Follow up/Credit Monitoring**

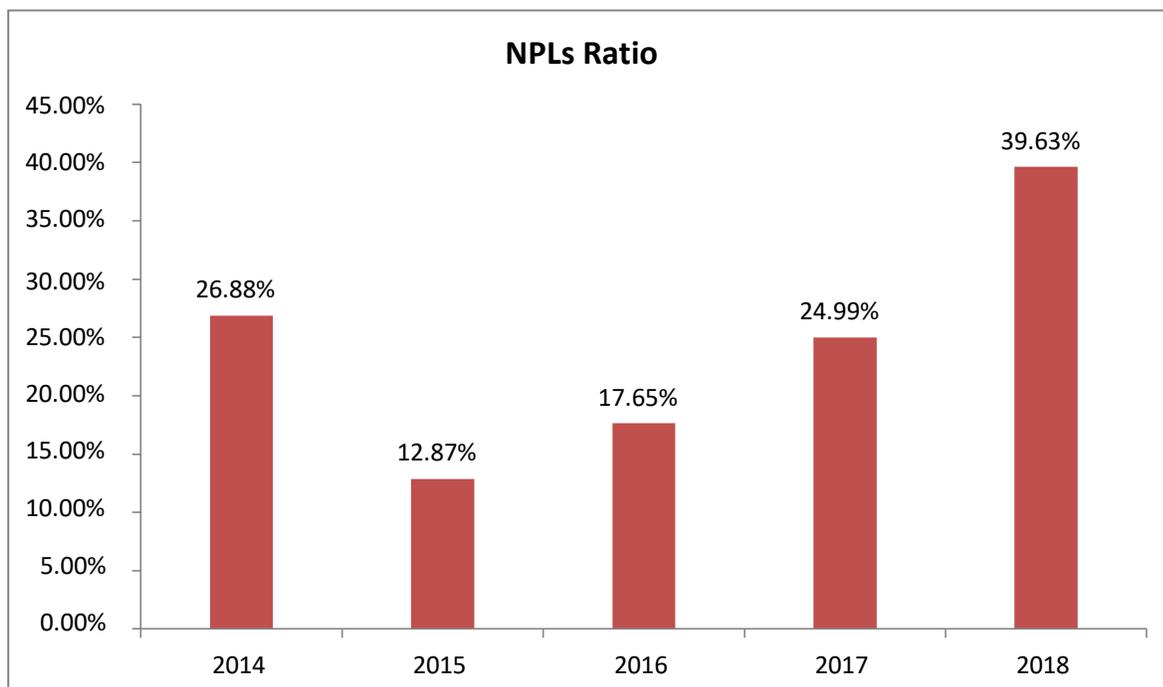
Follow-up or credit monitoring means bank officers checks the borrower's behavior of turnover, the information regarding the profitability, liquidity, cash flow situation, level of security offered, insurance coverage of security and trend in sales in maintaining various ratios of the borrower to meet its timely obligation.

## 2.2. Trend of DBE'S NPL 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).

**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, 2018).

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).



Source: - DBE's Loan Portfolio Annual Reports, 2022.

**Figure 1-DBE's Loan Portfolio Annual Reports,**

### ***2.3. Causes of non-performing loan(NPL)***

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 led to bankruptcies of the whole banking system or even the collapse of the financial system like: Asian crises of 2017 and Sub-Sahara African countries in the 2019'.

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).

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.

#### **2.3.1. Bank Specific Factors of Non-performing Loan**

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

### **2.3.1. 1. 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).

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)

### **2.3.1. 2. 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 (Strischek, 2000).

### **2.3.2. Non-Bank/Customer specific factors of NPL**

#### **A) Credit culture/orientation**

A Study conducted by (Rajan & Dhal (2003) in India indicated that credit orientation

significantly affects loan default. (Wondimagegnehu, 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, 2018).

## **B) Diversion of funds**

Diversion 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.

National bank of Ethiopia directive requires all banks to maintain provisions for Loan Losses account which shall be created by charges 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 provisions for Loan Losses Account always have a credit balance. Additions to or reductions of the provisions for Loan Losses Account should be made only through charges to provisions in the income statement at least every calendar quarter.

### **2.3.3. External 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.

#### **2.3.3.1. 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 validates 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 (Girma S, 2017).

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 (Girma S, 2017).

