

**ST. MARY'S UNIVERSITY
BUSINESS FACULTY
DEPARTMENT OF ACCOUNTING**

**AN ASSESSMENT OF THE CAUSES OF
NON PERFORMING LOANS IN THE
CASE OF WEGAGEN BANK S.C.**

BY

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JUNE 2014

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NONPERFORMING LOANS IN THE CASE OF
WEGAGEN BANK S.C.**

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**BY
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ABSTRACT

According to NBE, nonperforming loan means loans or advances where credit quality has deteriorated such that full collection of principal and/or interest in accordance with contractual repayment terms of the loan or advance is in question. Loans with pre-established repayment program are non-performing when principal and/or interest is due and uncollected for 90 (ninety) days or more beyond the Schedule payment or maturity.

The major source of income in the Banking sector is interest on loans. However, Banks are continuously reporting substantial amount of nonperforming loans in their annual report. Unless banks have proper procedures and rules that manage their non performing loans, one can expect what the result could be.

This particular research paper will attempt to look for the causes of non-performing loan in the case of Wegagen Bank S.C. and will also try to forward possible recommendations based on the findings.

The researchers will use the descriptive type research method. Both primary and secondary data will be used. Primary data will be collected through interview and questioner technique. Secondary data will be collected from internet, some selected books, journals, the NBE directives, and annual reports.

Data will be collected by using a non-probability sampling technique. The study will have a sample size of 39, which is composed of seven managers, seven loan section heads, sixteen loan officers and nine loan clerks.

CHAPTER ONE

1. INTRODUCTION

1.1. Background of the Study

Financial institutions play a enormous role in development of a national economy. The financial sector serves important function for economic growth and development. Among there other, Banks are generally chartered to support the community with adequate supply of loans its inline with the competitively determined interest rate. Loan means any financial facts of a bank arising from a direct or indirect advance or commitment to advance funds, by the bank to a person, that are conditional on the obligation of the person to repay the funds either on specified date or on demands usually with interest (Adriaan etal,2002).

It is impossible to think of the present day economy without the use of loan. Loan is an indispensable lubricant and a convenience tool for the economic progress of a country.

The success of every organization, particularly of commercial enterprise, depends on the amount of financial resources they invest. Loans are the bloodlines of banks. Proper mobilization and use of this key input is vital. Among the many operations of banks, loan management activities have significant role for the economic development of any country.

Lending is a risky business, and certain levels of losses must be planned for and expected. Yet large or frequent loan losses can point out weaknesses in loan administration and should be carefully examined, especially when they exceed acceptable levels. Due to various factors the loans and advances will be categorized into non-performing loans.

According to National Bank of Ethiopia Directive No. SSB/43/2008, non-performing loans and advances is defined as loans /advances whose credit quality has deteriorated such that full collection of principal and/or interest in accordance with the contractual repayment terms of the loan or advance is in question.

This particular research paper will attempt to look for the causes of non-performing loan in the case of Wegagen Bank S.C. and will also try to forward possible recommendations based on the findings.

1.2. Background of the organization

Wegagen Bank is a privately owned share company formed in Ethiopia which started operations on June 11, 1997 with a subscribed capital of birr 60 million and a paid up capital of birr 30 million. The numbers of share holders reached 2,154 while the total capital (including paid up capital, share premium and legal reserves reached over 1.4 billion as of April 30, 2013.

The bank is governed by the board of directors consisting of chairman, a vice chairman and seven directors. The overall management is entrusted to the management team which comprises the president, who is appointed by the board of directors, two vice presidents and twelve department managers. As of April 30, 2013, the number of permanent employees of the bank stood at 2,363 of which 1,314 were clerical, professionals holding diploma and first and second degrees (Wegagen Bank S.C Annual Report, 2012/13).

Currently, the bank offers full-fledged banking services and products which include the following. Deposit, all Kinds of Loans, international Banking, money Transfer, corporate Banking, personal banking , ATM Banking ,Internet Banking , SMS Banking , Agar Visa Card and Foreign Currency (Wegagen Bank S.c Brochure, 2013).

The bank provides a credit facility to its customers in different forms depending on their need and the nature of their business. Some of the credit lines offered include: overdraft facilities, term loans, letter of credit facilities, merchandise loans and personal loans.

