MEKELLE UNIVERSITY

DEPARTMENT OF ACCOUNTING AND FINANCE

COLLEGE OF BUSINESS AND ECONOMICS


# NON-PERFORMING LOAN AND ITS MANAGEMENT IN COMMERCIAL BANKS IN ETHIOPIA.

**(A CASE DASHEN BANK MEKELLE AREA BANK.)**


BY

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**A THESIS**

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**IN**

**FINANCE AND INVESTMENT.**

**ADVISOR**

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# DECLARATION

I, Mr.Teshome Dula, here by declare that the Project work entitled **"Non-performing Loan and Its Management in Ethiopia: A case study on Dashen Bank Mekelle Area Bank, in Tigray"** submitted by me for the partial fulfillment of Master of science Degree in Finance and Investment in the Department of Accounting and Finance, CBE, under the guidance of **G.Srinivasa Rao(Assist. Prof.)**,CBE, Mekelle University at Mekelle, is original work and it has not been presented for the award of any other Degree , Diploma, Fellowship or other similar titles of any other University or Institution.

Name of student: __________________________ Signature:_____________

Dated:_____________

Place: AcFn,CBE,MU, Mekelle

# CERTIFICATION

I certify that the project work entitled **"Non-performing Loan and Its Management in Ethiopia: A case study on Dashen Bank Mekelle Area Bank, in Tigray"** is a bona-fide work by Teshome Dula under my guidance.

Name of advisor: ________________________________ Signature: ____________

Place: AcFn, CBE, MU, Mekelle Date: ______________

# *ABSTRACT*

*Loan portfolio forms a substantial amount of the assets of banks and it is the predominate source of interest income. However, when loans become non-performing, they tend to have some serious effects on the financial health of banks. In view of the critical role banks play in the economy of a country, it is worth finding out the causes of non-performing loan. The study was carried out to identify the impact of non-performing loan on loan interest income, and lending fund, focusing on Dashen Bank Mekelle Area Bank. The study also looked at the trend of non-performing loans during the five-year period under review and the factors that account for non-performing loan from both borrower and lending institution side. Primary and secondary data were used in the study. Primary data gathering tools such as structured questionnaires and personal interviews were used. Regarding secondary data, client's files, report directives, and annual reports of the bank were used.*

*The findings showed that the bank recorded huge amount of non-performing loan during the period under consideration (2005-2009). It was identified that the non-performing loan negatively affected the financial performance of the bank through reduction in loan interest income and lending funds. The study identified ineffective loan monitoring and poor credit appraisal as the major factors accounting for non-performing loan from the lending institution side and lack of proper education on business area, lack of sufficient income, absence of sufficient infrastructure, lack of sufficient supervision from the bank, lack of saving account, high consumption expenditure and high interest charge were identified as the causes for non-performing loan from the borrower side. To improve on the quality of the bank's loan portfolio, the management commonly uses loan rehabilitation. Some measures have been recommended to management of the bank to minimize the existing burden of non-performing loan those are Credit training programs, effective loan monitoring i.e. giving good on sight supervision to client, full filling required credit staff and giving awareness to clients to present adequate collateral and advising clients to have good knowledge on the business area they engaged.*

***Key word**: **Non-performing Loan, Causes, Management and Commercial bank.***

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# ACRONYMS

NPL-Non-performing loan

NPLR-Nonperforming loan ratio

KYC- Know Your Customer

LPM-Loan Portfolio Management

NBE- National Bank of Ethiopia

BIS-Bank of International Settlement

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# CHAPTER I: INTRODUCTION

## 1.1 Back ground of the study

Lending is the principal business activity for commercial banks. The loan portfolio is typically the largest asset and the predominant sources of revenue. As such, it is one of the greatest sources of risk to a bank's safety and soundness. Whether due to lax credit standard, poor portfolio risk management, or weakness in the economy, loan portfolio problems have historically been the major cause of bank loss and failures. Effective management of loan portfolio and the credit function is fundamental to bank's safety and soundness. Loan portfolio management (LPM) is the process by which risks that are inherent in the credit process are managed and controlled. Because review of the LPM process is so important, it is primary supervisory activity. It involves evaluating the steps bank management takes to identify and control risk throughout the credit process (Comptroller, Handbook on loan portfolio management, April 1998:35).

The above literature gives ample evidence that healthy loan portfolios are vital assets for banks in view of their positive impact on the performance of banks. Unfortunately, some of these loans usually do not perform and eventually result in nonperforming which affect banks earnings on such loans. These nonperforming loans become cost to banks in terms of their implications on the quality of their assets portfolio and profitability. This is because in accordance with banking regulations, banks make provisions for non-performing loans and charge for NPLs which reduce their loan portfolio and income. For example on June 30, 2008, Dashen Bank Mekelle area Branch report on credit and deposit operation revealed that non-performing loans ratio increased from 1.04% in 2007, to 6.49% in 2008. The problem of NPL is not common in only Ethiopia but it is in other countries where the problem has led to the liquidation of banks. The findings of Caprio and Klingebiel (2002) cited in Fofack (2005), showed that in Indonesia, non-performing loans represented about 75% of total loan assets which led to the collapse of over sixty banks in 1997.

Modern banking in Ethiopia has begun in 1905, when bank of Abyssinia was first established in Addis Ababa. Though it is not the first, Dashen bank was established as per the new policy and Ethiopian investment code. The bank comes into existence on September 20, 1995 according to the commercial code of Ethiopia 1960 and licensing and supervision of banking business proclamation No. 84/1994 (http://www.nbebank).

Dashen bank Mekelle branch was established in 1996 and Like other branches, it renders major services namely, credit facility saving i.e. deposit schemes, international banking and fund transform and master card and visa card service.

It is fact that the bank plays important role in the economic development of the nation by providing different service to the customer. Loan is One of the most important services that the bank renders and relevant to this study. According to directives of national bank of Ethiopia "loan" 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 2002) .While performing one of its main functions granting loan, the bank is exposed to credit risk i.e. non-performing loan; A loan that is not earning income or Full payment of principal and interest is not longer anticipated i.e. Principal or interest is 90 days or more delinquent.

The issue of non-performing loans has gained increasing attentions in because the immediate consequence of large amount of NPL in the banking system is bank failure. Thus, the existence of non-performing loan in line with clients financed by Dashen Bank Mekelle Area needs a practical investigation.

## 1.2 Statement of the problem

One of the main activities of banks in Ethiopia and other parts of the world is Lending. This is evidenced by the volume of loans that constitute banks assets and the annual substantial increase in the amount of credit granted to borrowers in the private and public sectors of the economy. Loan portfolio is typically the largest asset and the predominant source of income for banks. In spite of the huge income generated from their loan portfolio, available literature shows that huge portions of banks loans usually become non-performing and therefore affect the financial performance of these institutions (Comptroller, 1998:55).

A report on the performance of banks in 2008 indicated that among other factors, higher loan loss provision accounted for a decline in the profitability of some banks in Ethiopia (NBE annual report, 2008). Based on NBE'S classification of advances of the Banking industry, Dashen Bank annul report 2002-2009 indicates that NPL i.e. under the category of doubtful, special mention and loss has a significant negative impact on the financial performance of the bank. Different studies on issues of non-performing loan indicates that Loan default disallow new applicants access to credit as the banks cash –flow management problems increase in direct proportion to the increasing default problem.

Hunt (1996) argues that default problems destroy lending capacity as the flow of repayment declines, transforming lenders into welfare agencies, instead of viable financial institutions. It incorrectly penalizes creditworthy borrowers whenever the screening mechanism is not efficient. An empirical study made by Ajayi (1992) on factors which influence default in mortgagee finance institution with particular reference to the federal mortgagee bank of Nigeria showed that non-payment of loan has largely been positively influenced by age of borrowers, repayment term and annual income of borrowers. Based on the understanding that the banking industry is different form other business, it is among the most regulated industries in the world (S. Mish kin, 1995). Despite heavy regulation of the banking industry, the NPLs problem in different economies does not necessarily share identical immediate causes. However, all studies above did not specifically identify and evaluated the cases for loan in becoming non-performing and methods that should be used by lending institutions to minimize NPL. Even the studies do not give emphasis for the lending institutions characteristics that cause loan to become non-performing. In view of the above problems, this paper is to identify the causes for loans in becoming non-performing from both borrower and lending institution side and how the bank manages it.

## 1.3. Research question

The research has attempted to address the following questions:

(1) What is the trend of non-performing loan of the bank during the five years period of 2005-2009?

(2) What is the impact of non-performing loan on loan interest income and liquidity during the five years period of 2005-2009?

(3) What are the causes for non-performing loan from both borrowers and lending institution side?

(4) What are the methods or approaches, to manage NPL that might reduce the existing size and volume of Non-performing loan of the bank?

## 1.4 Research objectives

### 1.4.1 General objective

The overall objective of this study is to examine the problems of Dashen Bank, Mekelle Area Bank, in the line with loan delivery, identify the causes for non-performing and the methods of managing the occurrence of NPL.

### 1.4.2 The specific objectives of the study are:

1. To assess the trend of Non-performing loans of the bank during the year i.e.2005-2009.
2. To identify the impact of nonperforming loan on loan interest income and liquidity during the year 2005-2009.
3. To identify the sector which records high amount of NPL and the reasons.
4. To identify the causes for loans in becoming non-performing from both borrower and lending institution side.
5. To identify methods used by the bank in managing NPL and thereby reduces the existing size and volume of Non-performing loan.

## 1.5 Significance of the study

The study will have the following significances to the beneficiaries:

1. Government and other parties involved in the promotion of the development of banking industries use the findings of the study as additional information to address the problems uncovered in the development of banks.
2. It will serve as a reference material for strategic orientation of banks in Ethiopia on the issue.
3. To initiate Academicians, consultants, and government agencies or other interested bodies to carry out further study in the area at an advanced level.

## 1.6 Scope of the study

In Mekelle, there were banks which give service namely united bank, Dashen bank, construction and business bank, Commercial Bank of Ethiopia etc. This study was limited to a manageable of one bank in Mekelle specifically Dashen Bank and even if there were different problems which need investigation, the aim of the study was to identify causes for non-performing loan from both borrowers and the lending institution side and possible methods to manage the problem. To find causes for nonperforming loan from the borrower and lending institution side, political factors and inflation are not considered.

## 1. 7 Limitation of the study

Since the study was comprised of the identification of factors for default from both borrowers and lenders side, it needed collection of primary data .Therefore time and financial resource were the main constraints.

## 1.8 Organization of the paper

The study was organized to have five chapters. The first introduces the background of the study, the research objectives and questions, significance of the study, the scope of the study, limitation of the study, and layout of the study. The second chapter presents both theoretical and empirical review of the related literatures. The third chapter deals with methodology of the study and background of the organization. The fourth chapter is mainly concerned with the analysis of data collected. The last chapter which is chapter five presents the conclusion and the recommendation drawn from findings of the data in addition with implications for further research.

# CHAPTER II: LITRATUE REVIEW

## 2.1 Introduction

This chapter focuses on the review of relevant literature on non-performing loans and other core aspects of the topic under study. Areas such as Definition of related concepts, lending practices in banks i.e. loan processing, description of performing loans, non-performing loans, loan classification and provisioning, impact of non-performing loans on performance of banks , possible factors that lead to non-performing loans, management of non-performing loan are covered. The chapter thus presents the conceptual and theoretical basis for the study.

### 2.1.1 Definition of the related terms.

**Collateral**: In lending agreements, collateral is a borrower's pledge of specific property to a lender, to secure repayment of a loan or assets that are offered to secure a loan or other credit and it is subject to seize on default**.** Collaterals are important credit risk management tools. It is which the properly promised to the lender as compensation. If the borrower defaults, it reduces the risks of loss in the case of loan default. If the borrower defaults on a loan, the lender can sell the collateral and use the proceeds to recover the loan (www.indygov).

**Financial system:** In finance, the financial system is the system that allows the transfer of money between savers and borrowers. It comprises a set of complex and closely interconnected financial institutions, markets, instruments, services, practices, and transactions. Financial systems are crucial to the allocation of resources in a modern economy. They channel household savings to the corporate sector and allocate investment funds among firms; they allow inter temporal smoothing of consumption by households and expenditures by firms; and they enable households and firms to share risks (http://en.wikipedia.org).

**Banks:** are financial institutions that accept deposits and make loans. Included under the term banks are firms such as commercial banks, saving and loan association, mutual saving banks and credit unions. Because banks are the largest financial intermediaries, most people keep a large proportion of their wealth in bank in the form of checking accounts, saving accounts, on other types of bank deposits (S.mishkin, 1997 :95).

**Loans:** An arrangement in which a lender gives money or property to a borrower, and the borrower agrees to return the property or repay the money, usually along with interest, at some future point(s) in time. Usually, there is a predetermined time for repaying a loan, and generally the lender has to bear the risk that the borrower may not repay a loan (http://www.investorwords.com/2858/loan.html).

According to Peter S.Rose, (1992) loans are among the highest yielding asset a bank can add to its portfolio, and they provide the largest portion of operating revenue. The principal business of commercial bank is to make loans to qualified borrowers. Far more important in dollar volume, however are direct loans both business and individuals. This loan arise from negotiation between the bank and its customer and result in written agreement designed to meet the specific credit needs of the customer and the requirement of bank for adequate security and income.

Historically, Commercial banks have preferred to make short term loans to businesses, principally to support purchase of inventory. In recent years, however, banks have long then end the maturity of their business loans (which have maturity over one years) to finance the purchase of building machinery and equipment. Because the longer- term loans carry greater risk due to un-expected changes in interest rates, banks have also required a much greater proportion of new loans to carry variable interest rates can be changed in response to shifting market condition(S.Rose, commercial-bank-management, 9th ed, 1992 :305).

**Loan processing:** Entire sequence of steps, from the time a loan application is received (or a loan offer is accepted) to the time loan is closed, the loan proceeds are disbursed, and the aggregate amount (principal plus interest is placed on the lender's books as an asset( http://businessdictionary.com).

**Loan provision:** A provision made by a bank for loans that will probably not be repaid .An expense set aside as an allowance for bad loans (customer defaults, or terms of a loan have to be renegotiated, etc). A non-cash expense for banks to account for future losses on loan defaults. Banks assume that a certain percentage of loans will default or become un collectible (Financial-dictionary/thefreedictionary.com).

## 2.2 Theoretical Literature

### 2.2.1Credit analysis

Credit analysis is the process of assessing the risk of lending to the business. The so-called credit risk must be evaluated against the benefits that the bank expects to derive from making the loan. The direct benefits are simply the interest and fees earned on the loan and possibly, the deposit balances required as a condition of the loan. Indirect benefits consist of the initiation or maintenance of a relationship with the borrower that may provide the bank with increased deposits and demand for a variety of bank services. Credit risk assessment has both qualitative and quantitative dimensions; the former are generally the more difficult to assess. The steps in qualitative risk assessment are primarily gathering information on the borrower's record of financial responsibility, determining his or her true purpose for wanting to borrow funds, identifying the risks confronting the borrower's business under future industry and economic conditions, and estimating the degree of commitment the borrower will have regarding repayment. The quantitative dimension of credit risk assessment consists of the analysis of historical financial data and the projection of future financial results to evaluate the borrower's capacity for timely repayment of the loan and, indeed, the borrower's ability to survive possible industry and economic reverses. The essence of all credit analysis can be captured in four basic factors or lines of inquiry:

- The borrower's character – most bankers agree that the paramount factor in a successful loan is the honesty and goodwill of the borrower.

- The use of loan funds – determining the true need and use of funds requires good analytical skills in accounting and business finance.

- Primary source of repayment – the analyst's accounting and finance skills are crucial in determining the ability of the borrower to repay a loan from cash flows. He must ascertain the timing and sufficiency of these cash flows and evaluate the risks of cash flows falling short.