### **2.3.3.2 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.

### **2.3.3.3 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 nalyze 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.

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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.

## **2.4. 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) investigated the “Macroeconomic Determinants of Nonperforming Loan of Banking Sectors in Pakistan”: The study was conducted on 30 commercial 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) examined the 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.

According to 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.

In addition, 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 is negatively related to non-performing loans where as doubtful debt expenses and disbursements are positively related with nonperforming loans.

Kassahun Fiseha, (2013) examined the “Factors affecting non-performing loan to Development Bank of Ethiopia Dilla Branch” studied by 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.

Arega, et al., (2016), conducted study on “Factors Affecting Non-Performing Loans: Case Study on Development Bank of Ethiopia Central Region” through descriptive research design and found that poor credit assessment and credit monitoring are the major causes for the occurrence of NPL in DBE. Credit size (includes aggressive lending, compromised integrity in approval, rapid credit growth and bank’s great risk appetite); high interest rate, poorly negotiated credit terms and lenient/lax credit terms, and elongated process of loan approval were bank specific causes for the occurrence of nonperforming loans. 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.

On the other hand, poor credit culture of customers, lack of knowledge of borrower for the business they engaged in, willful default, loan diversion, and project management problems were

identified as the major customer specific causes of NPLs. Hence, to reduce the occurrence of loan default it is suggested that the Bank should strengthen its applicant screening criteria and due diligence assessment to select potential risk taking applicants and adopt appropriate pre and post credit risk assessments. As a result, this attempted to examine exhaustively the major causes of the nonperforming loans in Development Bank of Ethiopia from both bank 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.

Zelalem T. (2013) made an empirical study on Ethiopia commercial banks; the study examines the bank-specific and macro-economic determinants of Non-performing loans (NPLs). The study adopts a mixed methods research approach by combining documentary analysis (structured review of documents) and in-depth interviews. The findings of the study show that, loan growth, financial performance, operational efficiency, effective exchange rate, inflation rate and gross domestic product have negative and statistically significant relationship with banks' NPLs. On the other hand, variables like bank size and state ownership have a positive and statistically significant relationship with banks' NPLs. However, the relationship for average lending rate and income diversification were found to be statistically insignificant

## **2.5. Summary of literature review**

Insight of the above discussions, numerous studies have 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.

## **2.6. Research and Knowledge gap**

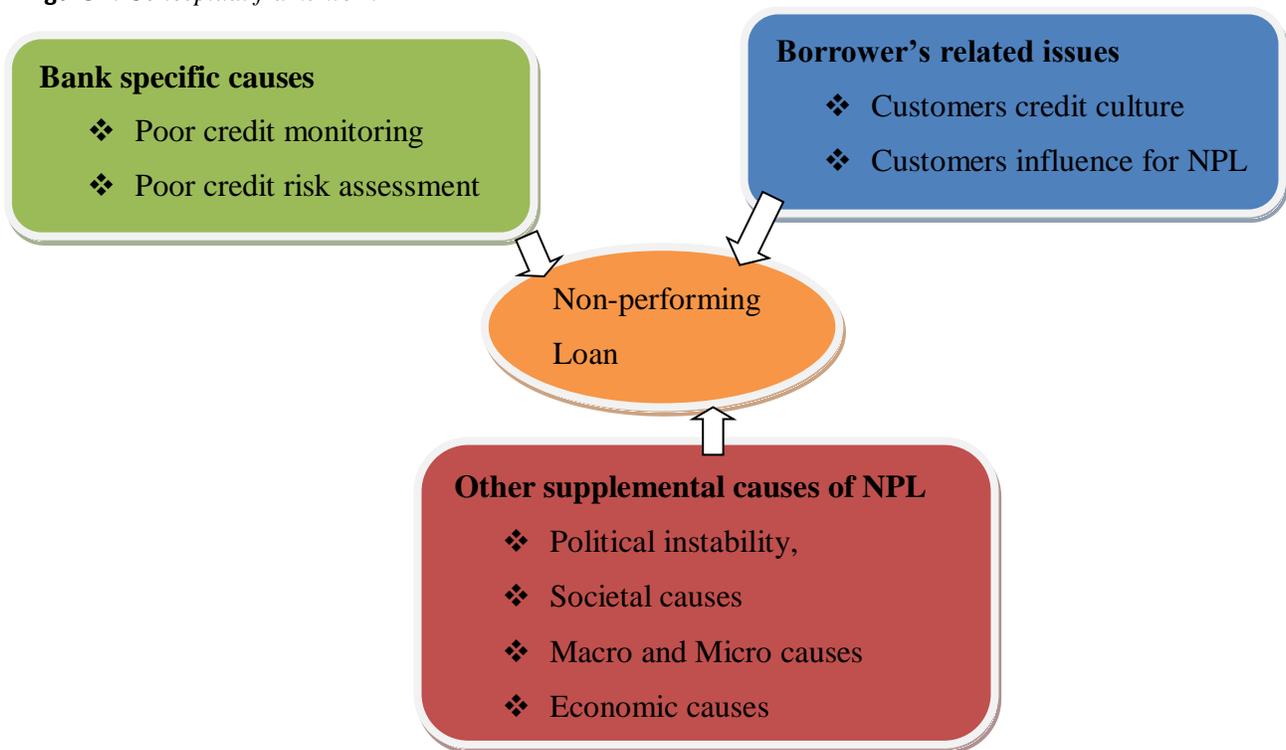
Numerous researchers have done various research studies and most of them concentrated on the macroeconomic determinants and bank specific factors of NPLs. Since these factors, not only