The other service the bank renders is deposit services including demand deposit, savings deposit, youth savings deposit and time/fixed deposit.

The bank also renders international banking services providing services like; opening letters of credit for importers, handling of incoming letters of credit for exporters, purchase of outward bills purchasing and selling of foreign currency denominated notes, receiving and transferring foreign currency payment by swift and handling incoming and outgoing international letters of guarantee.

Wegagen bank generates revenue from different sources, mainly from interest collected from loans and advances granted to customers. Considering the amount of income generated by forwarding loans & advances and collecting interest, the process of allowing loans and advances is one of the major operations of the bank which needs due professional care, high level of trust and professional ethics (ibid).

1.3. Statement of the problem

Just like many banking sectors, the major source of income for this bank is interest on loans. But nowadays, the bank's annual report is continuously reporting substantial amount of nonperforming loans which adversely affect the liquidity position of the bank, it reduce the bank profit and the bank money reserved by NBE. Unless the bank has proper procedures and rules that manage non performing loans, one can expect what the result could be. Non-performing loans have substantial negative impact on the performance

of the bank in particular and overall economy in general. Therefore, the purpose of this research is to assess the causes of non-performing loans.

1.4. Basic Research Question

The research paper tries to seek answers to the following basic questions.

- ❖ What are the causes of nonperforming loans?
- ❖ What are the consequences of nonperforming loans?
- ❖ What kind of measurement the banks use to protect the occurrence nonperforming loans?
- ❖ What are the ways or the means by which the Bank uses to improve bad/sick loans?

1.5. Objectives of the study

1.5.1 General Objective of the Study

The general objective of the study is to assess the causes of nonperforming loans of Wegagen Bank?

1.5.2 Specific Objectives of the study

- ❖ To find out the reason for the occurrence of nonperforming loans.
- ❖ To assess the consequence of nonperforming loans.
- ❖ To evaluate measurements taken by the bank to protect the occurrence of nonperforming loans.
- ❖ To suggest to the management the methods that they may have overlooked in improving the bad/sick loans.

1.6. Significance of the study

Apart from showing the major causes of Non-Performing Loans, the research work will:

- ❖ Giving direction to the bank on areas that need emphasis so as to protect the occurrence of NPLs.
- ❖ Help for those who are interested to conduct a comprehensive study regarding causes of NPLs in the operation of banks.
- ❖ Give full understanding about Loans and Causes for non performing Loans

1.7. Scope of the study

It would be better if this research were conducted by considering all other similar firms in the industry. But since the banking industry is broad, it will be difficult and beyond the reach of the researchers scope to include all firms that are in the industry. Therefore, the study will be delimited to the case of Wegagen Bank S.C. of seven selected branches. Moreover, the research covers only five years operation which is from 2008/2009 to 2012/13.

1.8 Research Methodology

1.8.1 Research Design

In order to answer the basic research question raised above the researchers used descriptive type of research method.

The researchers simply describe the things, events and data which were collected through questionnaires and interviews.

1.8.2. Population and Sampling Technique.

The researchers collected data by using a non-probability sampling techniques. The branches, as well as primary data were collected by using judgmental sampling method. From two hundred seventy five employees the questionnaire were distributed to thirty nine individuals comprising of managers, loan section heads, loan officers and loan clerks of the seven selected branches whose total portfolio is greater than 65% of the total portfolio of the bank.

1.8.3. Type of Data collected

The researchers used both primary and secondary data. The primary data were collected from loan officers, loan section heads and managers of the company. The secondary data were gathered from reference books, internet, various company documents and previous researches.

1.8.4. Method of Data Collection

The researchers used both open and close ended questionnaire, and unstructural interview to collect primary data. The secondary data gathered through different company documents, books & internet.

1.8.5 Method of Data Analysis

The data collected from respondents were analyzed by using both qualitative and quantitative techniques. The data obtained from interviews were evaluated by using unstructured qualitative method and Data were collected through questionnaire were evaluated by using quantitative method. The data analyzed are presented by tables and wordings.