- Secondary source of repayment – the collateral value should cover, in addition to the loan amount and interest due, the legal costs of foreclosure and interest during foreclosure proceeds. Even if the collateral is the preferred secondary source of repayment, others can be guarantors and co-makers, but in such cases, the collection usually requires expensive litigation and results in considerable ill will between the bank, borrower, and guarantor.

In credit investigation, banks usually depend on the following sources of information:

- ✓ Customer interview – it provides the most important information needed in credit investigation, including the type and amount of the loan required, sources and plans of repayment, eventual collateral and guarantors, previous and current creditors, primary customers and trade suppliers, accountants, main officers and shareholders etc.

- ✓ Internal sources – credit files on any current or previous borrowings, checking account activity, other previous or current deposits, liabilities, income sources, assets, expenses and revenues etc.

- ✓ External sources of information – specialized service agencies, newspapers, magazines etc.

Lending Bank loans finance different corporate groups in the economy. Manufacturers, distributors, service firms, farmers, builders, homebuyers, commercial real estate developers, retailers, and others all depend on bank credit. The ways in which banks allocate their funds strongly influences the economic development of the community and nation. Every bank bears a degree of risk in its granting of credit, and, without exception, every bank experiences some loan losses when certain borrowers fail to repay their loans. Whatever the degree of risk taken loan, losses can be minimized through highly professional organization and management of the lending functions. The composition and quality of a bank's loans should be reflected in its loan policy. The policy sets out the bank's lending philosophy and specifies procedures and means of monitoring lending activity. A written loan policy should serve to obtain three results:

- Produce sound and collectible loans.
- Provide profitable investment of bank funds.
- Encourage extensions of credit that meet the legitimate needs of the bank's market.

A meaningful loan policy will express strategies in concrete terms. The desired loan mix should be quantified. The loan mix expresses the diversification sought by the bank in its loan placements. Diversification reduces the level of default risk that is associated with large concentrations of loans in a single category. The bank's liquidity strategy should be indicated, because it acts as constraint on lending activity and because liquidity is partly determined by the maturity structure of the loan portfolio. The desired size of the loan portfolio expresses the bank's intended aggressiveness in expanding its loan portfolio. A highly aggressive loan policy has both a bright side and a dark side. The bright side is that a large loan portfolio might increase bank earnings. The dark side is that an aggressive policy might lead to lower credit standards, marginal loans, and an unacceptable amount of risk. Most borrowers are exposed to risks that threaten their ability to repay their bank loans. However, all collaterals brought as security should be insured. Most banks conduct loan reviews to reduce losses and monitor loan quality.

Loan reviews consist of a periodic audit of the on-going performance of some or all of the active loans in a bank's loan portfolio. Its essence is credit analysis, although, unlike the credit analysis conducted by the credit department as part of the loan approval process, credit analysis in loan review occurs after the loan is in the books. Other than its basic objective of reducing loan losses, some intermediate objectives of loan review are as follows:

- To detect actual or potential problem loans as early as possible;
- To provide incentive for loan officers to monitor loans and report deterioration in their own loans;
- To enforce uniform documentation.
- To ensure that loan policies, banking laws, and regulations are followed.
- To inform management and the board about the overall condition of the loan portfolio.
- To aid in establishing loan loss reserves.

  Whatever means are used to conduct loan reviews; the following points should be covered:

  - ✓ Financial condition and repayment ability of borrower.
  - ✓ Completeness of documentation.
  - ✓ Consistency with loan policy.
  - ✓ Perfection of security interest on collateral.
  - ✓ Legal and regulatory compliance.
  - ✓ Apparent profitability.

When a problem loan is detected, the responsible officer should take immediate corrective action to prevent future deterioration and minimize potential loss (Denisa, 2003:81-85).

### 2.2.2 Credit Approval Process

The individual steps in the credit approval process and their implementation have a considerable impact on the risks associated with credit approval. The quality of credit approval processes depends on two factors, i.e. a transparent and comprehensive presentation of the risks when granting the loan on the one hand and an adequate assessment of these risks on the other. Furthermore, the level of efficiency of the credit approval processes is an important rating element. Due to the considerable differences in the nature of various borrowers and the assets to be financed as well the large number of products and their complexity, there can not be a uniform process to assess credit risk.
The quality of the credit approval process from a risk perspective is determined by the best possible identification and evaluation of the credit risk resulting from a possible exposure. The credit risk can be distributed among four risk components.

(a) Probability of default (PD)

(b) Loss given default (LGD)

(c) Exposure at default (EAD) and

(d) Maturity (M) (Oesterreichische National bank, Credit Approval Process and Credit Risk Management, 2000).

The most important components in credit approval processes are PD, LGD, and EAD. While maturity (M) is required to calculate the required capital, it plays a minor role in exposure review. The significance of PD, LGD, and EAD is described below.

**a. Probability of default (PD):** Reviewing a borrower's probability of default is basically done by evaluating the borrower's current and future ability to fulfill its interest and principal repayment obligations. This evaluation has to take into account various characteristics of the borrower (natural or legal person), which should lead to a differentiation of the credit approval processes in accordance with the borrowers served by the bank. Furthermore, it has to be taken into account that for certain finance transactions interest and principal repayments should be financed exclusively from the cash flow of the object to be financed without the possibility for recourse to further assets of the borrower. In this case, the credit review must address the viability of the underlying business model, which means that the source of the Cash flows required meeting interest and principal repayment obligations has to be included in the review.

**b. Loss given default (LGD):** The loss given default is affected by the collateralized portion as well as the cost of selling the collateral. Therefore, the calculated value and type of collateral also have to be taken into account in designing the credit approval processes.

**c. Exposure at default (EAD):** In the vast majority of the cases described here, the exposure at default corresponds to the amount owed to the institution. Thus, besides the type of claim; the amount of the claim is another important element in the credit approval process.

### 2.2.2 Credit Decisions

Extending credit - it's the careful balance of limiting risk and maximizing profitability while maintaining a competitive edge in a complex, global marketplace. Credit analysis is the process of deciding whether or not to extend credit to a particular customer. It involves two Steps; gathering relevant information and determining credit worthiness (Holger M. Mueller2008).

### 2.2.3 Credit Information

If a firm does want credit information on customers, there are a number of sources. Information sources commonly used to assess credit worthiness include the following:

- Financial statements: A firm can ask a customer to supply financial statements like balance sheet and income statement. Rules of thumb base on financial ratios can be calculated.

- Credit reports on the customer’s payment history with other firms: Information obtained from firms that sell information on the strength and credit history of business firms.

- Banks: Banks will generally provide some assistance to their business customers in acquiring information on the creditworthiness of other firms.

- The customer’s payment history with the firm: The most obvious way to obtain an estimate of a customer’s probability of nonpayment is whether he or she has paid previous obligations and how quickly they have meet these obligations ( Holger M. Mueller2008)

### 2.2.4 Credit Evaluation and Scoring

Once information has been gathered, the firm faces the hard choice of either granting or refusing credit. Many financial managers use the "five C's of Credit" as their guide (Holger M. Mueller2008).

#### 2.2.4.1 Using the Five C's of Credit

**1. Character:** The history of the business and experience of its management are critical factors in assessing a company's ability to satisfy its financial obligations. Look at how long the business has been under the same control, and check for any previous litigation or bankruptcy information. Also, get a clear understanding of who owns the business, and who is ultimately responsible if a problem arises. Identify the exact business name and legal form of the organization. What products does it sell? And On what terms? Is it a seasonal business? What are its margins? Get a sense of the character of the owners and the business's ability to compete in its markets.

**2. Capacity:** Make sure to assess the capacity of the business to operate as an ongoing concern in every credit decision. Principals in small businesses are often forced to wear many hats. Businesses must be able to allocate resources evenly to the various functions of the organization such as marketing and sales, production and finance. Assess their experience and their ability to manage all aspects of the company without compromising efficiency.

**3. Capital:** Analyze the financial capacity of the organization in order to determine its ability to meet financial obligations in a timely fashion. Its ability to pay may be much more important. It is critical to understand the difference. Watching customer payment habits over time is an excellent indication of cash flow. Also, check bank and trade references, as well as any pending litigation or contingent liabilities. Check for a parent company relationships. A parent company's guarantee may be available. Intercompany loans might affect financial solvency.

**4. Conditions of the times:** General economic conditions in the nation, in the community, and in the industry will exert a modifying influence on the financial analysis of an account. Watch for any news items or special events that could affect the firm's ability to continue as an ongoing concern.

**5. Collateral:** A pledge of assets in the case of default.

### 2.2.4.2 Use Financial Ratio Analysis:

When entering into a relationship with a new customer, consider these two very important questions. Will I be paid slowly? And, will I be paid at all? Some companies are willing to accept some level of slow pay based on their goals and objectives and how much risk they are willing to take. Few firms are willing to accept no payment at all. Financial analysis will help Banks to determine a prospect's financial capacity to pay obligations in a timely fashion as well as their ability to maintain an ongoing relationship (Brigham, Financial management $10^{th}$ ed,2002:200).

When trying to understand the financial capacity of a prospect, a financial ratio analysis is a good place to start. The main trustworthiness ratios which summarize the four categories of financial ratios are:

**1. Liquidity (Solvency) Ratios** – supports to determine the cash available to pay obligations and the amount of debt of the prospect. Two frequently-used liquidity ratios are the current ratio (or working capital ratio) and the quick ratio.

**2. Efficiency (asset management) Ratios**- To determine how efficiently the firm runs its operations such as the collection period and inventory turnover

**3. Profitability Ratio** - To determine the firm's reinvestment in the business for future growth.

4. **Leverage ratios**: provide an indication of the long term solvency of the firm. Measures the extent to which the firm is using long term debt.

**2.2.4.3. Assess Track Trends:** An assessment of the financial capacity of a company should always include an evaluation of trends. Businesses can have a bad year, without resulting in financial difficulty. If a firm has a strong enough net worth it might be able to sustain losses for consecutive years. Evaluate trends over a three to five year period to get a clear picture of the direction a firm is heading. Look at a company's profitability and cash flow. Assess their receivables. Are they selling inventory fast enough to generate needed working capital? Is the company retaining profit to help the business grow? Profitability over time is an excellent indicator of management's efficiency. A reduction in expenses may have a minimal impact if revenues do not increase. Look at the trends of these key indicators. They will tell a clear story of a company's direction. These and a host of other questions can be answered with a thorough analysis of a company's financial capacity.

#### 2.2.4.4: Compare to a Peer Group:

Ratio results should always be compared to a peer group of or an industry comparison. Is the firm collecting faster or slower than the rest of the industry? Is this company more Profitable than other companies just like them? Make maximum use of ratios by comparing the firm to its peers using established benchmarks. Compare the company to firms in the same line of business, geographic area and employee size for a more accurate comparison.

### 2.2.5: Performing Loans

Legally, a loan or credit facility refers to a contractual promise between two parties where one party, the creditor agrees to provide a sum of money to a debtor, who promises to return the said amount to the creditor either in one lump sum or in installments over a specified period of time. The agreement may include provision of additional payments of rental charges on the funds advanced to the borrower for the time the funds are in the hands of the debtor. (htt://en.wikipedia.org/wiki/loan).

The additional payments that are in the form of interest charges, processing fees, commissions, monitoring fees among others, are usually paid in addition to the principal amount lent. Indeed these additional payments when made in accordance with the loan contract constitute income to the lender or the creditor. A loan may therefore be considered as performing if payments of both principal and interest charges are up to date as agreed between the creditor and debtor. The foregoing reveals that loans that are up to date in terms of principal and interest payments are described as performing facilities.

### 2.2.6: Non-Performing Loans

The term ''bad loans'' as described by Basu (1998), is used interchangeably with non-performing and impaired loans as identified in Fofack (2005).

(Berger and De Young, 1997) also considers these types of loans as “problem loans”. Thus these descriptions are used interchangeably throughout the study.

Generally, loans that are outstanding in both principal and interest for a long time contrary to the terms and conditions contained in the loan contract are considered as non-performing loans. This is because going by the description of performing loans above, it follows that any loan facility that is not up to date in terms of payment of both principal and interest contrary to the terms of the loan agreement, is non-performing.

Available literature gives different descriptions of bad loans. Some researchers noted that certain countries use quantitative criteria for example number of days overdue scheduled payments while other countries rely on qualitative norms like information about the customer’s financial status and management judgment about future payments (Bloem and Gorter, 2001).

Alton and Hazen (2001) described non-performing loans as loans that are ninety days or more past due or no longer accruing interest (Caprio and Klingebiel 1990), cited in Fofack (2005), consider non-performing loans as loans which for a relatively long period of time do not generate income, that is the principal and or interest on these loans have been left unpaid for at least ninety days.

A non-performing loan may also refer to one that is not earning income and full payment of principal and interest is no longer anticipated, principal or interest is ninety days or more delinquent or the maturity date has passed and payment in full has not been made (http://teachmefinance.com).

A critical appraisal of the foregoing definitions of bad loans points to the fact that loans for which both principal and interest have not been paid for at least ninety days are considered non-performing.. Therefore any loan that is outstanding for ninety days or more is considered a non-performing loan. According to (Berger and De Young 1997), such loans could be injurious to the financial performance of banking institutions.

### 2.2.7: The standard loan classifications

There is no global standard to define non-performing loans at the practical level. Variations exist in terms of the classification system, the scope, and contents. Such problem potentially adds to disorder and uncertainty in the NPL issues. For example, in the U.S., federal regulated banks are required to use the five-tier non-performing loan classification system according to BIS: Pass, Special Mention, Substandard, Doubtful, and Loss. Presently, the five-tier system is the most popular risk classification method, or, in some cases, a dual system of reporting according to their domestic policy guidelines as well as the five-tier system(http://www.bis.org/banking/index.htm).

(1) **Passed**: Solvent loans.

(2) **Special Mention**: Loans to enterprises which may pose some collection difficulties, for instance, because of continuing business losses;

(3) **Substandard**: Loans whose interest or principal payments are longer than three months in arrears of lending conditions are ceased. The banks make 10% provision for the unsecured portion of the loans classified as substandard.

(4) **Doubtful**: Full liquidation of outstanding debts appears doubtful and the accounts suggest that there will be a loss, the exact amount of which cannot be determined as yet. Banks make 50% provision for doubtful loans.

(5) **Loss (Unrecoverable)**: Outstanding debts are regarded as not collectable, usually loans to firms which applied for legal resolution and protection under bankruptcy laws. Banks make 100% provision for loss loans.

Non-performing loans comprise the loans in the latter three categories, and are further differentiated according to the degree of collection difficulties. In addition to the standardized system, efforts have been made to improve the classification of loans. For example, more countries are shortening the period when unpaid loans become past due, intending to put loans on lenders' timetable sooner and require them to address these loans before losses start to escalate. The International Accounting Standard 39 revised in 2003 focuses on recognition and measurement of financial instruments and, most importantly, defines and establishes the measurement and evaluation of impaired loans. As lenders usually make little or no loss provision for impaired loans, they are at risk to be suddenly forced to reclassify such loans as a loss and take a full write-down if the borrowers go bankrupt. The initiation of this standard is to prevent lenders from being caught off-guard.