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).

## 2.7. Conceptual framework

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.** *Conceptual frame work*



Source: Developed by the researcher for this study, 2023.

## **CHAPTER THREE**

### **RESEARCH DESIGN AND METHODOLOGY**

Overview of the chapter This chapter of the study presents the major issues related to the research methodology deployed for this particular study and accordingly, the research approach, the research design, the target population, the sample size determination formula, the data sources, the data collection instruments, the measurements of variables and the data analysis methods of the study was presented under this section of the study.

#### **3.1. Description of the study area**

The Development bank of Ethiopia (DBE) is one of government owned financial institutions engaged in providing short, medium and long term development credits by financing viable projects from the priority areas of the government. Therefore, loan recovery is considered as a crucial factor affecting the liquidity and profitability of the bank. Thus, the present study attempts to identify the determinants of non-performing loans in development bank of Ethiopia.

#### **3.2. Research approach and 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, descriptive design was applied to describe the existing situation, narration of facts, characteristics of phenomena (Kothari, 2004). In addition, both qualitative and quantitative (mixed approach) was applied to get relevant information (Creswell, 2012).

#### **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 used census method to conduct the study. 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 is asked customers whose project under NPL and employees close to non-performing loan projects. Furthermore the selected projects which be in the bank were grouped under NPL status, whereas foreclosed, written-off and taken over projects not included for this study because it is difficult to acquire customers in this regard.

Table 1: The total customer population and employees were 34 and 45 respectively

**Table 1-Sample size customer respondents and employee respondents**

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: - own survey, 2023

### 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 study 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.

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 was collected primary data from head office and Addis Ababa district since the population was a small population and implied that a census is 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 was 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.

The researcher was used five-point Likert rating scale that helps to measure statement that respondents show the level of agreement or disagreement that is **Strongly agree=5**, **"Agree=4"**, **"Neutral=3"**, **"Disagree=2"**, **Strongly disagree=1** points (John Robert, 2005). Furthermore, interview and document analysis will use to get enough information.

**Table 2 Likert rating scale**

No	Range	Rank	Interpretation	Remark
1	1-1.8	Strongly disagree	Very low	
2	1.81-2.6	Disagree	Low	
3	2.61-3.4	Neutral	Medium	
4	3.41-4.2 Agree	agree	High	
5	4.21-5	Strongly	Very high	

Source:- literatures (2023)

### 3.6. Data analysis

The data was analysis after checkups of completeness, consistency, blank or missing data were checked, analysis was done by using both qualitative and quantitative techniques by using (SPSS version 26).the result was present in the form of tables' graphs with mean STD and percentage frequency.

### **3.7. Reliability and Validity of the Data**

The data reliability was used parallels to measures equivalent of questioner by using triangulation, cross-checked the information gathered from key informant interview, documents and personal observations with adequate descriptions of contexts, to avoid misinterpretation and to get reliable data, the questionnaire were have converted into mother language if possible to avoid any potential ambiguity.