1.9. Organization of the Study

The research paper is organized in four chapters. The first chapter is introduction which includes background of the study, statement of the problem, basic research question, objective of the study, significance of the study, delimitation of the study, research design and methodology and organization of the study. The second chapter deals with review of related literature. The third chapter presents raw data, analysis and interpretation. Finally, the summary, conclusions and recommendations are presented in the fourth chapter.

CHAPTER TWO

2. LITERATURE REVIEW

2.1. Loan

Loan is an arrangement of advancing a sum of money on interest for a pre-agreed period sometimes for a particular purpose as well. The main features of loan advanced by a bank are:

- i) The bank sanctions a sum of amount as loan for (a) pre-arranged period, and (b) at an agreed rate of interest.
- ii) A separate Loan account is opened in the name of borrower with the amount of loan sanctioned.
- iii) The loan sanctioned has to be taken in full and not partially as the full amount is transferred to the debit side of the account so opened and starts hearing interest from the date of entry in the debit side.
- iv) From his loan account the customer is allowed to transfer the amount to his current account.
- v) Installment repayment of loan is not permitted. But relaxation depends on the bank's discretion (Kumar etal, 2002).

The main business of a banking company is to receive deposits and lend money. Receiving deposit involves no risk, since it is the banker who owes a duty to repay the deposit, whenever it is demanded. On the other hand, lending always

involves much risk because there is no certainty of repayment. But, a banker earns a bulk his income only through lending.

A banker should be very cautious in lending, because he is not lending money out of his own capital. A major portion of the money lent comes from deposits received from the public. These deposits are mostly repayable on demand (Mithani et al, 2008).

In finance, a loan is a debt evidenced by a note which specifies, among other things, the principal amount, interest rate, and date of repayment. A loan entails the reallocation of the subject asset(s) for a period of time, between the lender and the borrower.

In a loan, the borrower initially receives or borrows an amount of money, called the principal, from the lender, and is obligated to pay back or repay an equal amount of money to the lender at a later time. Typically, the money is paid back in regular installments, or partial repayments; in an annuity, each installment is the same amount.

The loan is generally provided at a cost, referred to as interest on the debt, which provides an incentive for the lender to engage in the loan. In a legal loan, each of these obligations and restrictions is enforced by contract, which

can also place the borrower under additional restrictions known as loan covenants.

2.1.1 Types of loan

To address the credit needs of the business, banks have different categories of loans. However, each category of the loan is granted to deserving business, so as to match the need of the business to the type of facility. Though there are many, the major loan products or credit facilities practiced are listed here under.

I. Term loans

Term loans given by financial institution and banks have been the primary source of finance for private and public firms. All term loans are provided against fixed assets like residential and commercial buildings or movable assets like various types of motor vehicles. Generally, term loans are divided in to three different categories depending on their period of maturity which are Short term loans, Medium term Loans and Long term loans. (Wegagen Bank S.C Credit Procedure Manual, 2010.)

II. Overdraft facilities

Overdraft facilities are provided by banks to allow customers to overdraw their current accounts up to an agreed maximum amount. Interest is charged on the minimum balance at a close each day. The facility usually lasts for

twelve months and then can be renewed by mutual agreement. Overdraft facilities are provided to favorable customers who borrow frequently. These are persons or firms of reputed integrity; who have large business turnovers and whose business activities justify such a line of credit.

There is no repayment expected, as in the case of term loans except until agreed period of time elapses, which usually is twelve months. An immediate signal in financial deterioration of the business cannot be detected, unless reviewed when the time elapses. An overdraft should not be granted for acquisition of fixed assets or pay out long term obligations. If an overdraft is tied up to the maximum limit for a considerable time, or moves up and down slightly, this is an indication of problems in utilizing the account. This signifies that the overdraft has been used for acquisition of assets, utilized for investment, pay out long – term financial commitments or the firm is in a financial crisis. When such states of affair prevail, the bank should immediately call in the overdraft or arrange conversion of the facility to a term loan.

Firms applying for an overdraft facility should be able to provide current provisional or audited financial statements or both including cash flow- forecast. An overdraft shall be reviewed every six months primarily to see the progress of the customer and to witness the sound and proper

utilization of the account. If the overdraft facility has not been used to the satisfaction of the bank during review, cancellation, conversion partly or wholly to a term loan or reduction of the facility to lower level is advisable. The problem of such an account can easily be manifested by the swing and turnover (ibid).