#### 2.2.7.1 Directives of NBE on Classifications of loan or advances.

As per the NBE's directives, (2002) banks shall classify all loan and advances in to the following five classifications;

1) **Pass**: loans or advances in this category are fully protected by the current financial and paying capacity of the borrower and are not subject to criticism. In general any loan or advance, or portion thereof, which is fully secured, both as to principal and interest by cash or cash- substitutes, shall be classified under this category regardless of past due status or other adverse credit factors.
2) **Special mention:** loans or advances with pre-established repayment programs past due 30(thirty) days or more, but less than 90(ninety) days. Interest is due and uncollected for 30 days or more but less than 90 days shall be classified as special mention.
3) **Substandard**: Non-performing loans or advances part due 90 days or more, but less than 180 days shall, at a minimum, is classified as substandard.
4) **Doubt full**: Non-performing loan or advances pas due 180 days or more, but less than 360 days shall be classified at minimum, as doubtful.
5) **Loss**: Non-performing loans and advances with pre-established payment programs pas due 360 days or more at a minimum shall be classified loss.

   According to internationally accepted standard, the General provision for non-performing loan in a well managed banking institution is between 1% to 1.5% of total loan (Tan Tok Shiong, 1998:1). In Ethiopia, Banks shall maintain the following minimum provision percentages against the out standing principal amount of each loan or advance classified in accordance with the criteria for the classification of loan or advances.

| Classification category | minimum provision |
|---|---|
| 1. Pass------------------------------------------------------------------------ | 1% |
| 2. Special mention ----------------------------------------------------------- | 3% |
| 3. Sub-standard--------------------------------------------------------------- | 20 % |
| 4. Doubt full------------------------------------------------------------------ | 50% |
| 5. Loss ------------------------------------------------------------------------- | 100% |

In Ethiopia, a major factor considered in making loans is the ability of the borrower to repay the loan. However, to mitigate the risk of default, banks ensure that loans are well secured. Though advances shall be granted on the basis of the borrower's ability to pay back the advance and not on the basis to pledge sufficient assets to cover the advance in case of default, it is highly desirable for all advances made to customers and staff to be well secured. This means that in the event of default the bank shall fall on the collateral used in securing the facility to mitigate the effect of loss of principal and interest (Banking Act, 2002).

In view of the above, banks take into account the assets used in securing the facility to determine the level of provision to be made. Bank regulations act 2002 indicates that certain amount of provisions are made on the aggregate outstanding balance of all current advances, and aggregate net unsecured balance of all other categories.

### 2.2.8 Loan Processing in Banks

There is risk in the provision of credit to borrowers. This risk exists because an expected payment may not occur. Credit risk is defined as potential losses arising from the inability of credit customers to pay what is owed in full and on time (Kay Associates Limited, 2005).

In view of these credit risks that might lead to bad loans, banks have some loan request procedures and requirements contained in their credit policy documents to guide loan officers in the processing of loans for customers.

#### 2.2.8.1 Loan Approval Criteria

Approval of loan request depends on how well borrower presents himself, his business, and his/her financial needs to a lender. Lenders want to make loans, but they must make loans they know will be repaid and loan proposal should contain the following:

1. **Credit history**

Borrower Obtains a credit report on his/her business from credit reporting agencies before he/she apply so he/she know what the lender will see. Then if there are any inaccuracies or problems, he/she can address them before he/she submit his/her loan application (http://.financing/loanapp.html).

## 2. Cash flow history and projections for the business

Cash flow history is used to estimate business's cash inflows and outflows over a period of time. Lenders use it to predict the ability of clients business to create the cash necessary to pay back the loan. (http://.financing/loanapp.html).

## 3. Information about any collateral that might available.

In a startup business, a commonly used source of collateral is the equity value in real estate, such as home. Other possible collateral sources are inventory, accounts receivable, equipment and securities (http://.financing/loanapp.html).

## 4. Information about the character

Characteristics assessed in valuing character are such intangibles prior business experience, an existing or past relationship with the lender and references from professionals (accountants, lawyers, business advisors) who have reviewed clients proposals. Additionally, the care and effort that clients have put into the business planning process suggests the level of commitment to the business that the borrower has (http://.financing/loanapp.html).

## 5. Business and personal financial statements and income tax returns

There are a wide variety of ratios lending institutions might look at in assessing financial statements of borrowers. Some of the most common are:

**Liquidity:** The amount of cash and working capital a company has.

**Leverage:** The amount of debt on a company's balance sheet.

**Inventory:** An accurate count of inventory to determine inventory turnover, particularly for a wholesale or retail operation.

**Turnover (or Activity):** The turnover of receivables, inventory and sales.

**Receivables Turnover**: The amount of accounts receivable in relation to sales.

**Gross Profit Margin:** Net sales (minus returned goods, discounts, and price reductions) minus cost of goods sold.

**Return on Sales:** The percentage of profits remaining after direct expenses, overhead, unusual items and taxes. The most commonly reported mistake in obtaining a loan is that the person does not know how much money they need. Be prepared to provide not only an exact amount, but how you arrived at that amount, and what you plan on using it for.

All of this information is important for borrower to know his /her financial position and have available whether or not he/she seek a loan. Loans are indeed possible and the process of applying is in all likelihood also good for deeper understanding of the financial outlook the business (http://.financing/loanapp.html).

### 2.2.9: Factors considered in granting of loan:

There are many factors which may influence the granting of loans by most Bank Managers and a number of them are outlined below:

1. **The type of Account the Customer operates**: Although non-account owners get loans, loans are normally given to current account owners more than those who operate savings accounts.
2. **The Amount Involved**: If it is a large sum of loan, the Bank Manager will consider whether if such an amount is removed, it will not affect the financial standing of the bank.
3. **The Past Financial Dealings of the Customer with the Bank**: one with sound past financial dealings with a bank has a higher chance of getting a loan and vice versa.
4. **The Purpose for which the loan will be used**: financially yielding projects are considered more by bank managers in order to make sure that the loan will be used for projects that will yield profit so that it will enable the borrower to repay the loan.
5. **The Collateral Security Offered**: These collateral securities which are fixed assets must be the things the bank can sell easily and more than the value of the loan given.
6. **The Period of Repayment**: The period of re-payment of such loan is very important because, the Bank would not want its loan to be tied down for a very long time in spite of the fact that it changes interest on the loan.
7. **The Customers Referee**: The referee must be one who is well known to the bank and who will guarantee that in case the borrower defaults or becomes insolvent, that he will repay the loan.
8. **The Earning Power of the Customer**: The person's earnings vis-a-vis the amount to be given out as loan are some of the determining factors in granting and issuing loans.
9. **The Sources of Re-payment**: The Bank Managers will also like to know the possible sources the customer intending to borrow loans has for repaying the loan.

10. **The Present Government Policy on Bank Lending**: A Customer may fulfill all the Conditions but if government policy on lending is credit squeeze, the Bank will not grant the Loan and vice versa (Ezin article .com).

## 2.2.10: Credit Administration in banks.

Ongoing administration of the credit portfolio is an essential part of the credit process. Credit administration function is basically a back office activity that support and control extension and maintenance of credit. A typical credit administration unit performs following functions:

a. **Documentation:** It is the responsibility of credit administration to ensure completeness of documentation (loan agreements, guarantees, transfer of title of collaterals etc) in accordance with approved terms and conditions. Outstanding documents should be tracked and followed up to ensure execution and receipt.

b. **Credit Disbursement**: The credit administration function should ensure that the loan application has proper approval before entering facility limits into computer systems. Disbursement should be effected only after completion of covenants, and receipt of collateral holdings.

c. **Credit monitoring**: After the loan is approved and draw down allowed, the loan should be continuously watched over. These include keeping track of borrowers' compliance with credit terms, identifying early signs of irregularity, conducting periodic valuation of collateral and monitoring timely repayments.

d. **Loan Repayment:** The obligors should be communicated ahead of time as and when the principal/markup installment becomes due. Any exceptions such as non-payment or late payment should be tagged and communicated to the management. Proper records and updates should also be made after receipt.

e. **Maintenance of Credit Files**. Institutions should devise procedural guidelines and standards for maintenance of credit files. The credit files not only include all correspondence with the borrower but should also contain sufficient information necessary to assess financial health of the borrower and its repayment performance.

f. **Collateral and Security Documents.** Institutions should ensure that all security documents are kept in a fireproof safe under dual control. Registers for documents should be maintained to keep track of their movement. Procedures should also be established to track and review relevant insurance coverage for certain facilities/collateral. Physical checks on security documents should be conducted on a regular basis (Loan Portfolio Management Comptroller's Handbook April 1998, p.35-40).

## 2.3 General causes for loans in becoming NPL

It is fact that NPLs have a greater impact on the technical efficiency of the loans. A multiplicity of factor is responsible for increasing size of NPLs in banks. A few prominent causes for loan in becoming non-performing are:

- Poor credit appraisal system.
- Lack of proper monitoring.
- irresponsible advances to achieve the budgetary target
- There is no or lack of corporate culture in the bank. Inadequate legal provisions on for closure and bankruptcy.
- Change in economic policies / environment.
- Poor auditing practices.
- Lack of coordination between banks.
- Directed lending to certain sector.
- Failure on the part of promotes to bring their portion of equity from their own source or public issue due to market turning luck warm (Tsinghua, 2003).

**Other additional cases for NPL**

**1. Non-standardized outside circumstance is the primary factor of formation of NPL**

During the shift from planned economy to market economy, Chinese banks are affected badly by outside circumstance, for example, national policies, behavior of local governments and social credit environment, and they commit great cost for social development, economic mechanism reform and economic structure adjustment. A great deal of enterprises take the advantage of the shift to escape or abolish the bank debts, especially at the end of 1990s, through bankrupting, spinning off, merging and other various methods.

**2. Enterprises' undeveloped inside operation management is the main factor of formation of NPL**

Enterprises trouble by inflexible operation mechanism and management confusion. Enterprises lack of accurate judgment for the trend of market and enlarge production scale in industries without any consideration, which lead to serious imbalance in supply and demand; some projects even go out of production during construction. And some enterprises enter funding circulation outside the bank system to escape monitoring, through measures of opening many accounts in different banks, paying cash just after received without booking. The above factors make it difficult to reclaim loans for banks and evolve into NPL.

**3. Banks' extensive inside operation management is the important factor for NPL**

In practice, the operation mechanism, credit culture and management skills are much more influential than operational performance level, so it is important to analyze carefully on banks' internal operation management to improve credit risk management and assure sustainable healthy development (Tsinghua, 2003).

## 2.4: General methods of management of NPLs

Management of non-performing loans is the difficult task in practice. Management of NPLs means how to resolve the NPLs account in the Banks. The methods are differs from bank to bank. Some general methods of management of NPLs by the banks are;

1. **Compromise:** settlement of dispute reached by mutual concessions. Compromise should be a negotiated settlement under which the bank should ensure recovery of its dues to the maximum extent possible of minimum expense.
2. **Legal remedies**: the banks observed that the borrower is making will full default; no more time should be lost instituting the appropriate recovery preceding. The legal remedies are filling of civil suits.
3. **Regular training program**: to all of executive i.e. supervisory are compelling to under growth the regular training program on the credit and NPLs properly.
4. **Recovery camps:** the bank should conduct the regular or periodical recovery camps in the bank premises or some other common places; such type of recovery i.e. improvement camps reduce the level of NPLs in the banks.

5. **Write offs:** is also one of the common management techniques of NPLs. The assets are treated as loss assets, when the bank writes off the balances. The ultimate aim of the write off is to cleaning the balance sheet.
6. **Spot visit**: the bank officials should visit to the borrower's business place or borrower's field regularly or periodically. It's also help full to the bank to control or reduce the NPLs limit.
7. **Rehabilitation of potentially viable units**: the unit is sick due to technical obsolescence of in efficient management or financial regulations. When the bank settles the duties, of such, companies through the compromised or through the legal actions the better is to be followed (Wondimu, 2007).

## 2.5: Impact of non-performing loan on the Balance Sheet.

Banks are set up by their owners for profit. The revenue of a Banks comes mainly from the interest paid by borrowers. Main expenses of a bank are interest paid to depositors and operating expenses such as rentals, salaries of employees and various utilities. A simple profit equation is given below as:

**Profit** = Interest received from borrowers– interest paid to depositors – operating expenses. However, part of the loans given out by the bank may become non-performing. Nonperforming loan reduces the profit of the bank. The simple profit equation can be modified to account for the effect of non-performing loan on the profit of the bank.

**Profit** = Interest received from borrowers– interest paid to depositors – operating Expenses – lost loans (Tan Tok Shiong, 1998:p.1 and Yixin Hou, 2003).

## 2.6: Empirical Literature

Ning-ning (2007) in his study made on nonperforming loan causes and consequences concluded that the main root causes of NPLS as follows:

There is so-called "4-3-3" distribution for the causes of formation of corporate customers' NPL from actual practice, i.e. non-standardized outside circumstance factors account for 40%, enterprises' undeveloped inside operation management factors account for 30%, and banks' extensive inside operation management factors account for 30%.Berger and De Young (1997) identified poor management as one of the major causes of problem loans. They argue that managers in most banks with problem loans do not practice adequate loan monitoring and control. A World Bank policy research working paper on Non-performing Loans in Sub-Saharan Africa revealed that bad loans are caused by adverse economic shocks coupled with high cost of capital and low interest margins (Fofack, 2005).

Goldstein and Turner (1996) stated that ‘’the accumulation of non-performing loans is generally attributable to a number of factors, including economic downturns and macroeconomic volatility, terms of trade deterioration, high interest rate, excessive reliance on overly high-priced inter-bank borrowings, insider lending and moral hazard’’.

Rouse (1989) indicated in his work that problem loans can emanate from overdrawn account where there is no overdraft limit, overdraft taken on an account which has not been actively operated for some time and overdraft taken in excess of reasonable operational limits. He also identified lack of good skills and judgment on the part of the lender is a possible cause of bad loans. Bloem and Gorter (2001) indicated that non-performing loans may rise considerably due to less predictable incidents such as the cost of petroleum products, prices of key export products, foreign exchange rates or interest rates change abruptly. They also stated that deficient bank management, poor supervision, overoptimistic assessments o f creditworthiness during economic booms and moral hazard that result from generous government guarantees are some of the factors that lead to bad loans.

According to Pandmanabhan (1986: 26-31), causes of defaults could be classified as relating to three levels: borrower level, financing institution level, and economy level.

## Causes at borrower level:

- Loan officers often thrust a loan on an unwilling borrower in order to complete loan quotas or targets. An unwilling borrower turns out to be inefficient producer and a defaulter.
- Borrowers who deliberately divert loans to non-essential consumption find it difficult to meet repayment commitments on time.
- Investments fail to generate sufficient incomes due to improper technical advice; absence of supporting services, inadequate marketing, etc. investments also fail due to unforeseen causes like floods, drought, etc. in both cases repayment would be affected.

- When lenders have liabilities towards informal lenders, they get precedence over institutional lenders.
- Contingencies at borrower household like death, sickness, etc, affect repayment performance. Formal institutions which do not extend consumption and emergency loans are liable to have higher default rates.

## Causes at financing institution level:

- Defective procedures for loan appraisal in the financing institutions could lead to the financing of bad projects and consequent defaults.
- Quality of loan officers, their mobility in the field, and their capacity to judge borrowers as also the incentive packages available to them affect repayment performance.
- Fixing of inappropriate repayment schedules and lack of flexibility often result in defaults. Similarly, when the procedure for repayment is cumbersome borrowers tend to delay repayments.
- Defaults have a 'spread effect' particularly in the marginal cases. When lenders show reluctance to enforce sanctions against conspicuous defaulters, defaults tend to increase through a process of imitation.
- Absence of sound book-keeping has been the major cause of defaults in many institution

Although there are a large number of variables that causes non-performing loans of the bank many of them are not quantified at the branch level and unattainable with limited time. The researcher has focused on the following variables which are taken from different theoretical and empirical literatures and Understanding the relationship between the factors and non-performing loan ratio can help the bank to balance the total outstanding loan amount and take different methods to minimize the occurrence of non-performing loan.