To measure the questionnaire's rationality, the researcher was used experts 'experience about the study area, employee's feeling and items validity test through SPSS program. Therefore, assembling mixed types of information through different sources were enhanced the reliability of the data and trustworthiness of results (Creswell, 2012). And the researcher reliability using Cranach's Alpha ( $\alpha$ ) which is an internal consistency test that measures the degree to which the items or measurements consistently measures the underlying construct.

### **3.8. Ethical Consideration**

The study was conducted by considering appropriate ethical principles. It has not undermined all aspects of gender, religious, and language and includes using proper citation, providing information to the respondents on the purpose of the study and the use of the information as well as reporting of the findings in a moral way. Information obtained was kept in strict confidence and was use for the intended purpose only.

Individuals have provided sufficient information in order to make an informed decision on their participation and demonstrated with any ethical issues of consent of confidentiality are clearly defined. The researcher observes the principles of ethical issues like confidentially and dignity of the participants, integrity, on no account plagiarism, and never fabricating and destroying data.

### **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

Overview: The study aimed to investigate the causes of non-performing loans in development bank of Ethiopia Addis Ababa. This chapter is therefore made up of data analysis, findings and interpretation on these key aspects of the study. The response was systematically reviewed and analyzed using descriptive, correlation analysis and regression analysis with the help of statistical package. Seventy-nine (79) questionnaires were distributed, and all respondents returned all questionnaires and valid for analysis, because the study was used 5% of contingency sample for non-response rate (Baruch, 1999).

#### 4.1. The Response rate

**Table 3-Response rate**

<b>.Description</b>		<b>Frequency</b>	<b>Percentage (%)</b>
Target Population	Employees	45	100%
	Customers	34	100%
Questionnaire distributed	Employees	45	100%
	Customers	34	100%
Questionnaire returned	Employees	45	100%
	Customers	34	100%
Response rate (%)	Total	79	100%

Source; filed survey data (2023).

Table 3:- Seventy nine questionnaires distributed to customers and employees and out of total distributed questionnaires the whole completed and collected (See table 4.1 above). Therefore, in this study response rate of respondents is 100% and it is more significant.

#### 4.2. Demographic characteristics of respondents

As shown in the table 4.2 below the gender distribution of the respondents, 67(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-Demographic characteristics of respondents**

		<b>Frequency</b>	<b>Percentage (%)</b>
<b>Gender</b>	Female	12	15.2
	Male	67	84.8
	<b>Total</b>	79	100.0
<b>Education</b>		<b>Frequency</b>	<b>Percent</b>
	Diploma	1	1.3
	Degree	49	62.0
	Masters	29	36.7
	<b>Total</b>	79	100.0

Source: SPSS result, 2023

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 5-Working experience of respondents**

	<b>Categories</b>	<b>Frequency</b>	<b>Percentage (%)</b>
<b>Work Experience</b>	Less than two	1	1.3
	3-5	27	34.2
	6-8	14	17.7
	Greater than 8	37	46.8

	<b>Total</b>	79	100.0
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Source: - Survey outcome and own computation, 2023

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 6-the bank employees composition**

	<b>Item</b>	<b>Frequency</b>	<b>Percentage (%)</b>
Position of employees	Rehab officers	27	60.0
	Loan officers	6	13.3
	Senior loan officers	7	15.6
	Team manager	4	8.9
	Attorney	1	2.2
	<b>Total</b>	45	100.0

Source: SPSS result, 2023

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 7-Positions of customer's respondent**

		<b>Frequency</b>	<b>Percentage (%)</b>
Positions of customer's	Project managers	6	17.6
	Production managers	8	23.5
	Employees of the Project	11	32.4
	Marketing managers of the project	9	26.5
	<b>Total</b>	34	100.0

Source: SPSS result, 2023

### 4.3. Responses respond on non-performing loan

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 8-Rank the factors of NPL**

S/N	Factors towards the causes Non- performing Loan	Results	Remark
1	Poor credit monitoring of the bank	87.5% ranked 1 <sup>st</sup>	
2	Macroeconomic factors	81.3% ranked 5 <sup>th</sup>	
3	Customers credit attitude/culture	78.8% ranked 4 <sup>th</sup>	
4	Poor credit risk assessment	77.5% ranked 3 <sup>rd</sup>	
5	Political Instability	60% ranked 2 <sup>nd</sup>	
6	Marketing Factors	70% ranked 6 <sup>th</sup>	