III. Merchandise loan

Merchandise loan is a kind of loan facility granted against pledge of stocks of merchandise items in secured premises. It is advanced at a certain percentage depending on the nature and marketability of the items pledged. Care should be taken on advancing loan against pledge of perishable items and items with limited shelf. Consider deterioration in quality, and stock obsolescence when granting merchandise facility. Generally, a merchandise loan is granted to relief short term working capital constraints of customers; say for example, in peak harvest season, grain traders make purchases in anticipation of better price some time in future (ibid).

IV. Advance against import letters of credit

Margin on letter of credit is usually requested when customer feels that the individual or a firm cannot fully meet the value of L/C (Letters of Credit) (from his own resource alone). Depending upon credit worthiness, financial standing of the applicant to collect import documents from bank when

the goods arrive; the bank can fix and L/C margin ranging say between 10-50%. The bank may grant short-term loans, the proceeds of which can be used for settlement of bills drawn under the L/C opened by the banks. L/C limit can run for a period from 6-12 months, subject of review.

It is particularly important that care should be exercised both in approving L/C limits or fixing margins such that the importer is capable of collecting import documents as soon as advised. A letter of credit is an arrangement (usually expressed in the form of a formal letter) whereby a bank (the issuing bank) at the request and in accordance with the instructions of its customer, the applicant, undertakes revocable or irrevocable to reimburse or to cause to be reimbursed, a third party (Beneficiary) against presentation of documents and compliance in terms and conditions stipulated in the arrangement (ibid).

V. Advance Against Export letters of Credit

Export business can be financed in three ways:

A. Pre Shipment Credit

It is a credit facility extended to exporters before shipping the goods. Generally, it is granted to allow the exporter to procure the goods and pack them for export. The advance shall be liquidated when the relevant export bills come to the bank for negotiation. The bank grants pre-shipment credit to

the exporter against the assurance of a letter of credit or after verifying the existence of affirms export order with the buyer.

An export letter of credit and sales contract serves as evidence of a definite arrangement for realization of the export proceed and also quantity of finance required by the exporter.

B. Revolving Credit

An advance extended to exporters with a limited margin until goods are loaded on board. Upon presentation of all relevant export documents to the Bank, except the bill of loading. The facility has tenure of six months or one year. The facility is availed to finance the temporary working capital requirement of customers when the good are in transit for shipment.

This kind of export credit will be settled from the export proceeds when all relevant export documents are presented to the Bank. The facility has to be renewed every six months or every year.

C. Post shipment credit

The exporter proceeds to execute the order after obtaining a letters of credit (L/C) in his favor from the importer. Upon shipping the goods, the exporter obtains the required shipping documents and transmits the documents to the importer through his local bank. The correspondent bank,

which acts as an intermediary, releases the documents after securing payment from the buyer. The payment obtained is transferred to the credit of the exporter to fill the above gap that the exporter be availed with post shipment credit (ibid).

VI. Temporary credit

A. Temporary overdraft

This is an overdraft that is allowed when the customer faces temporary liquidity problem. It is granted only until they are in a position to generate cash from their business or collections of receivables. It is granted for clearance of imported documents. The facility runs from 15 days to four months duration. This temporary facility is granted for a reliable customer with satisfactory record. Irrespective of its duration, the interest rate is 10%.

B. Temporary term loans

It is much similar with temporary overdrafts. The loan is to be paid in one lump sum or installments depending on cash flow (ibid).

VII. Personal loans

This is a type of loan granted to employees of the bank. As the name indicates, a personal loan is a lump sum advance to staffs to meet personal requirements. Source of repayment for such loan is monthly salary. Personal loan is considered an exception basis for cases believed. Lower interest rate is

charged. As any other loan, personal loans must be secured by personal guarantees of persons of high integrity and financial capacity. This loan is approved at head office level (ibid).