### 2.6.1 Theoretical Frame work on Causes for non-Performing loan

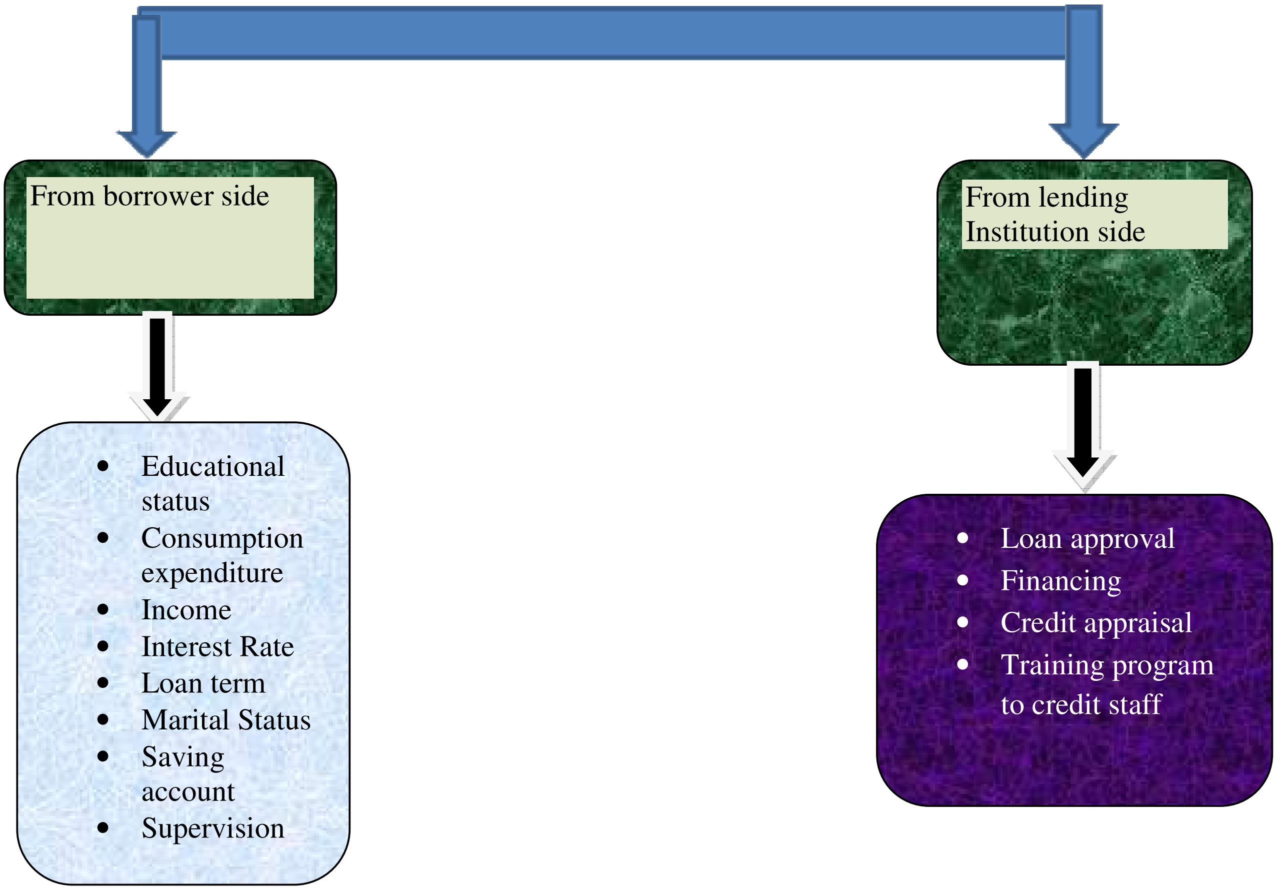



Figure 2.1 Theoretical frame works on causes for non performing loan (researcher own summary from literature reviewed).

# CHAPTER III: ORGANIZATIONAL PROFILE AND METHODOLOGY

## Introduction

This chapter pays attention to profile of the organization , how questions of the research were answered, methods that were employed in the study, the target population, sample size and sampling techniques as well as the various and appropriate sources of data and how the data were collected.

## 3.1 Organizational Background

### 3.1.1 Historical Foundation of Dashen Bank

Dashen Bank was established as per the intent of the new policy and the Ethiopian investment code. The bank came into existence on September 20, 1995 according to the Commercial Code of Ethiopia, 1960, and the Licensing and Supervision of Banking Business Proclamation No. 84/1994 (Sophia and Seid, 2005).The bank first aligns to the banking business in Ethiopia by making the inscriptions of the National Bank i.e. having the required initial capital, the minimum number of shareholders, nationality and the like. Accordingly because of meeting these requirements and getting the license to be a bank, it enrolled to the banking business in the country.

The first founding members were 11 businessmen and professional that agreed to combine their financial resources and expertise to form this new private bank. Since then the Bank has been growing now having 52 branches all over the country.

**Vision Statement:** “In as much as Mount Dashen excels all other mountains in Ethiopia, Dashen Bank continues to prove unparalleled in banking services”.

**Mission Statement:** “Provide efficient and customer focused domestic and international banking services, overcoming the continuous challenges for excellence through the application of appropriate technology”.

### 3.1.2 Services Offered by the Bank

Currently, the bank renders four major services in all of its branches namely, Credit Facility, Saving i.e. Deposit Scheme, International banking, and Fund Transfer. Moreover, the bank is has recently introduced customers Master card and Visa cards services so that they can access and use their accounts internationally. In the future, the bank has a strategy to render Internet and phone banking services to its customers. It is believed that the services will attract more customers and gain strategic advantage (Sophia and Seid, 2005).

### 3.1.3 About the Pillars of the Dashen Bank's Success

Here we want to address few facts that served as the major fabrics for the success of Dashen Bank .Like some great achievers might not seek for the role model; Dashen Bank did not stand at one point and wait for its role model in the country. Through employing visionary and shared goals, it has been climbing the mountain and plying a leading role in the Ethiopian private financial market .This is evident from that won recognition and appreciation both within and beyond the border. To mention some of the awards:

- "The most Honorable Business Leader" and "Outstanding Enterprise" award of Addis Ababa Chamber of Commerce.
- "The Best Bank of The Year" award of "The Banker" in London for four consecutive years in a row since 2000.
- Rated as "The Clear Leader and Best Bank of the Year" by globally known Euro money Magazine.
- Listed as among the top 100 banks in Africa by the renowned African business magazine.
- Rated as "Ethiopia's best Bank of the Year for 2005" by Global Finance (Dashen Bank Anniversary Special Issue, 2005).

### 3.1.4 Dashen Bank   Mekelle Branch

Dashen Bank, Mekelle branch was established in 1996 and .Like other branches, it renders major services namely, Credit Facility, Saving i.e. Deposit Scheme, International banking, and Fund Transfer, and Master card and Visa cards services. As per March 20/2010, the bank has 235 borrowing clients and 5 credit staff including the manager. It gives loan service to the following sectors: Domestic Trade and Service, Manufacturing, Building and construction, real stat and staff housing loan.

### 3.1.5: Credit facility of the Bank

The main credit facility given by the bank is over draft, Term loan i.e. short-term, medium term and long term.

**3.1.5.1: overdraft loan:** Are usually made to customers of satisfactory record as supplement of working capital. They are normally availed to individuals (business organizations) whose financial position is strong with voluminous business transaction, and that are aware of handling all transactions through the overdraft account. Such customer is also believed to be well known for their best integrity and credit worthiness. They are extended for all most all kinds of business or economic activity and are normally of short term duration usually 6month to 1year (credit manual, page 1-25).

**3.1.5.2: Term loans:** Are credit facilities which are provided for specific duration and are payable by periodic installment to be made with in the time specified. The duration is classified as:

- **Short term (maximum period 18 moth)**: financing is made to assist working capital.
- **Medium term (maximum period 60 month)**: financing is made for purchase of capital goods, trucks, public transport.
- **Long term have maximum duration exceeding 60 month**: it is extended for new investments that involve huge outlay of cash or expansion program of existing business (credit manual 1999:1-25).

## 3.2 Methodology of the Study

### 3.2.1 Research design

Descriptive study type of research was used because this method or type of research is commonly conducted to collect detail description of existing phenomena with the intent of employing data to justify current conditions and whenever possible to draw valid general conclusions from the facts discovered (Koul, 2006). This Study was a case Study on Dashen Bank Mekelle area Bank. It constitutes assessment of the trend of Non-performing loans of the bank during 2005-2009, assess the impact of non-performing loan on loan interest income and liquidity during 2005-2009, identify the causes for loans in becoming non-performing from both borrowers and lending institution side and identify methods that are used by the bank in managing NPL and thereby reduces the existing size and volume of Non-performing loans of the bank. These five consecutive years would help to have a clear picture of the bank's trend of non-performing loan. To do so, the study has highly focused on both primary and secondary data.

### 3. 2.2 Target group

The target groups of the study were the clients i.e. borrowers of Dashen bank Mekelle area and the employees who are directly involved in lending process.

### 3.2.3 Sampling technique and sample size

To select the case study i.e. Dashen Bank Mekelle Area, the researcher has used Judgment due to the personal interest of the researcher and willingness of the Bank to give relevant data regarding the study. From the two branches of Dashen Bank found in Mekelle city, Mekelle branch was selected by the researcher's personal judgment. To deter mine the sample size, the researcher has used both judgmental and a stratified random sampling. Judgmental sampling was used to determine the sample size from each stratum i.e.50% of the population from each stratum was taken because of difficulties to access all the borrowers. A stratified random sampling was chosen for three basic reasons: first, it gives more efficient sample than could be taken based on simple random sampling. Second, the assurance that the sample will accurately reflect the population on the basis of the criteria used for stratification. Third Dashen Bank classifies its clients as non-performing and performing clients based on their performance in paying back the loan as per agreement Using stratified random sampling, data of the bank as of march 20, 2010 was used and stratify as performing and Non-performing clients for the purpose of this study. There were 235 clients out of which 195 were performing clients and 40 were Non-performing clients. Following the selection of these clients, 98(50%195) of performing clines and 20(50% of 40) of non-performing clients were randomly selected. In total, 118 of clients were the sample size of the study. There are several approaches to determine the sample size. These include a census for small population, using published tables and applying formulas to calculate a sample size. In this study, the researcher has used a simple ratio (50%) of the stratified population to determine the sample size.

### 3.2.4 Types of Data

Both primary and secondary data were used. The secondary data were collected from the banks report, action plan, journals, and bulletins while the primary data were collected through questionnaire and interview.

### 3.2.5 Methods of Data Collection

Data was collected using both primary and secondary sources. Primary data gathering tools such as structured questionnaire and personal interview were used. Questionnaires that contain both open and closed ended questions were prepared and distributed to clients who were selected by the sampling technique mentioned above. Interview questions were also prepared and administered again to the branch manager and employees whose works were related to loan. Regarding secondary data, client's files, report directives, and bulletins of the bank were used.

### 3.2.6 Data Analysis Method

After the collection of primary data, the data was edited and classified i.e. response from borrower side and response from lending institution side. After that, it was analyzed and discussed by using descriptive method in the forms of tables, percentage and charts. The data collected was both qualitative and quantitative in nature and presented by using descriptive analysis.

# CHAPTER IV: RESULTS AND DISCUSSION

## Introduction

This section is concerned with the presentation, analysis, and interpretation of data gathered via the secondary sources and primary sources. Secondary sources; the banks annual report and manuals and Primary source both questionnaire and interviews were used in order to collect more information on important issues which are much related to the research objective. As stated in the previous chapter two sets of questionnaires were administered to two sets of respondents: one for clients i.e. borrowers, another for credit staffs of Dashen bank and interview was conducted with credit staffs.

## 4.1: Analysis of secondary data:

### 4.1.1 Analysis of the Trend of non-performing loans i.e. objective one

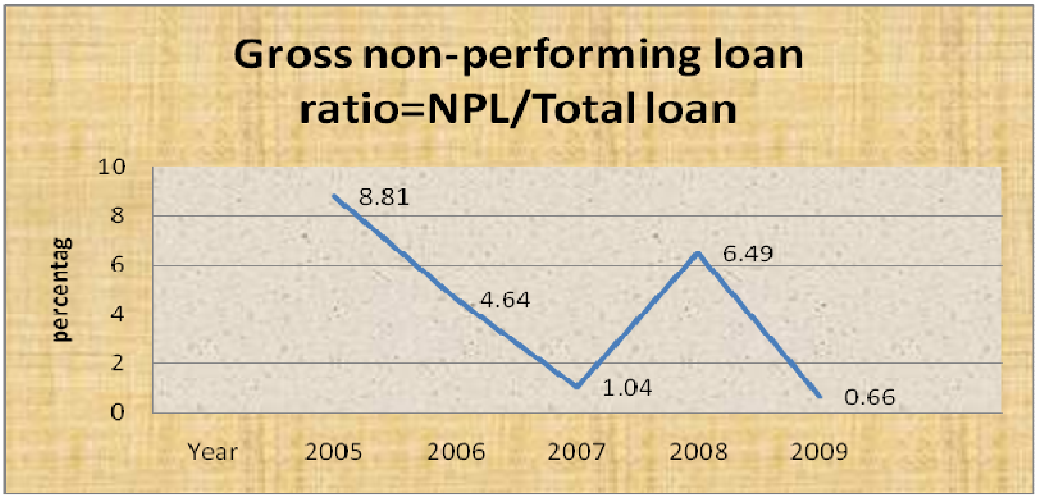
This analysis is to found the trend of non-performing loans during the period under Consideration (2005-2009).

**Table 4.1: trend of non-performing loan Dashen bank, Mekelle are branch.**

| years | Total actual loan | Total non-performing loan | **Gross Non-Performing Loans Ratio(Total NPLs/Total Loan)** |
|---|---|---|---|
| 2005 | 86,705,000 | 7,635,000 | 8.81% |
| 2006 | 104,572,000 | 5,162,000 | 4.94% |
| 2007 | 121,839,000 | 1,273,000 | 1.04% |
| 2008 | 123,938,000 | 8,040,000 | 6.49 |
| 2009 | 121,052,000 | 801,000 | 0.66% |

**Source**: Annual Report of credit and deposit operation, 2005-2009

**Figure4.1: Trend of non-performing loan (2005-2009)**




Source: credit and deposit operation report (2005-2009), un disclosed.

Table 4.1and figure4.1 shows the trend of non-performing loans ratios during the five-year period under review. Non-performing loans ratio refers to the total amount of bad loans expressed as a percentage of the total loan portfolio during the period. The ratios of non-performing loans for 2005, 2006, 2007, 2008 and 2009 were 8.81%, 4.94%, 1.04%, 6.49 and 0.66% respectively. The table further reveals that 2005 recorded the highest proportion of non-performing loans followed by 2008, 2006 and 2007, while 2009 recorded the lowest.

According to the manager's justification, in 2005, most of the bank's loans did not perform well due to poor and reluctant customers follow up and hence creating repayment problems. These repayment problems resulted in the huge non-performing loans during the period. To improve on the loan portfolio quality of the bank, management put in place certain measures which resulted in a general falling trend of the non-performing loan ratios as indicated by Figure 4.1 for the year 2006 and 2007 and it resulted declining of nonperforming loan to 4.94% and 1.04% respectively. The main reasons for the improvements were; strengthened coordination between head office and the area bank in line with assessment of risk, evaluation of customer before disbursement of loan and rescheduling of customer visit and follow up frequency.

In the year 2008, as shown by the figure, ratio of nonperforming loan increased to 6.49%.This was due to market problem and deliance of loan repayment, especially loan granted to Domestic Trade and Service. The factors that accounted for the declining trend in the year

2009 are stability of the market to some extent and strong follow up taken by the loan officer and branch manager in collaboration with the Head office in accessing information on the clients. Thus, the non-performing loan ratio as of June 30, 2009 was reduced to 0.66%.