**Hint: - 1=Highest**

**6= Lowest**

Source: - Survey outcome and own computation, 2023

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 9 Factors which cause NPL in DBE**

	<b>Items</b>	<b>Mini</b>	<b>Maxi</b>	<b>Mean</b>	<b>Std.</b>	<b>Rank</b>
1	Poor credit monitoring of the bank	1.00	6.00	1.3165	1.00695	1
2	Macroeconomic factors	1.00	6.00	4.5696	1.13999	5
3	Customers credit attitude, culture	1.00	6.00	3.6962	.70446	4
4	Poor credit risk assessment	1.00	6.00	3.2405	.86551	3
5	Political instability	1.00	6.00	3.1646	1.65971	2
6	Marketing factors	1.00	6.00	5.0886	1.58672	6
Source: - Survey outcome and own computation, 2023						

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. Respondents responded on non-performing loan of the bank**

##### **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 categorizes in to 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 for the occurrence of nonperforming loans.

Thus the respondent provided their opinion as percent of agreement and disagreement regarding the factors affecting for 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 1.82agreed 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 1.91by 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 1<sup>st</sup> and 2<sup>nd</sup> 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 10 Bank specific causes 4.7.**

No	Items	1		2		3		4		5		Mean	Std
		F	%	F	%	F	%	F	%	F	%		
1	Poor 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 is 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	5	6.3	5	6.3	11	13.9	32	40.5	26	32.9	3.87	1.13
4	Inefficient/improper know	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

**Hint:** - 1=Strongly Agree 2=Agree 3=Neutral 4=Disagree 5= strongly disagree

Source: - survey result 2023

#### **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.

**Table 11-Customer related causes of NPL in DBE**

No	Customer related causes of NPL in DBE	1		2		3		4		5		Mean	STD
		F	%	F	%	F	%	F	%	F	%		
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	.93
3	Diversion of loan fund	19	24.05	45	56.9	11	13.9	4	5.06	0	0	2.01	.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		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

**Hint:** - 1=Strongly Agree 2=Agree 3=Neutral 4=Disagree 5= strongly disagree

Source: - (SPSS result, 2023)

#### **4.5. Responses respond on 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.

#### ***4.6. Non-performing loan at DBE result of secondary data; The Trend of DBE's NPLs from 2018 to 2023G.C***

Non-performing loan at DBE result of secondary data

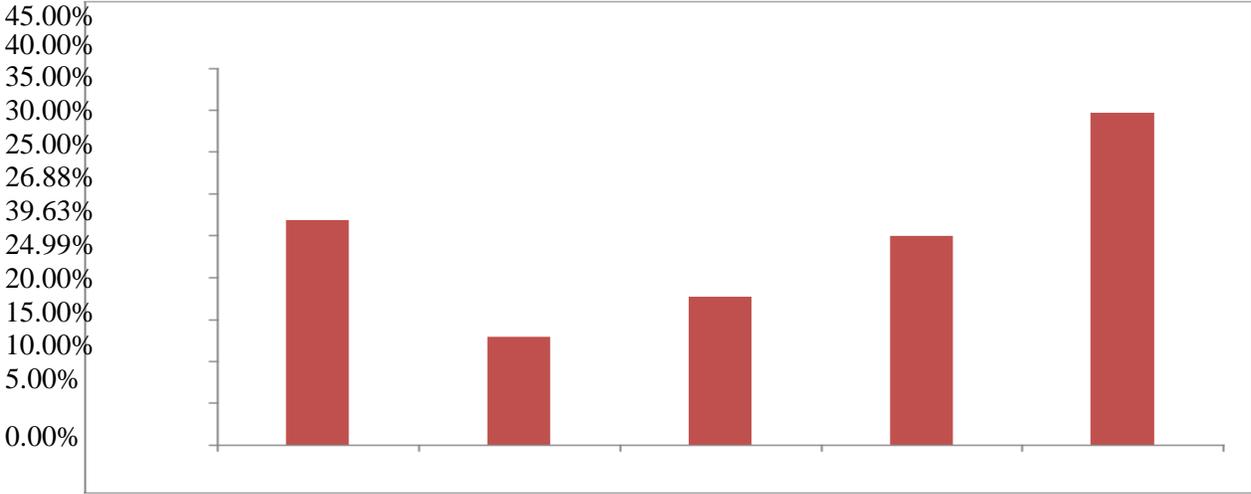
Based on the findings secondary data from DBE the result indicated that