2.1.2 General principles of sound lending

While lending his funds, the banker should follow the following well known principles of sound lending

- i) **Safety.** The first and foremost principle of lending is to ensure the safety of the funds lent. While lending money, the banker must carefully consider the chance of its being repaid by the borrower along with interest. The repayment of the loan will depend on the following two points:
 - a) Borrower's capacity to pay, and
 - b) Borrower's willingness to pay

Borrower's capacity to pay is determined by the financial soundness of the borrower and willingness to pay depends upon his honesty and integrity. So, the banker should be very careful in ensuring that the business for which a loan is sought is of sound nature and the borrower is capable of carrying it out successfully (N.Kumar and R.Mittal, 2002).

- ii) **Liquidity.** The next principle of sound commercial bank lending is that the advances should be readily realizable into cash without much loss of value, which is possible when they are short-term, temporary

advances granted to finance some purchase of stock, raw material, etc. This is what is referred to as "real bills doctrine" repayment out of the sale proceeds of the very assets which bank accommodation helped to finance. Advances to healthy business will be repaid from profits as the trading cycle turns over, perhaps once a year. Long-term advances will be repaid again out of profits, but subject to periodical reductions over a period (ibid).

iii) **Profitability.** Commercial banks are profit-earning institutions; the nationalized banks are no exception to this. They must employ their fund profitably so as to earn sufficient income out of which to pay interest to the depositors, salaries to the staff and to meet various other establishment expenses and distribute dividends to the shareholders (the Government in case of nationalized banks). The rates of interest charged by banks primarily depend on the directives issued by the reserve bank. The variations in the rates of interest charged from different customers depend upon the degree of risk involved in lending to them. A customer with high reputation is charged a lower rate of interest as compared to an ordinary customer. The sound principle of lending is not to sacrifice safety or liquidity for the sake of higher profitability. That is to say that the banks should grant advances to parties

with doubtful repaying capacity, even if they are ready to pay a very high rate of interest. Such advances ultimately prove to be irrecoverable to the detriment of the interests of the bank and its depositors (ibid).

iv) **Purpose of the loan.** This is also an important and well-known principle of lending. Bankers should not grant loans for each and every purpose. While lending his funds the banker should see the purposes for which to the customer seeks the loan. It is necessary that funds should be lent for productive purpose only. After nationalization, loans for initial expenditure to start small trades, businesses, industries etc. are also granted by the banker (ibid).

v) **Diversification of risks.** Another important canon of sound lending is that the banker should hold loan assets of a diversified character so as to reduce the degree of credit risks. He can face the loss with grants equanimity if he does not lay all his eggs in one basket. If the basket is upturned, all the eggs will be broken and lost. So it is desirable that the banker advances money not to one particular region or industry, but instead distributes his resources over a large number of firms in a wide geographical area. It should be one of the banker's axiom to advance relatively moderate sums to many customers rather

that larger sums to few customers. Loans are also tried to be diversified with respect to maturity, security and the type of borrowers (ibid).

2.2. Loan repayment schedule

According to NBE, financial institutions base periodic loan collections from their borrowers on cash generating capacity of the business financed by the loan. They shall collect medium and long term loans at least:

- ❖ Monthly from the business that regularly generates cash daily;
- ❖ Quarterly from business that regularly generate cash in two to thirty days;
- ❖ Semi annually from business that generate cash in 181 to 360 days; and
- ❖ As shall be determined by board of directors of each institution in all other cases (www.nbe.gov.et, 2010).

2.3. Nonperforming Loan

Loans and advances constitute the primary source of income by banks. As any business establishment a bank also seeks to maximize its profit. Since loans and advances are more profitable than any other assets, a bank is willing to lend as much of its funds as possible. But banks have to be careful about the safety of such advances. Nonperforming loan means loans or advances where credit quality has deteriorated such that full collection of principal and/or

interest in accordance with contractual repayment terms of the loan or advance is in question.

According to NBE directive No.SBB /43/2008 define none performing loans (NPLS) as loan or advances with pre-established repayment program in which principal and/or interest is due and uncollected for 90 consecutive days or more beyond the scheduled repayment date.

In addition to this directive also states that OD and Loans or advances that do not have pre-established repayment program shall be none performing when:

- The debt remaining outstanding for 90 days or more beyond the scheduled repayment date or maturity,
- The debt exceed the borrower approved limit for 90 consecutive days more,
- Interest is due and uncollected for 90 consecutive days or more,

For overdraft accounts:

- The OD account has been inactive for 90 consecutive days,
- Deposits are insufficient to cover the interest capitalized during 90 consecutive days,
- The account fails to show 5% or less debit balance of the approved limit once in a year (ibid).