It can therefore be concluded that though the bank had huge proportions of nonperforming loans during the period, management was able to improve on the quality of its loan portfolio by minimizing the ratios of non-performing loans.

### 4.1.2 Nonperforming loan and Loan Interest Income i.e. objective Two

Loan interest income is the predominate source of income for the bank. The analysis found the impact of non-performing loan on loan interest income as Shown in Table 4.2 bellow:

**Table 4.2 Impact of non-performing loan on Loan Interest Income**

| Year | Loan interest income expected to collect. | Nonperforming loan i.e. uncollected interest income. | Ratio of nonperforming loan to loan interest income |
|---|---|---|---|
| 2005 | 20,579,000 | 7,635,000 | 37.1% |
| 2006 | 27,263,000 | 5,162,000 | 18.93% |
| 2007 | 45,326,000 | 1,273,000 | 2.81% |
| 2008 | 59,053,000 | 8,040,000 | 13.62% |
| 2009 | 73,856,00 | 801,000 | 1.09% |
| TOTAL | 226,077,000 | 22,911,000 | 10.13% |

**Source: Annual Report of credit and deposit operation, 2005-2009**

Table 4.2 shows that there was a consistent increase in the interest income generated by the bank's loan portfolio. However, this was reduced by NPLS which are shown by the ratios 37.1%, 18.93%, 2.81%, 13.62% and 1.09% for 2005, 2006, 2007, 2008 and 2009 respectively. The table further shows that in 2005 and 2006, NPL eroded a substantial amount of the bank's loan interest income as indicated by 37.1% and 18.93%. The huge reduction in loan interest income by 37.1% in 2005 was due to high NPLS caused by Domestic Trade and service loans, and ineffective loan recovery attributed to inadequate follow ups. The ratios of NPLS to loan interest income declined from 37.1% in 2005 to 18.93% in 2006 and dropped further to 2.81% in 2007.

This was due to improved loan monitoring and recovery supported by increased credit staff good coordination with the Head office. However, the ratio in 2008 rose from 2.81% in 2007 to 13.62% in 2008. This was as a result of huge non-performing loan in that year, which was due to market problem. Non-performing loan ratio also decreased from the 2008 ratio of 13.62% to 1.09%in 2009, indicating effective measures put in place by management to improve upon its interest income through good monitoring and improved market condition. It can be concluded from the foregoing that the huge reduction in loan interest income impacted negatively on the total income earnings of the bank during the period. It can therefore be concluded that though the bank was able to reduce NPLS from 2005 to 2007 and from 2008 to 2009 through intensive loan recovery activities, the overall impact of NPLS on its loan interest income was negative.

### 4.1.3 Analysis of the impact of non-performing loan on Lending Fund i.e. objective Two

Banks depend largely on customers' deposits to create loans. Therefore if banks grant loans and they are not able to recover such loans including interest charges, it reduces the funds available for lending and as such affect its capacity to create more loans for customers.

**Table 4.3: Impact of non-performing loan on liquidity**

| **Year** | Nonperforming loan amount | Funds that would have been available for lending(2006-2010) |
|---|---|---|
| 2005 | 7,635,000 | - |
| 2006 | 5,162,000 | 7,635,000 |
| 2007 | 1,273,000 | 5,162,000 |
| 2008 | 8,040,000 | 1,273,000 |
| 2009 | 801,000 | 8,040,000 |
| | | |

**Source: Annual Report of credit and deposit operation, 2005-2009**

Table 4.3 shows that an amount of 7,635,000,5,162,000,1,273,000,8,040,000,and 801,000 would have been available for lending in the subsequent years(2006-2009), but as a result of NPLS lending funds have been reduced by this amount. This obviously affected the financial performance of the bank since the interest income was lost due to NPL. It is therefore worth pointing out again that the incidence of NPL during the period seriously affected negatively the liquidity of the bank.

### 4.1.4: Analysis of the sector with high non-performing loan i.e. objective three

**Table 4.4: Sectors with high non-performing loan**

| Sectors | No. of defaulters | percent |
|---|---|---|
| Domestic Trade and Service | 30 | 75 |
| Manufacturing | 4 | 10 |
| Building and construction | 6 | 15 |
| Total | 40 | 100 |

Source: customer profile of the Bank as per March28, 2010.

The study also found out the sector which records high rate of NPL. It was revealed that 75% of the defaulters are from Domestic Trade and Service sector loans and recorded higher NPLS. As per the response of the management, this fact was due to lack of market and poor educational status of the clients on business activity. As shown by table4.4, 15% and 10% of the defaulters were clients who have been engaged in Building and construction and manufacturing respectively. In case of Building and construction and Manufacturing, the problem is due to lack of market and loan diversion. As it can be seen from the above table, it can be concluded that there is concentration of loan portfolio on one sector i.e. Domestic Trade and service. This could result in weak portfolio diversification and high credit risk.

## 4.2: Analysis of primary data:

**Table 4.5: Questionnaire distributed and collected**

| Questionnaires | **Response** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Clients(borrowers)** | | | | **Total** | | **Employees** | |
| | **Performing** | | **Nonperforming** | | | | **No.** | **Percent** |
| | **No.** | **percent** | **No.** | **percent** | **No** | **percent** | | |
| Distributed | **98** | **83.1** | **20** | **17** | **118** | **100** | **5** | **100** |
| Collected | **63** | **53.4** | **11** | **9.31** | **74** | **62.71** | **5** | **100** |
| uncollected | **35** | **29.67** | **9** | **7.62** | **44** | **37.29** | **-** | **-** |

Source: primary data collected through questionnaire.

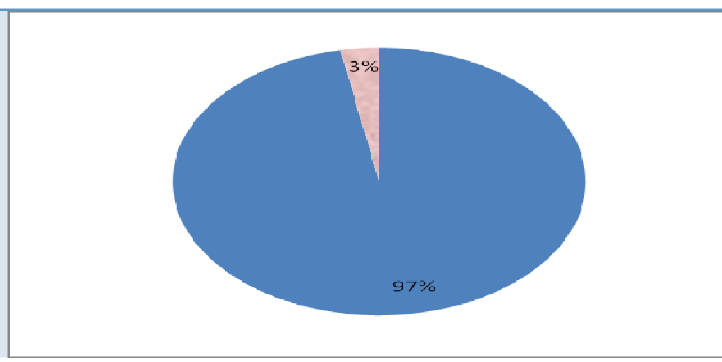
As it can be seen from the above table 4.5, though 118 questionnaires to borrowing clients and 5 questionnaires to employees of the bank were distributed; only around 62.71% from clients and 100% of them from employees were collected. This is sufficient response rate because more than half of the questionnaires were collected and used for the analysis. About 44% of the questionnaires from clients were not collected due to the reluctance of the respondents. Thus, only74 (62.71%) of the questionnaire from borrowing clients and 5(100%) of questionnaires from employees were used for the analysis.

### 4.2.2: Responses from the banks client i.e. borrowers.

#### 4.2.2.1: Demographic characteristics of banks client respondents.

Demographic factors are the most important indicators of performance in any affairs of economic activity. Thus, in this research, the demographic characteristics of respondents like sex, age, marital status and education level were emphasized.

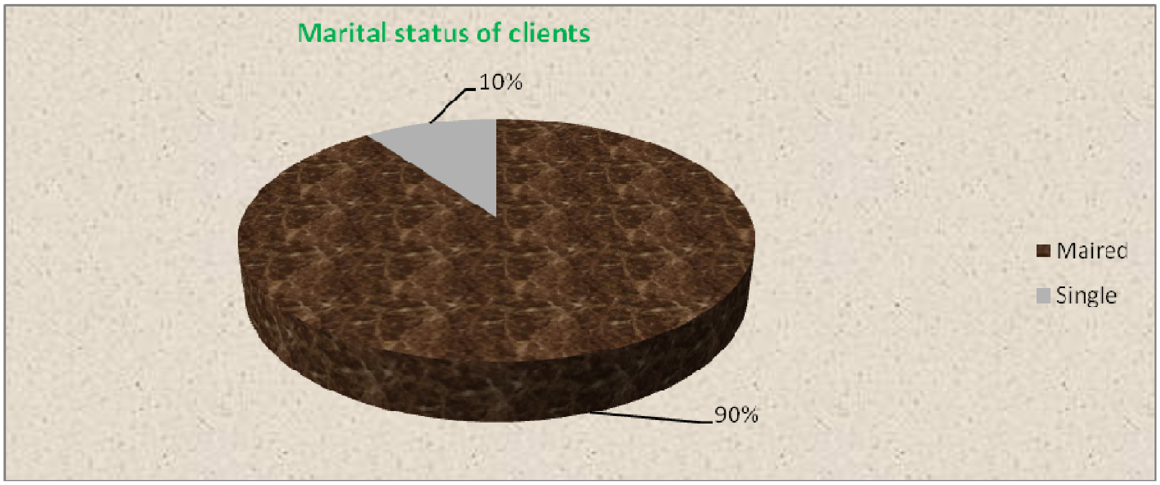
**Figure4.2: sex of Respondents**




Source: primary data collected through questionnaire.

As it can be seen from figur4.2 about 97% of the respondents are male while 3% of the respondents are female. This indicates that more of the bank's clients i.e. borrowers are male this is because of the fact that most of the clients approaching the bank for borrowing fund are male. Thus it can be concluded that female clients are very few as compared to male.

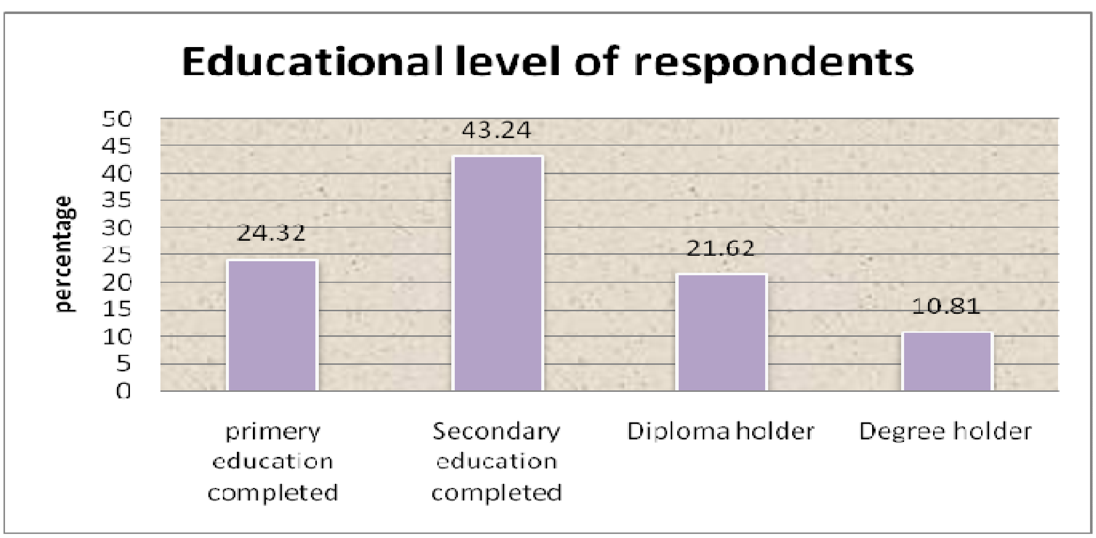
**Figure4.3: Marital status of respondents**.




Source: primary data collected through questionnaire.

Knowing the marital status of borrowing clients of the bank helps to protect itself from difficulties incase of default (avoiding disputes of the couples while seizing the collaterals. as shown by figure 4.3, 90% of the borrowers are married and 10 % are single. Thus, it can be said that creating belongingness of the project (collaterals) among family members could not be as such a problem incase of default and seizing of collaterals.

**Figure4.4: Educational level of respondent**




Source: primary data collected through questionnaire

As shown by figure 4.4, 24.32 % of the borrowers are primary education completed, 43.24% are secondary education completed, 21.62 % are diploma holders and10.81% are Degree holders. Thus, it can be concluded that majority of the borrowing clients are secondary educated (9-12) completed.

#### 4.2.2.3: Response on maturity profile of the loans by clients

**Table 4.6: Maturity profiles of clients' loan**

| Loan based on maturity | Total clients/loan type. | Sampled Borrowing clients | | | | Total respondents | |
|---|---|---|---|---|---|---|---|
| | | Performing | | Nonperforming | | | |
| | | No. | percent | No. | percent | No. | percent |
| Short-term(with 1year) | 41 | 15 | 20.72 | 3 | 4.1 | 18 | 24.32 |
| Medium term(between 2-5years) | 176 | 40 | 54.05 | 6 | 8.1 | 46 | 62.16 |
| Long term(over5years) | 18 | 8 | 10.81 | 2 | 2.7 | 10 | 13.52 |
| Total | 235 | 63 | 85.12 | 11 | 14.9 | 74 | 100 |

Source: primary data collected through questionnaire.

As it can be seen from table 4.6, out of the 74 borrowing clients sampled, 18(24.32%), 46(62.16), and 10(13.52) of the clients are short term, medium term and long term loan borrower respectively. Thus, it can be concluded that majority of the banks borrowing clients are medium term loan borrower and this could reduce credit risk due to long maturity period and also encourages good repayment as compared to other loan types.

#### 4.2.2.4: Responses on the business activity in which the borrower client is engaged.

Dashen Bank, Mekelle area Bank, North Region, Tigray is one of the financial institutions engaged in providing short, medium and long-term loan. There are different sectors which are financed by the Bank including: Industry, Building and construction and Service. In order to know which sector as a project is mostly undertaken and financed by the bank, respondents are asked to give their responses.

Accordingly, the responses of the respondents are summarized as follows:

**Table 4.7: Business activities in which the clients are engaged.**

| Business activities | Total clients /business activities. | Clients. | | | | Total respondents | |
|---|---|---|---|---|---|---|---|
| | | Performing | | Non- performing | | | |
| | | No. | percent | No. | percent | No. | percent |
| Domestic trade and service | 195 | 46 | 62.16 | 3 | 4.05 | 49 | 62.23 |
| Manufacturing (industry) | 15 | 8 | 10.81 | 2 | 2.70 | 10 | 13.51 |
| Building and construction | 10 | 4 | 5.41 | 5 | 6.76 | 9 | 12.16 |
| others | 15 | 5 | 6.76 | 1 | 1.35 | 6 | 8.11 |
| Total | 235 | 63 | 85.14 | 11 | 14.86 | 74 | 100 |

Source: primary data collected through questionnaire.

As it is shown by table 4.7, Domestic trade and service is the dominant sector and it is highly financed by the Bank by constituting about 49% of the respondents' responses. About 10% of the respondents have indicated that Industry (manufacturing) is the second sector/project financed by the bank while Building and construction and other sectors like staff housing loan and loan under reactivation are ranked third and fourth respectively.

This indicates that the bank is highly financing Domestic trade and service because most of the societies living around Mekelle Town and clients in other small cities like Maicho, Wukuro are engaged in this sector. The bank does not give loan to agricultural sector especially in Tigray region. Thus, as it is indicated by table 4.7, there is concentration of loan portfolio to one sector (Domestic Trade and Service) which resulted in high non-performing loan .Thus, it can be concluded that the bank do not finance agricultural sector in the region. But whatever the communities are mostly engaged in one dominant economic activity, there are certain areas which are favorable for agriculture. Considering the farmers potential in agriculture, financing of the sector could support the bank by diversifying portfolio risk and even encourage development of the agricultural sector in the region.