- the Bank's NPLs stood at 24.1% by the end of June 2019/2020.
- the Bank's NPLs stood at 26.13% by the end of June 2020/2021
- NPL of year 2021/2022 (G.C) (2014 E.C) was 19.27

This Data implies that NPL showed increment by 8.4% when compared with 2019/2020 and 2020/2021 of NPL; This Data implies that the average ratio of non-performing loans in the bank for (2019-2022) ( 2012-2014 E.C) was 23.16%, which is high compared to the acceptable standard of 15%. The Data implies that NPL at DBE is high compared to the acceptable standard of 15% of the total loan outstanding set by the Association of African Development Finance Institutions.

**Figure 3 Trend of DBE's NPLs from 2018 to 2023G.C**

Trend of DBE's NPLs from 2018 to 2023G.C



Source: - DBE's Loan Portfolio Annual Reports, 2023

## CHAPTER FIVE

### CONCLUSIONS AND RECOMMENDATIONS

#### Overview

This section of the study presents the summary of main findings, conclusion drawn based on the study 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.

#### 5.1. Summary of findings

This study mainly investigate the **assessment of the causes of non-performing loans in development bank of Ethiopia** Addis Ababa, besides, the study also surveyed the key factors that affecting the non-performing loans in development bank of Ethiopia. The study was use proportionate sampling methods of 79 respondents who have direct involvement in the sampling process were selected. Structured questionnaire, interview and secondary data were also deployed as a data collection instrument in this study.

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 2018-2023. 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

The successful implementation of non-performing loans in development bank of Ethiopia access to, and application of a range of supporting tools and techniques and effective the decision making, therefore, this study mainly focused to assess the assessment of the causes of non-performing loans in development bank of Ethiopia Addis Ababa

Based on the findings from secondary data, the average ratio of non-performing loans in the bank for the last five years (2018-2023) 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 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**

The purposes of this study were this study mainly focused to assess causes of non-performing loans in development bank of Ethiopia Addis Ababa. Hence, based on the study findings and conclusions, the researcher recommended the points.

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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## APPENDIX: - I



**St. Mary's university**  
**School of graduate studies**  
**Department of business and economic**  
**Masters of business administration program**

Dear respondents

I am Bethlehem Desalegn right-now I am prepared these questionnaires to conduct research entitled that; “*Assessment of the causes of non-performing loan in the case of Development Bank of Ethiopia, Addis Ababa*” 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 and Use ✓ up on given choices alternatives.

### **Part1:-Demographic characteristics of respondents**

1. Sex;

1 Female

2. Male

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

1. Diploma

2. Degree

2. Masters

3. Doctorate

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

1. 0-2 years
2. 3-5 years
3. 6-8 years
4. More than 8 years

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

1. 0-2 years
2. 3-5 years
3. 6-8 years
4. More than 8 years

5. Your working areas? (For staff only)

1. Head office
2. Addis Ababa District

6. Your position right now?

1. Manager
2. Staff
3. Senior staff

**Part Two: - The causes of non-performing loans**

S/N	Items	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	

Part three: - The statements pertaining to Non-performing loan ratio in DBE is high?

No	Causes of NPL	S/A (1)	Agree(2)	N (3)	D/A(4)	S/D (5)
1	Non-performing loan ratio in DBE is High					

Part three: - The statements pertain to bank related causes of Non-performing loan?

No	Causes of NPL	S/A(1)	Agree( ) (2)	N(3)	Disagree( ) (4)	S/D(5)
1	dishonesty of customers for credit					
2	Poor credit appraisal are the causes of NPL in DBE					
3	Insufficient experience of credit service employees					
4	Inefficient know your customer study of the bank					
5	Poor credit advice and consultancy of customer					
6	Under/over financing of projects					
7	Loan manual policy of the bank					

N

No	Items	S/A (1)	Agree( ) (2)	N(3)	Disagree( ) (4)	S/D (5)
1	Carelessness and dishonesty of customers for credit					
2	Insufficient 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					

**Part four: Discuss questions**

1. 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?

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

.....  
.....

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

.....  
.....

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

.....  
.....

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

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**Thank You**  
**BETLEHIME DESALEGN**

**2023**  
**ADDIS BABA, ETHIOPIA**