2.3.1. Causes of Nonperforming loans

A more or less predictable level of nonperforming loans, though it may vary slightly from year to year, is caused by an inevitable number of wrong economic decisions by individuals and plain bad luck (inclement weather, unexpected price changes for certain products, etc) under such circumstances, the holders of loans can make an allowance for a normal share of nonperformance in the form of bad loan provisions, or they may spread the risk by taking out insurance. Enterprises may well be able to pass a large portion of these costs to customers in the form of higher prices. For instance, the interest margin applied by financial institutions will include a premium for the risk of nonperformance on granted loans. The amount involved in nonperforming loans may rise considerably as a result of less predictable incidents, such as when the costs of fuel, prices of key export products, foreign exchange rates or interest rates change unexpectedly. A similar effect may be caused by the sudden failure of a major company in an overly optimistic financial market. If the resulting loss of confidence begins to snowball toward a crisis, at least three effects tend to further aggregate the situation, a fall in the prices of loan collaterals (often real estate) may cause more loans to become classified as doubtful.

Large bad loan portfolio will affect the ability of banks to provide credit and the resulting liquidity crises may suffocate otherwise good creditors; depositors and foreign

investors may start a run on the banks, pushing them into bankruptcy.

The chance for the financial sector to derail are usually considered to be much higher under conditions of deficient bank management, poor supervision, and overoptimistic assessments of creditworthiness during boom economics, and moral hazard that results from (too) generous government guarantees or the expectation of assured bailouts. Large exposure to international financial markets can also complicate considerably (Bloem et al, 2001)

2.3.2. Classification of nonperforming loans

The extent to which authorities have been involved in developing criteria to distinguish between "good" and "bad" loans differs substantially between countries. Some countries use quantitative criteria, for example number of days of overdue Scheduled payments, while other countries exclusively rely on qualitative norms (such as a variability of information about the clients' financial status, management judgment about future payments). Loans with pre-established repayment program are non-performing when principal and/or interest is due and uncollected for 90 (ninety) days or more beyond the Schedule payment or maturity (NBE Directive, 2008).

In our country's case the National Bank of Ethiopia has issued directive number SBB/43/2008 pursuant to the authority vested in it by article 41 of the Monetary and Banking proclamation number 83/1994 and by article 15 (1) and 36 of the Licensing and Supervision of Banking Business proclamation number 84/1994.

According to this directive banks shall classify non-performing loans, weather such loans have pre – established repayment Schedule or not, in to the following five classifications using the criteria described below.

- a) **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 advances 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.
- b) **Special Mention** – loans or advances with pre established repayment programs past due 30(thirty) days or more, but less than 90(ninety) days and overdrafts and loans/advances that do not have a pre established repayment program shall be classified under this classification.
- c) **Substandard** - loans or advances with a pre-established repayment programs past due 90(ninety)

days or more, but less than 180(one hundred eighty) days and overdrafts and loans/advances that do not have a pre-established repayment program shall be classified under this classification.

- d) **Doubtful** – loans or advances with a pre established repayment programs past due 180 (one hundred eighty) days or more, but less than 360 (three hundred sixty) days and overdrafts and loans/advances that do not have a pre established repayment program shall be classified, at a minimum, as doubtful.
- e) **Loss** – Non – performing loans or advances with a pre established repayment programs past due 360(three hundred sixty) days or more and overdrafts and loans/advances that do not have a pre established repayment program shall be classified shall be classified loss (NBE, 2008).

2.3.3. Disposal of nonperforming loans

Once the loan became non – performing, the bank official try to exert effort in collecting the loan balance. The first step is communicating the borrower through different means to repay the loan. The last resort is to acquire the collateral, provided that the collateral is foreclosed. Acquiring the collateral property as an alternative means of debt settling is not without cost. The collateral property is not readily sold in the market. The bank has to incur maintenance and administrative cost as previously mentioned. Thus disposing

non – performing loans through sale proceeds of its collateral is not easily successful.