**Table 4.8: Clients' response on factors that causes Non-performing loan from the borrower side i.e. objective four**

| | | Clients | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Performing(1) | | | | Non-performing(2) | | | | Total Respondent /each factor. | | | |
| **Causes** | Total sample (1+2) | yes | | No | | yes | | No | | yes | | No | |
| | | No. | % | No. | % | No. | % | No. | % | No. | % | No. | % |
| Lack of sufficient income | 74 | 39 | 53 | 24 | 32.4 | 7 | 9.16 | 4 | 5.4 | 46 | 62.16 | 28 | 37.84 |
| Lack of proper education on the business area. | 74 | 40 | 54.0 | 23 | 31.1 | 9 | 12.2 | 2 | 2.7 | 49 | 66.22 | 25 | 33.78 |
| Lack of saving account. | 74 | 20 | 27 | 43 | 58.1 | 5 | 6.78 | 6 | 8.1 | 25 | 33.78 | 49 | 66.22 |
| Absence of sufficient infrastructure. | 74 | 35 | 47.3 | 28 | 37.8 | 8 | 10.81 | 3 | 4.05 | 43 | 58.11 | 31 | 451.89 |
| Lack of sufficient supervision from the bank. | 74 | 27 | 36.5 | 36 | 48.7 | 7 | 9.45 | 4 | 5.4 | 34 | 45.95 | 40 | 54.05 |
| High consumption expenditure. | 74 | 15 | 20.28 | 48 | 64.9 | 8 | 10.8 | 3 | 4.05 | 23 | 31.08 | 51 | 68.92 |
| High interest rate charged by the bank. | 74 | 10 | 13.5 | 53 | 71.6 | 2 | 2.7 | 9 | 12.2 | 12 | 16.12 | 62 | 83.78 |

Source: primary data collected through questionnaire.

The explanation (justification) given by borrowing clients on the causes of default have been described as follows:

### 1. **Lack of sufficient income and proper education on the business area.**

Table 4.8 above reveals that 46 (62.16%) of clients responded lack of sufficient income and 49(66.22%) of clients responded that lack of proper education on the business area are the main causes for NPL from the borrower side. this is because of poor feasibility study before starting the business, high competition, lack of good awareness' on business condition and fluctuation of market.

**2. Absence of sufficient infrastructure and lack of sufficient supervision from the bank**.

As it is shown by table 4.8 above, 43(58.11%) of respondents replied lack of sufficient infrastructure and 34(45.95%) of respondents replied absence of sufficient supervision are also main causes for loan default from the borrowers side. As justification given by respondents, the absence of sufficient infrastructure like power, water especially affects the production performance of industries and building and construction sectors. This leads to inability of the borrowers to pay the loan on time. Next to lack of sufficient infrastructure the main cause for default is absence of scheduled client's supervision from the bank. The clients justified that the management on behalf of the bank makes supervision through field visit mostly two times; at the time of loan request before disbursement and at the time when default occurs. From the justification it can be concluded that even if frequently visiting and supervising the client is not as such recommendable point because of the reason that the cost of visiting clients frequently exceeds its output; the frequency of clients' supervision by the bank is low.

3. **High consumption expenditure, lack of sufficient saving account and High interest rate charged by the bank**.

Table 4.8 above reveals that out of 74 respondents, 25( 33.78 % ), 23( 31.08 %), and 12( 16.22% ) respondents indicated that lack of saving account, high consumption expenditure and high interest rate charged by the bank respectively causes delliance of loan repayment. the justification given by the respondents on those factor are as follows: regarding lack of sufficient saving account, they justify that especially clients who are engaged in Building and construction sector are incapable of earning good return because of fluctuation of market condition and increasing cost of inputs. As it can be seen from the table, 12(16.22%) of the respondent indicated that high interest rate charged by the bank is also one factor for deliance of loan repayment. As the justification of clients especially those who take long term loan, the interest rate charged on long term loan is 11% and the existing market problem hinders repayment of the loan on time. In addition to the above mentioned factors, 23(31.08 %) of the respondents have indicated that burden of high consumption expenditure is also another problem for bad loan.

#### 4.2.3: Employee's response on loan delivery, problems related to loan delivery and factors accounting for nonperforming loan from lending institution side.

##### 4.2.3.1: Employees Responses on how the bank gets information on potential borrowers before loan decision.

To identify the strength of the bank in relation to identification of client's financial status and general back ground, the researcher has used three means of accessing information and responses of the employees were as follows:

**Table4.9. Means of accessing information on borrowers.**

| Means of accessing information on borrowers. | Total sampled | Yes | Percent | No. | Percent |
|---|---|---|---|---|---|
| Community and neighborhood ties. | 5 | 1 | 20 | 4 | 80 |
| The companies own record like balance sheet, income statement, and feasibility of the projects. | 5 | 5 | 100 | - | 0 |
| Through interviewing of borrowers. | 5 | 5 | 100 | - | 0 |

Source: primary data collected through questionnaire and interview.

As it can be seen from table 4.9, 100 percent of respondents said that the bank relied on the company's own record like balance sheet, income statement, and feasibility of the projects and through interviewing of borrowers for information on potential borrowers before loan. 20 percent of respondents said that the bank relied on community and neighborhood ties. The managers engaged themselves in obtaining personal details of their customers. They went the extra mile to know the residences of their customers or identified the various traders' organizations to which they belonged. Information relating to the character of the customers is obtained from interactions with people in the community or the traders' organizations to which they belonged. They have found this method of gathering information on their clients to be very useful as it enables them to know the customers better (KYC principle). Especially when the borrowing clients do not have assets that could be used as collateral for the credit advanced to them, the Bank relied on information gathered by this method to ensure that the loans granted did not go bad. But as compared to the other means of accessing information about client before giving loan, this method is not much used by the bank.

### 4.2.3.3: Employees' response on factors considered in evaluating loan request of clients.

Table 4.10. Factors considered by the bank in evaluating loan request of clients.

| Factors considered | Employees | | | | TOTAL | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | Yes | | No | |
| | Yes | Percent | No | Percent | No. | percent | No. | % |
| Feasibility study | 5 | 100 | - | 0 | 5 | 100 | 0 | 0 |
| collateral | 5 | 100 | - | 0 | 5 | 100 | 0 | 0 |
| Financial statement | 5 | 100 | - | 0 | 5 | 100 | 0 | 0 |
| Track record(repeated borrowing) | 1 | 20 | 4 | 80 | 1 | 20 | 4 | 80 |

Source: primary data collected through questionnaire and interview.

As it can be seen from table 4.10, 5(100%) of the respondents have replied that to evaluate the financial status of clients before approval of loan the bank mostly depends on Feasibility study, collateral value and Financial statement.1 (20%) of the respondents has replied that the bank also use information regarding the character of the client with respect to repeated borrowing and this information could be accessed from the national bank of Ethiopia. As compared to other criteria, it is less frequently used in the bank. Thus, it can be said that regardless of the financial status of a client as per financial statement or collateral value, consideration repeated borrowing habit of client by the bank is low. This could support the bank to avoid loan diversion problems of clients which result in delayed loan repayment.

### 4.3.3: Employees' response on factors hindering effective monitoring of loan.

Table 4.11: Employees' response on factors which affect effective monitoring of loan.

| Causes | Employees | | | |
|---|---|---|---|---|
| | yes | | No | |
| | No. | percent | No. | percent |
| Under staffing | 2 | 40 | 3 | 60 |
| Insufficient training program to executives on credit and NPL. | 3 | 60 | 2 | 40 |
| Poor road to project sit | - | 0 | 5 | 100 |

Source: primary data collected through questionnaire and interview.

As it can be seen from table 4.11.above, 3(60%) and 2(40%) of the respondents notified that the main factor that hinders effective monitoring of loan are ineffective supervision or training program given to executives (management) and under staffing respectively. As per the interview conducted with the manager of the bank the justification given for the causes are as follows:

As per the legislation of Dashen bank S.C., if area banks borrowing client reach's above 100 in number, there must be loan clerk who follow up loan collection and supports loan officer in different activities. But Dashen bank Mekelle area bank has 235 borrowing clients as per data of March 20th 2010.this implies that there is work load on the loan officer and this leads to in effective monitoring of loan.

Regarding supervision (training program to executives, the bank has no scheduled training program to executives rather training on credit and NPLS is made very infrequently. Thus, Proactive effort taken in dealing with executives of the bank to implement remedial plans, by maintaining frequent training and follow-up actions is low. Often rigorous efforts made at an early stage to have skilled man power on credit management prevent institutions from litigations and loan losses of performance.

### 4.12: Employees' response on delliance of loan approval.

**Table 4**.12 **causes for delayed loan approval**

| Causes | Employees | |
|---|---|---|
| | No. | percent |
| Rigid approval procedure | 2 | 40 |
| Customer inability to meet approval requirement. | 3 | 60 |
| Liquidity problem | - | 0 |
| Total | 5 | 100 |

Source: primary data collected through questionnaire and interview.

As it can be seen from table 4.12, 60% 0f interviewed employees have responded that cause for delayed loan approval is customer inability to meet approval requirement and 40% of the respondents replied that rigid approval procedure has also a significant effect on effective loan approval. Thus, it can be concluded that the main reasons for delayed loan approval are customer's inability to meet requirement and rigid approval procedure.

**4.13: Employees response on under financing of projects**

Table 4.13 causes for under financing of projects.

| Causes | Employees | |
|---|---|---|
| | No. | Percent |
| Poor credit appraisal | 2 | 40 |
| Inadequate collateral | 3 | 60 |
| Liquidity problem | - | 0 |
| Total | 5 | 100 |

Source: primary data collected through questionnaire and interview.

As it is shown by table4.13, the main causes for under financing of projects of client are poor credit appraisal and inadequate collateral presented by clients. As per the response of the employees, 60% of the respondents replied that inadequate collateral is the 1st main factor. Thus, it can be concluded that inadequate collateral presentation is the most factor that causes under financing and poor credit appraisal is also the other factor. As it can be seen from table 4.13, the bank do not face problem of under financing clients project because of liquidity problem.

**4.2.3.6: Employees' response on Factors accounting for non-performing loan from the lending institution side i.e. objective four**

Table 4.14: Factors accounting for non-performing loan from lending institution side.

| Causes | Employees | | |
|---|---|---|---|
| | No. | percent | Rank |
| In effective monitoring of loan | 1 | 20 | 2nd |
| Poor credit appraisal | 3 | 60 | 1st |
| Delayed loan approval | 1 | 20 | 2nd |
| Under financing | - | 0 | |
| Total | 5 | 100 | |

Source: primary data collected through questionnaire and interview.

From Table 4.14, respondents ranked poor credit appraisal, ineffective monitoring and delayed loan approval as the most important factors affecting the quality of loan recovery. The explanations given by respondents for the causes of bad loans in the bank have been explained as follows:

- **Poor Credit Appraisals and Ineffective Monitoring**

Table4.14. Above reveals that poor credit appraisal; ineffective monitoring and delayed loan approval are ranked the most important factors with a score of 60%, 20% and 20% responses for each of these three factors. The respondents indicated that poor appraisal of credit requests by credit officers result in wrong credit approval decisions that lead to loan repayment problems. The reason is that ineffective analysis of financial ratios, cash flow statements, credit risks analyses among others, usually give misleading information to the approving authority on the customer's financial position and ability to repay the loan. According to the respondents poor credit vetting also result in delayed loan approval which results in loan problems. The table further shows that ineffective monitoring of loans is a major cause of bad loans as indicated by a score of 20% shown in table 4.14 above. The respondents explained that monitoring of loans entails keeping track of the loan customers' activities in relation to the loan on regular basis to ensure that the terms and conditions of the facility are complied with as contained in the loan agreement. This includes on-sight and off-sight monitoring. It come up that mostly credit officers ignore on-sight monitoring which has to do with field visits to determine how customers are performing in their activities and their ability to repay loans on time. The problem of ineffective monitoring is due to inadequate resources such as under-staffing and logistics that aid effective monitoring.

- **Delayed loan Approval and under financing.**

The respondents believed that delayed loan approval (see table 4.14 above) is one of the second major factors that accounts for non-performing loans. A key respondent indicated that this has serious consequences for time-bound projects like construction and some trading activities. The data shows that 20% of respondents' scores indicate that delayed loan approvals is also one factor for loan becoming non- performing and this is due to Poor credit appraisal. Table 4.14 also shows that no inadequate financing because if the customers come with full filling the requirements, the bank can finance fully.

## 4.3. Employees response on the methods that management uses to reduce non-performing loan i.e. objective five

As per interview conducted with the manager and loan officer of the bank as well as employees whose work are related to credit activity, the bank commonly uses the following methods to manage non-performing loan:

- During loan assessment, giving attention to factors like; sit, location, demography of borrowers (sex, age, education level, and culture).
- Credit-follow up: it involves the following procedures:

1. After disbursement of the loan, programmed visit is made to know the direction of the business of the customer, to have clear picture of performance of borrowers.
2. If borrower appear negligent, giving verbal reminder calling him and discussing over the matter.
3. If verbal reminder do not show positive result, giving good awareness how his delliance of repayment affects other borrowers and lending institution.
4. If the above mentioned measures do not show positive result, giving second reminder indicating that the bank will take serious measures and the loan is passed to "reactivation account" and stopped interest earning. Area bank loan officers and manager discuss with the client and consider alternatives like extension of the life of the loan based on justification.

- Rehabilitation of loan: Loan rehabilitation is the process of recovering a loan that has gone into default and making the loan active once again. The process for any type of rehabilitation of the loan involves establishing new guidelines for repayment, refinancing the current balance owed. In general, a loan rehabilitation program of any type seeks to protect the interests of both the lender and the debtor by providing a fresh start for both parties. The debtor has the opportunity to put past financial issues behind him or her, and make a fresh start. The lender avoids the expense and time associated with pursuing recompense through legal channels, a process that often adds more financial burden to the lender.

If the above mentioned measures cannot solve the problem of bad loan with reference to particular borrower, the bank sometimes uses court action and seizing of collaterals.

In the lending process, the bank prefers maturity period of loan as primary bases and collateral and credit worthiness as a second base. The bank prefers maturity period of loan (short term and medium term) loan mostly.

This is for the seek of securing the bank by setting frequent repayment schedule(monthly and quarterly loan repayment schedule) for short and medium term loans charging interest rate of 8.5% and9.5% respectively.

One of the main approaches for treatment of defaulter is loan rescheduling; if there is promissory condition that reveals the borrower can improve its financial status only. Thus, it can be concluded that the Bank can sustain the soundness of its assets as well as its profit performance by applying rehabilitation in most case rather than taking court action and even seizing of collateral unless the Bank determines that rehabilitation of a debtor would be difficult. Selling of seized collateral is difficult in the area because of cultural constraints, especially if defaulter is living in small Towns like Wukuro, Maicho etc and this is because of considering the event as evil did.

## 4.4: Techniques of evaluating a client to deter mine whether loan is recoverable.

In order to determine whether loan is recoverable, the loan officers in collaboration with credit analysts try to know the status of the business situation of clients and determine the Grade or rank of the loan as follows:

**Table 4.15: Techniques of evaluating clients to determine loan recoverability.**

| No | Status of business situation | Grade(rank) |
|---|---|---|
| 1 | No arrears | 1.pass |
| 2 | One or two payment arrears but no visible weakness in the business | 2.pass |
| 3 | Irregular payment and occasional delinquency | 3. Causing concern |
| 4 | Irregular payment, adverse trend in the business operation, unfavorable business condition. | 4. marginal |
| 5 | Have well defined weakness, inadequate collateral coverage | 5.substandared |
| 6 | Collection of loan under current circumstance is highly questionable | 6.default |
| 7 | If considered uncollectible and not recoverable at future date | 7.loss |

Source: credit manual November, 1999(page 83).