In Ethiopian case Proclamation no. 90/97 gave banks full right to foreclose and sell the collateral property after serving 45 days of legal notice to the borrowers. However these does not help much the banks and yet have been possessing large number of collateral property that should have been sold.

2.3.4. Provision for Nonperforming Loan

A) Loan Provisioning

Loan Provisioning is the determination or estimation of the amount of non-performing loans which are likely to be uncollectible and providing for those on the basis of aging and risk class category of the loans concerned.

The status of every loan has to be regularly examined very carefully and the necessary corrective measures taken before a loan turns bad. If, however, a loan remains delinquent in spite of continued efforts of follow-up, provision is to be held in order to hedge against probable losses.

According to NBE directive No.SBB /43/2008, all banks shall maintain a provision for loan losses Account which shall be created by charges to provision expenses in the income statement and shall be maintained at a level adequate to absorb potential losses in the loan portfolio.

Banks maintain specified minimum provisions percentage against the outstanding principal balance of each loan classified in accordance with the criteria for the classification of loans. The table below depicts minimum provision requirement set out by National Bank of Ethiopia.

Table 2.1 Provision Requirement for Non - performing loans as per NBE Directive No SBB /32/2002

For the purpose of NBE directive, the minimum provision percentage to be maintained against the outstanding principal amount of each loan or advance classified in accordance with the criteria for the classification of loans and advances is as follows:

Risk classification	Description	Minimum provision
Pass	Loans that are fully protected by current financial and paying capacity of the borrower regardless of past due status.	1% of the outstanding loan balances
Special Mention	Past due 30 days or more but < 90 days	3 % of the outstanding loan balances
Substandard	Past due 90 days or more but <180 days	20 % of the net loan balance
Doubtful	Past due 180 days or more but < 360 days	50 % of the net loan balance
Loss	Past due 360 days more	100 % of the net loan balance

Source: NBE Directive No. SBB/32/2002

The minimum provision requirements given above are applicable only against the total outstanding principal balance and not against the amount of past due payments for each loan or advance or past thereof classified regardless of whether the loan or advance is analyzed and provided for individually or as part of a group. In calculating loan

provision all loans categorized under NPLs (substandard doubtful and loss) should apply "Net Recovery Value". Net Recovery value means the most probable value of a loan or advance which will be realized from the sale of collateral securing the loan or advance in a competitive and open market. The most probable value of a loan or advance recoverable from the sale of collateral securing a loan or advance shall be the outstanding principal balance of a loan multiplied by the "Average Recovery Rate". The Average Recovery Rate Shall be provided to all Branches by Credit Department.

The directive provides room for banks to maintain large provision where reliable information such as historical loans loss experience, current economic conditions, delinquency trends, ineffectiveness of lending policies, and /or collection procedures or lack of timeliness and accuracy in the loan review function suggests that losses are likely to be more than the above minimum provision percentage.

2.4. Credit Methodology

Credit methodology encompasses every activity involved in lending including sales, customer selection and screening, the application and approval process, repayment monitoring, and delinquency and portfolio management. It is also linked with the institutional structure pertaining to the credit process. Quality of credit methodology is one of the most

determinant factors for the efficiency, impact and profitability of the financial institutions. Thus getting the credit methodology is therefore one of the most demanding as well as rewarding challenges of every financial institutions (banks). The key risk in a bank has been credit risk. Indeed, failure to collect loans granted to customers has been the major factor behind the collapse of many banks around the world. Banks need to manage credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Effective credit risk management is the process of managing an institution's activities which create credit risk exposures, in a manner that significantly reduces the likelihood that such activities will impact negatively on a bank's earnings and capital (NBE, 2010). Credit risk is not confined to a bank's loan portfolio, but can also exist in its other assets and activities. Likewise, such risk can exist in both a bank's on-balance sheet and its off-balance sheet accounts.