Depending on the status of a client as per the above grade (rank), the loan officers determine provision for each category of loan. The minimum provision rate used by the bank per each category of loan (pass, special mention, substandard, Doubtful and Loss are described as follows:

**Table 4.16: Loan category and Minimum provision as Per the Bank.**

| **Loan category** | **percentage tag of Minimum provision as per the bank(loss/total loan by a client)** |
|---|---|
| Pass | 1% |
| Special mention | 1-5% |
| Sub standard | 5-20% |
| Doubtful | 50% |
| Loss | 50-100% |

Source: credit manual November, 1999(page 90).

As shown by table 4.16, the bank determines Specific provision rate by identifying specific customer who turned bad. The provision is created based on reviewing the individual debtor who is owing to the company.

Unlike the general provision rate (as per the directives of National bank of Ethiopia 2002), these specific provisions might be based on documentary evidence like litigation and other investigations that prove that the debtors might turn bad hence the need to create the specific provision. Thus, even if it needs a critical investigation of each client's business status, it could help to determine good estimate of provision for doubtful loan. but as it is shown by table 4.16, the provision for special mention loan is (1-5%) and it is not in conformity with the standard provision rate set by national bank of Ethiopia (3%).For instance if the provision rate is taken as 5%, it understate the net income of the bank and reduce tax payable to government. therefore it can be concluded that the bank uses the higher standard rate for special mention loan.

In general it can be concluded that the provision rate for doubt full loan by the bank is much greater than the generally accepted standard rate of well managed Bank i.e.1-1.5%.

# CHAPTER FIVE

# SUMMARY, CONCLUSION AND RECOMMENDETION

**5.1 Introduction**

This chapter entails a summary of the research findings, conclusions and recommendations relating to the study objectives. This is very essential as it gives the implications of the findings and the possible measures that could help reduce the problem of bad loans.

## 5.1 Summary of Findings.

The findings show that the bank recorded huge amount of non-performing loans, especially in 2005 and 2008 as shown by 8.81% and 6.49% of total loans respectively, during the period. The non-performing loans ratios for the past five years, however, indicated a general declining trend. This means that management of the bank improved upon its loan monitoring and recovery activities during the period.

The analysis revealed that loan interest income has been reduced by NPL amount of 22,911,000 representing 10.13% of the loan interest. This indicates that a substantial amount of the loan interest income was eroded by bad loan. The impact of NPL on loan interest income was particularly high in 2005 and 2008 with ratios of 8.81% and 6.49% respectively. This greatly affected the financial performance of the bank since loan interest is a major source of income to the bank. In spite of this, the ratios showed improved trend due to effective loan recovery carried out by management of the bank.

The findings also show that the bank also lost loan amount of 22, 911, 000 which would have earn interest on the lending funds lost, as a result of NPL . This means that NPL reduced the liquidity position of the bank and as such affected its lending capacity. It is also worth noting that among the sectors of the bank's lending activities, the Domestic Trade and Service recorded the highest incidence of NPL as shown by 75% of the respondents and other sectors; Building and construction and Manufacturing loans Recording 15% and 10% each.

The findings of the study revealed several factors that caused loan default and hence bad loans. Ineffective monitoring of loans, delayed loan approval and poor credit appraisal were emphasized by all respondents as major causes of the loan problems from the bank side and lack of sufficient income, lack of knowledge on the business area, inefficient infrastructure, high consumption expenditure, high interest charge, and lack of sufficient supervision from the bank are identified as causes for bad loan from the borrower side.

To manage occurrence of NPL, the bank commonly uses the strategies like: During loan assessment, giving attention to factors like; sit, location, collateral value, demography of borrowers (sex, age, education level, and culture). After disbursement of the loan, programmed visit is made to know the direction of the business of the customer, to have clear picture of performance of borrowers and also uses loan rehabilitation which seeks to protect the interests of both the lender and the debtor by providing a fresh start for both parties.

## 5.2 Conclusion

The findings as briefly summarized above give rise to some conclusions that could be drawn from the analysis.

- It is evident from the findings that the bank's loan portfolio contained some amounts of non-performing loans as shown by non-performing loan ratios during the period. The declining trend however reflects management efforts at improving the bank's loan portfolio management.
- In view of the reduction of the loan interest income, and lending funds, it can be concluded that bad loans seriously affected the financial performance of the bank in the five-year period.
- Regarding the sector with the high nonperforming loan, the finding of the study reveals that Domestic Trade and Service sector credit which is a core lending activity of the bank is heavily exposed to credit risk than other sectors because of lack of market and poor educational status of the clients on the business activity they engaged.

- Most of the borrowers are married. Thus, it can be said that creating belongingness of the project (collaterals) among family members could not as such a problem incase of default and seizing of collaterals.
- Majority of the borrowing clients are secondary educated (9-12) completed and it has an adverse effect on effectiveness of clients on the business area they engaged.

- Majority of the banks borrowing clients are medium term loan borrower and this could reduce credit risk due to long maturity period and also encourages good repayment as compared to other loan types.
- To access information on clients before giving loan, the bank largely depends on client's financial statement. But it does not use other ways; Community and neighborhood ties.
- There is problem of delayed loan approval due to rigid approval procedure and Customer inability to meet approval requirement.

- The bank is highly financing Domestic trade and service because most of the societies living around Mekelle Town and clients in other small cities like Maicho, wukuro are engaged in this sector.
- Regarding the factors that cause nonperforming loan from the borrower side, the findings of the study shows that lack of sufficient income, lack of proper education on the business area they engaged, lack of saving account, absence of sufficient infrastructure, lack of sufficient supervision from the bank, high consumption expenditure, and high interest charge are the factors identified but lack of sufficient income(market problem),lack of proper education, lack of sufficient infrastructure and lack of sufficient supervision from the bank are the main problems. Also there are factors that cause NPL from the lending institution side like Ineffective monitoring of loans, delayed loan approval and poor credit appraisal.
- To manage burden of nonperforming loan, the bank follows different approaches; in the lending process, the bank prefers maturity period of loan as primary bases and collateral and credit worthiness as a second base. The bank prefers maturity period of loan (short term and medium term) loan mostly. This is for the seek of securing the bank by setting frequent repayment schedule(monthly and quarterly loan repayment schedule) for short and medium term loans charging interest rate of 8.5% and9.5% respectively and treating defaulted clients by using Rehabilitation.
- To determine whether loan is recoverable, the loan officers in collaboration with credit analysts try to know the status of the business situation of clients and determine the Grade or rank of the loan. Thus, even if it needs a critical investigation of each client's business status, it could help to determine good estimate of provision for doubtful loan.

## 5.3 Recommendations.

The foregoing findings reveal more or less not an aggravating situation about the NPL portfolio of the bank during the period under review. A critical review of the analysis shows that NPL eroded the financial gains the bank has made over the years. Indeed, it shows that the problem has affected the financial performance of the bank during the period. In view of the important role the bank plays in the economic development of Ethiopia, it is very essential for all stakeholders, especially management to adopt practical measures to minimize the problem of NPLS in the bank. Therefore, On the basis of the results and conclusions of this study, the following policy implications ore suggested so as to be considered in the future intervention strategies to solve occurrence of NPL.

- Regarding the trend of non-performing loan, the finding revels that the NPL was declining and get lowest in the year 2009 this was due to management efforts at improving the bank's loan portfolio management. Therefore it is recommended that this effort to avoid NPL should be strengthened more and more.
- Regarding the sector with high non-performing loan, it is identified that Domestic Trade and service; the sector which the bank highly finance, shows highest bad loan due to market problem and lack of proper education. Therefore it is recommended that the bank has to consider education level as measure criteria to minimize risk of default.
- Majority of the borrowing clients are secondary educated (9-12) completed. Thus, it is recommended that the clients should have knowledge on the business management, marketing, and accounting etc. This could help them to have a skill on well management of their business activity.
- Regarding factors which cause non-performing loan from the borrower side, monitoring and supervision of clients, market problem, and lack of knowledge on the business area are the main factors. Therefore it is recommended that the management should set scheduled on site visit; this would prevent diversion of funds into business ventures other than the agreed purposes, help loan officers assist customers who are facing some business management problems such as improper records keeping, and overtrading that affect their business operations.

- Regarding cause for non-performing loan from lending institution side, the main causes as reveled by the finding were poor credit appraisal, ineffective monitoring, delayed loan approval and under financing. Therefore it is recommended that management should organize regular training programs for credit staff in areas like credit management, risk management and financial analysis. This would sharpen the knowledge and skills of credit officers so as to improve on the quality of credit appraisal, prevent delayed loan approvals, enable credit officers appreciate the need to comply with credit policy and further enhance monitoring of credit.

- To avoid under financing, the loan officer has to give good awareness to clients about collateral value to get sufficient loan from the bank.
- To ensure effective monitoring, it is recommended that management should ensure that credit offices of the branch should be adequately resourced in terms of staff, vehicles and other logistics, to support monitoring activities. It enables the lender assesses borrowers' current financial conditions, ensure the adequacy of collaterals, ensure that loans are in compliance with the terms and conditions of the facility, and identify potential problem loans for action to be taken.

- In view of the fact that bank and other lenders cannot tell from the looks of people's faces whether they are good borrowers or bad borrowers, it is recommended that loans granted to customers should be well secured in terms of adequacy of the collateral provided and also ensure that proper legal documentation is put place. This would reduce the losses arising from problem loans and minimize the effects of such loans in the form of bad debt provisions, on the financial performance of the bank.

- Regarding measures taken to manage and minimize burden of nonperforming loan, it is recommended that the bank has to use rehabilitation mechanism as primary measure because it could support both the lender and lending institution since it is an action of making the loan active once again.

## 5.4: Implications for further research.

This study emphasized Dashen Bank only one branch; Mekelle, North Region, with the objective of identifying the trends of non-performing loan for the recent five years, identify the causes for NPLS and to identify possible ways to manage the occurrence of NPLS.

Because regions have different environmental situations, it is important studying the problems associated with non-performing loan in different banks of the country.

A major limitation in this study was time constraint which led to the use of case study approach. In future, different methods of research could be used for study of the same topic or other related aspects of the topic. Specifically, a future study might research into the NPL problems in different banks with emphasis on Trade and service, Building and construction and agriculture which are key sectors of the banks lending activities.

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# Annexes

## Annex A. Questionnaire for clients (in English)

**Mekelle University**

**School of graduate studies**

**Finance and investment**

**Questionnaire for the assessment of Nonperforming loan and its management. A case study on Dashen Bank Mekelle area Bank.**

**Dear Respondent,**

I am a prospective graduating student from Mekelle University (post graduate in finance and investment). In partial fulfillment of the program, I am undertaking a thesis on **'Assessment of Nonperforming loan and its management**. The research exclusively relies on data collected through structured questioner and interview. Consequently, this questionnaire aims to collect sufficient and valid data in order to comply with this academic requirement. The findings of this research are expected to be used by policy makers, academicians and other concerned bodies. Your respectful response to these questions, thus, will have a great impact on the result of the study. Finally, yet importantly, I assured you that all personal information obtained from you will be kept confidential.

Thank you very much!

Teshome Dula

Contact address

Mobile no.0912169730

**Instruction**

Tick this mark (√) on the boxes provided

**Basic information of the respondents**

Respondent identification number____________________

Age: ___________ sex: male: □ female: □

Educational level: illiterate: □ elementary: □ junior: □

High school □ Preparatory: □ higher education: □

**1. Information about access to loan and repayment**

1.1 What type of arrangement did you follow to get loan from Dashen bank?

Present collateral □ present business plan □ other □

1.2 Which business activities you engaged in after taking loan from Dashen bank?

Manufacturing (food processing, Commercial (trade) □

Textile production, crafts, leatherwork □ Agriculture (food production)

Service (hairdressing, restaurants, others (please specify□

Food stalls, cleaning services, local drinks) □

1.3. Do you repay your loan on time? Yes□ No □

1.4. 16. What is the maturity profile of your loans?

Short term (within 1 year) □ Medium term (between 2years and five years) □

Long term (over 5 years) □ other (please specify) ______________________

1.5. How do you see the interest rate you pay on the loan you took from Dashen bank?

Too high □ High □ Normal □ Low □

1.6. Does the interest rate charged by the bank case dalliance of loan repayment?

Yes □ No □

**2. Information about client's income.**

2.1 Indicate the level of your monthly household income after taking the Loan using the following given income levels.

50-500 birr □ 501-1000 birr □

Over 1000 birr□

Is it sufficient to repay the loan?

yes□ No□

2.2 Do you have any sources of income other than the one generated from the business activities financed by loan from Dashen bank?

Yes □ No □

2.3. Does the monthly income from the business is capable of to repay the loan?

Yes □ No□

**3. Information about client's savings**

3.1 Did you have a saving account? Yes □ No □

3.2 If yes for Q3.1, specify the annual saving amount in birr _______________

3.4 Does your saving account support you to repay the loan?

Yes □ No □

3.5 What is the trend of your saving mobilization over the last two years?

□ Increased □ Stayed the same □ Decreased

3.6 For what purpose do you save?

□ To earn interest income □ for loan repayment

□ For expansion of your business □ others (specify) ________________

**4. Information about household assets**

4.1 Do you have your own house? Before the loan yes □ No □

After the loan yes □ No □

4.2 Does it support you to get loan from Dashen bank? Yes □ No □

.

**5. Information on factors that case default from borrower side.**

**1.** Do you pay the loan you took from Dashen Bank on time?

**Yes** □ **No** □

2. What are the cases for a borrower to delay payment of loan?

**Tick your specification and writ your justification for each factor**

a. lack of sufficient income □ b. high interest rate charged by the bank□

c. lack of saving account□ d. lack of proper education on business condition□

e. high consumption expenditure□ f. lack of supervision □

g. absence of sufficient infrastructure facilities□ h. other factors________

Specify

## Annex B. Questioner for clients (in Amharic)

**መቀሌ ዩኒቨርስቲ**

**የድህረ ምረቃ ፕሮግራም**

**ፋይናንስና ኢንቨስትመንት**

***ይህ መጠይቅ ዋና አላማው የብድር አወሳሰድና አከፋፈል ጋር ተያየዞ ያሉትን ችግሮች ለማጥናት ሲሆን በዳሽን ባንክ መቀለ አካባቢ ባንክ ደንበኞች የሚሞላ ነው::***

***ውድ መልስ ሰጭዎች***:

*አኔ በመቀሌ ዩኒቨርስቲ በፋይናንስና ኢንቨስትመንት የሁለተኛ ድግሪ ተማሪ ስሆን የሚማያ ጥናቴን የምስራው ማለትም ለማጥናት የምፈልገው **ብድርና የብድር አከፋፈል ችግሮቹን በተለመከተ ነው**:: በዚህም መሰረት የጥናቱ ጥራትና በጊዜ የመጨረሱ ሁኔታ የሚወሰነው በተጠያቂዎች ትብብር ማለትም የተሰጣቸውን መጠይቅ በሚፈለገው ገዜ ሲመልሱ ነው:: በመጨረሻም ላረጋግጠላችሁ የሚፈልገው ማንኛውም የእናንተ መልስ ለምንም አይነት መጥፎ ድርጊት የማያጋልጥ መሆኑን ላረጋግጠላችሁ እወዳለሁ::*

**ስለትብብራችሁ በጣም አመስግናለሁ!!**

*ተሾመ ዱላ ።*

**ስልክ 0912169730**

*መጠይቁ የሚሰበሰበው ከአንድ ሳምንት ባልበለጠ ጊዜ ወስጥ ሰለሆነ በጊዜ እንደምትመልሱት ተስፋ አደርጋላሁ::*

***<u>መሰረታዊ መመሪያ</u>***

***ለመልሳቸሁ በተሰጠው ሳጥን ይህን ምክልት*** ( ✓) ***አስቀምጡ::***

*ዕደሜ* ----------------- *ፆታ* ☐ *ወንድ* ☐ ☐ *ት*

***የት/ት ደረጃ***

*ያልተማ* ☐ ***አንደኛ ደረጃ ት/ቤት የጨ*** ☐ 1-6

***መለስተኛ ት/ቤት*** (1-8) ***የ*** ☐ ***ሰ***

***መለስተኛና ሁለተኛ ደረጃ ት/ቤት*** (1-10 ☐ ***የጨረሰ***

***መሰናዶ ት/ቤት*** (11-12) ***የ*** ☐ ***ረሰ***

ድፕሎማ የጨረሰ ድግ ☐ የጨረሰ

**የብድር አገልግሎት የሚሰጣቸዉ ደንበኞች የሚሞሉት መጠይቅ**

***ለሚከተሉት ጥያቄዎች ተገቢውን መልሳችሁን( ✓) ምልክት በማድረግ መልስ ስጡ***

1. ስለ ብድር አወሳሰድና አከፋፈል በተመለከተ ለሚከተሉት ጥያቄቆች የመሰላችሁን መልስ ስጡ:

1.1 ከዳሸን ባንክ ብድር ለማግኘት ምን ዓይነት ቅድመ ሁኔታዎች ይጠበቅብሀል?

ተያዥ ንብረት አቀ☐ሉሁ የሥራ ዕቅድና ዝርዝር ሁኔታዎችንአቀርባለሁ ☐

የገቢ መግለጫ አቀ☐ለሁ

ሌሎች ----------

እባክዎን ያብራሩት።

1.2 ከዳሸን ባንክ ብድር ከወሰዱ በኋላ በየትኛው የሥራ ዘርፍ ነው የሚሰማሩት?

አምራች ድርጅት (የምግብ ምርት ጨርቃ ጨርቅ) ☐

የንግ☐ሥራ

የግብር☐ሥራ

አገለግሎት ድርጅት (ሆቴል የመሳሰለ☐)

ሎሎች -----------------

--------------------

እባክዎን ያብራሩት

1.3 የወሰዱትን ብንድር የሚፉሉት በተፈለገዉጊዜ ነው?

አዎ☐ አይደ☐

1.4 የወሰዱትን ብድር የሚከፉሉት እንዴት ነው

በየወሩ ☐ በየሦስት ወ☐ በግማሽ ዓመት☐

በአራት ☐ በዓ☐ት ሎሎች ---------------

ያብራሩት

1.5 በወሱዱት ብድር ላይ የሚከፍሉት ወለድ እንዴት ይመስልዎታል?

በጣም ከፍ☐ኛ ከፍ☐ኛ መ☐ለኛ ☐ተኛ

1.5 የባንክ የብድር ወለድ በክፍያ ላይ ጫና በመፍጠር ብድር ክፍያን በጊዜ ላለመክፈል አስገድዶሃል /ሻል?

ኣዎ☐ ኣይደለም☐

## 2. ከዳሽን ባንክ የብድር ኣገልግሎት የሚያገኙ ደንበኞች ገቢያችውን በተመለከተ መልስ የሚፈልጉ ጥያቄዎች::

2.1 የባንክ ብድር ወስደው ስራ ከጀመሩ በኋላ የሚያገኙት የወረ ገቢ ምን ያክል ነው?

50 -500 ብር☐

501-1000☐☐ ☐

ከ1000 ብር በላይ☐

2.2 የሚያገኙት ገቢ የወሰዱትን ብድር ለመክፈል በቂ ነው?

አዎ ☐ አይደለም☐

2.3 ብድር ለመክፈል የሚያግዝህ/ሽ / ሌላ የገቢ ምንጭ ኣለህ/ሽ/

ኣለኝ☐ የለኝም☐

## 3.የደንበኞች የቁጠባ ሂሳብን የሚመለከት መጠይቅ

3.1 የቀቁጠባ ሂሳብ አለወዎት?

ኣለኝ☐ የለኝ☐

3.2 በዓመት ምንያክል ብር ይቆጥባሉ? ----------------------------------------

----------------------------------------

ያብራሩት

3.3 የቁጠባ ሂሳብዎ ያለብዎትን ብድር ለመክፈል በቂነዉ?

አዎ☐ አይደለም☐

3.4 በባንክ የሚቆጥቡትን ለምን ሲሉ ነው?

ወለድ ለማግኘት☐ የግል ገቢዎን ለማሳደግ☐ናከር

ለቤተሰብ የምግብ

ፍጆታን ለመሸፈን☐ ያ ለብዎትን ብድር☐መክፈል

ሌሎች ----------------------------------

ያብራሩት

## 4.የባንክ ብድር በጊዜ እንዳይከፈል የሚያደርጉ ችግሮችን በተመለከተ የቀረቡ ጥያቄዎች

4.1 ብድር በጊዜ እንዳይከፈል የሚያደርጉ ችግሮች ምንድን ናቸው? የሚከተሉትን ችግሮች □ደረጃ ( ✓) ምልክት በማስቀመጥ 1 , 2,3….በማለት ቁጠር ስጣቸው::

ሀ/ በቂ ገቢ ኣለማግ □

ለ/የባንክ ወለደ ከፍተኛ መ□ን

ሐ/ የቁጠባ ሂሳብ ኣለመ□

መ/በተሠማራበት የስራ ዘርፍ በቂ ዐውቀት□መኖረ

ሠ/ከባንኩ ምክርና ክትትል አለማ□ኘት

ሽ/የምግብ ፍጆታ ወጪ □መር

ቀ/የመንገድ መብራትና የመሳሰሉት□ሮች

በ/የገበያ ዕጥረት □

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ያብራሩት

## Annex C. Questionnaire for employees

## Questionnaire for Credit Staff

The following questionnaire is meant to collect data for academic study. Your response to this questionnaire would be highly appreciated.

1. In your opinion, which of the following factors account for non-performing loan in the bank? **And give your justification**.

I. delayed loan approval □ ii .poor credit appraisal □

iii. Ineffective monitoring □ iv. Under financing □

Others, please specify____________________________________

____________________________________________________________

2. Do you think non-compliance with credit policy accounts for nonperforming loan?

(a) Yes (b) No

3. Refer Q2 and If yes, which of the following account for that?

(a) Customer pressure

(b) Management pressure

(c) All the above

(d) Other please specify________________________________

4. What are factors that causes nonperforming loan from the Bank side? **and Give justification.**

I. Delayed loan approval □ II. Poor credit appraisal □

III. Under financing □ IV. Ineffective monitoring □

5. Which of the following factors hinder effective monitoring of loans in your institution?

(a) Lack of logistic□ (b) Under staffing□

(c) Ineffective Training to management□ (d) Poor road to project site

6. is there delayed loan approval problem in the bank?

Yes □ No □

7. Refer Q6 and if your answer is yes, what are the causes of delayed loan approval in the bank?

(a) Rigid approval procedures □

(b) Customers inability to meet approval requirements □

(c) Liquidity problems □

(d) Poor credit appraisal □

8. Which of the following reasons account for loan diversion by customers?

(a) Lack of proper monitoring□

(b) Anticipation of high gains in other business ventures□

(c) Ignorance of terms and conditions attached□

(d) Differences in interest rate applied on loans in different sectors□

(e) Inadequate financing□

9. What account for the problem of under financing of projects?

(a) Poor credit appraisal□ (b) Inadequate collateral□

(c) Liquidity problems □ (d) low account turnover□

10. Which of the sector record higher bad loans out of the sectors financed by your bank?

(a) Manufacturing loans □ (b) Domestic trade and service loans □

(c) Real stat loans □ (d) Agricultural loans □

(e) Other please specify________________________________________________

11. Are there any particular reasons for your answer above?

Please specify______________________________________________________

12. What Methods does management use to reduce nonperforming loan? Pleas specify.

a) ____________________________________________________________

b) ____________________________________________________________

9. What are Factors considered by the Bank in evaluating credit requests (please tick those applicable)

Feasibility Studies □ Collateral □ Track record (repeat borrowing) □

Character based assessment (selection based on personal relations) □

Family connections or knowledge □ Business relations □

Financial Statements of client's □

11. What is the time between loan application, processing and disbursement?

One week- fortnight □ One Month □

12 Which of these lending approaches do you practice?

Individual based lending □ Group based lending □

13 What is your loan default experience?

High □ Moderate □ Low □

13. How do you protect yourself against possible loan default?

Lending against collateral □ lending against cash security □

Through rigorous appraisal □

14. Does the bank give loans to non savers? Yes□ No□

15. Which of the following measures do you adopt to reduce credit risk/default risk?

Credit rationing □ Collateral to strengthen repayment incentives □

Small loan amounts □ shorter term loans □

Lending for certain sector economic activities only □

Lending for purposes that will provide ability to repay □

Others (specify)

16. How do you manage interest rate risk?

Short term loans □ Transfer to customers' □

17. How do you get information on potential borrowers before loan decisions are Made? Tick your answer

Community and neighborhood ties □ Transactions in other market □

The company's own records □ others (Please specify________________

18. What problems do you encounter and would like to be addressed related to loan delivery in your bank? (Please specify)

____________________________________________________________

**Annex D. Interview question for employees**

Q1. Which sector records high non-performing loans?

a. Which of the sectors of the bank's lending activities is associated with high non-performing Loan?

b. What are the factors that account for this?

Q2. How can the incidence of nonperforming i.e. bad loans be minimized?

Specify__________________________________________________________

Q3.What is the mechanism to give loan to client?

Specify.____________________________________

Q4. Does the bank have a supervision program?

Yes ☐ No ☐

Q5. What is the frequency of supervising the borrowers?

Specify._________________________________________

Q6. Does the supervision of clients support the bank to minimize the risk of default?

Specify.___________________________________________

**Annex E. Data taken from undisclosed credit and deposit operation report (2005-2009).**

**Dashen Bank S.C.**
**Credit and Deposit operation report 2005**

1. Credit expansion effort of area Banks performance overview 2005

| **Area Banks** | Total budget | Actual | Variation | |
|---|---|---|---|---|
| | | | Absolute | % |
| Mekelle | 80,545,000 | 86,705,000 | 6,160,000 | 7.6 |
| | | | | |
| | | | | |
| | 2.Loan distribution by Term | | | |
| | Short term | Medium term | Long term | Total |
| Mekelle | 40,082 | 19,947,000 | 14,822,000 | 86,705,000 |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | 3. Loan collection performance July2004-June 2005. | | | |
| | Expected collection | Actual collection | Variation | |
| | | | Absolute | % |
| Mekelle | 28,453000 | 20,579,000 | (7,881,000) | -28 |
| | | | | |
| | | | | |
| | 4.June 30 2005 total non-performing loan | | | |
| Mekelle | 7,635,000 | | | |

**Dashen Bank S.C.**
**Credit and Deposit operation report 2006**

1. Credit expansion effort of area Banks performance overview 2006

| **Area Banks** | Total budget | Actual | Variation | |
|---|---|---|---|---|
| | | | Absolute | % |
| Mekelle | 92,500,000 | 104,572,000 | 12,072,000 | 13.05 |
| | | | | |
| | | | | |
| | 2.Loan distribution by Term | | | |
| | Short term | Medium term | Long term | Total |
| Mekelle | 63,359,000 | 25,709,000 | 15,504,000 | 104,572,000 |
| | | | | |
| | | | | |
| | 3.Overview of loan disbursement June30,2006 | | | |
| | Total loan | Total Disbursement | Percentage of total disbursement | |
| Mekelle | 39,104,000 | 60,004,000 | 3.58 | |
| | | | | |
| | | | | |
| | 4. Loan collection performance June30 2006. | | | |
| | Expected collection | Actual collection | Variation | |
| | | | Absolute | % |
| Mekelle | 33,024,000 | 27,263,000 | (5,761,000) | -17.4 |
| | | | | |
| | | | | |
| | 5.June 30 2006 total non-performing loan | | | |
| Mekelle | 5,162,000 | | | |

**Dashen Bank S.C.**
**Credit and Deposit operation report 2007**

1. Credit expansion effort of area Banks performance overview 2007

| **Area Banks** | Total budget | Actual | Variation | | |
|---|---|---|---|---|---|
| | | | Absolute | % | |
| Mekelle | 124,850,000 | 121,839,000 | (3,011,000) | -2.41 | |
| | | | | | |
| | | | | | |
| | 2.Loan Loan distribution by Term | | | | |
| | Short term | Medium term | Long term | Total | |
| Mekelle | 45,805,000 | 62,097,000 | 13,937,000 | 121,839,000 | |
| | | | | | |
| | | | | | |
| | 3.Overview of loan disbursement June30,2005 | | | | |
| | Total loan | Total Disbursement | Percentage of total disbursement | | |
| Mekelle | 45,666,000 | 50,516,000 | 2.61 | | |
| | | | | | |
| | | | | | |
| | 4. Loan collection performance June 2005. | | | | |
| | Expected collection | Actual collection | Variation | | Total collection |
| | | | Absolute | % | |
| Mekelle | 52,051,000 | 45,326,000 | (6,725,000) | -12.9 | 51,185,000 |
| | | | | | |
| | | | | | |
| | 5.June 30 2005 total non-performing loan | | | | |
| Mekelle | 1,273,000 | | | | |

**Dashen Bank S.C.**
**Credit and Deposit operation report 2008**

1. Credit expansion effort of area Banks performance overview 2008

| **Area Banks** | Total budget | Actual | Variation | |
|---|---|---|---|---|
| | | | Absolute | % |
| Mekelle | 150,472,000 | 123,938000 | (26,534,000) | -17.63 |
| | | | | |
| | | | | |
| | 2.Loan distribution by Term | | | |
| | Short term | Medium term | Long term | Total |
| Mekelle | 46,854,000 | 68,274,000 | 8,805,000 | 123,938,000 |
| | | | | |
| | | | | |
| | 3.Overview of loan disbursement June30,2008 | | | |
| | Total loan | Total Disbursement | Percentage of total disbursement | |
| Mekelle | 52,013,000 | 60,324,000 | 2.8 | |
| | | | | |
| | | | | |
| | 4. Loan collection performance June 2008 | | | |
| | Expected collection | Actual collection | Variation | |
| | | | Absolute | % |
| Mekelle | 75,834,000 | 59,053,000 | (16,781,000) | -22.13 |
| | | | | |
| | | | | |
| | 5.June 30 2008 total non-performing loan | | | |
| Mekelle | 8,040,000 | | | |

**Dashen Bank S.C.**

**Credit and Deposit operation report 2009**

1. Credit expansion effort of area Banks performance overview 2009

| **Area Banks** | Total budget | Actual | Variation | | |
|---|---|---|---|---|---|
| | | | Absolute | % | |
| Mekelle | 154,005,000 | 121,052,000 | (32,953000) | -21.4 | |
| | | | | | |
| | | | | | |
| | 2.Loan Loan distribution by Term | | | | |
| | Short term | Medium term | Long term | Total | |
| Mekelle | 28,235,000 | 81,814,000 | 11,003,000 | 121,052,000 | |
| | | | | | |
| | | | | | |
| | 3.Overview of loan disbursement June30,2009 | | | | |
| | Total loan | Total Disbursement | Percentage of total disbursement | | |
| Mekelle | 70,113,000 | 85,613,000 | 3.7 | | |
| | | | | | |
| | | | | | |
| | 4. Loan collection performance June 2009. | | | | |
| | Expected collection | Actual collection | Variation | | |
| | | | Absolute | % | |
| Mekelle | 96,650,000 | 73,856,000 | (22,794,000) | | |
| | | | | | |
| | | | | | |
| | 5.June 30 2009 total non-performing loan | | | | |
| Mekelle | 801,000 | | | | |