2.4.1. Credit administration policy

Credit administration is a critical element in maintaining the safety and soundness of a bank. Once a credit is granted, it is the responsibility of the bank to ensure that the credit is properly maintained. This includes keeping the credit file up to date, obtaining current financial information, sending out renewal notices and preparing various documents such as

loan agreements (NBE, 2010). In developing credit administration arrangements, banks should ensure:

- ❖ The efficiency and effectiveness of credit administration operations, including monitoring of credits, maintenance of adequate documentation, observance of contractual obligations and legal covenants and maintenance of collateral, etc.;
- ❖ The accuracy and timeliness of information generated by management information systems;
- ❖ The effectiveness of the segregation of duties and
- ❖ Compliance with prescribed management policies and procedures as well as applicable laws and regulations.

2.4.2. Credit Files

The credit files of a bank should include all the information necessary to ascertain the current financial condition of counterparties as well as sufficient information to track the decisions made and credit history of borrowers. According to NBE, each credit file needs at a minimum information that:

- ❖ Identifies the borrower by name and occupation or type of business, and identifies guarantors and connected parties;
- ❖ Provides evidence of the borrower's legal ability to borrow, financial condition and the ability to repay, including the timing and source of repayment;

- ❖ Describes the terms of the credit obligation, including the purpose of the credit;
- ❖ Describes and evaluates the collateral, indicating the marketability and/or condition thereof; and
- ❖ Provides a history of the credit, including copies of the most recent credit authorization and internal credit reviews and evidence of the level of approval.

2.4.3. Credit/loan Follow up

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

- ❖ Ensuring compliance with terms and conditions
- ❖ Monitoring end use of approved funds
- ❖ Monitoring performance to check continued viability of operations
- ❖ Detecting deviations from terms of decision
- ❖ Making periodic assessment of the health of the loans and advances by noting some of the key indicators of

performance that might include: profitability, activity level and management of the unit and ensure that the assets created are effectively utilized for productive purposes and are well maintained.

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

Basically there are three types of loan follow up systems. These are: Physical follow up, financial follow up and legal follow up (NBE Directives, 2010). Each is discussed in section that follows:

A. Physical Follow -up

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

B. Financial Follow- up

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

C. Legal Follow- up

The purpose of legal follow up is to ensure that the legal recourse available to the Bank is kept alive at all times. It consists of obtaining proper documentation and keeping them alive, registration, proper follow up of insurances. Specific issues pertaining to legal follow up include: ascertaining whether contracts are properly executed by appropriate persons and documents are complete in all aspects, obtaining revival letters in time (revival letters refer to renewal letter for registration of security contracts that have passed the statutory period as laid down by the law), ensuring loan/mortgage contracts are updated timely and examining the regulatory directives, laws, third party claims among others (ibid).

CHAPTER THREE

3. DATA PRESENTATION, FINDINGS AND ANALYSIS

In order to get the required information, a thorough analysis of the bank's document and policies related to loan has been made. In addition to this, both questionnaire and interview has been made with managers, loan section heads, loan officers and loan clerks. The sample population was selected by Judgmental sampling.

3.1 characteristics of the study population

The objective of this study is to examine the cause of nonperforming loans in Wegagen Bank S.C. In order to achieve this objective, Thirty Nine questionnaires were distributed to seven selective branches of the bank.

3.1.1 Total no of respondents

Table 3.1.1 Response rate

Position	Questionnaire Distributed	Respondent	Not Responded	%age
Loan Clerk	9	9	0	100%
Loan Officers	16	14	2	88%
Loan Section Heads	7	7	0	100%
Branch Managers	7	6	1	86%
Total	39	36	3	94%

Source: Primary Data

From the total number of questionnaires distributed, 94% of respondents were returned the questionnaires the rest 6% did not (table 3.1.1).

3.1.2 Gender of Respondents

Table 3.1.2 Demographic Features

No	Item Sex	No, of respondents	Not Responded
1	Male	26	3
2	Female	10	-
Total respondent		36	3

Source: Primary Data

As the above table the total numbers of participants were 39, out of which only 3 participants were not willing to respond. From the total number of respondents 26 are males and the rest are females.

3.1.3 Educational Background

Table 3.1.3 Educational Background

Diploma	Degree	2 nd Degree
3	32	1

Source: Primary Data

From total number of respondents 2 are diploma holders 23 are 1st degree holders and there is only one 2nd degree holders, Therefore, the level of qualification and working experience of the respondents capable of handling the questionnaires on such topic as assessment of present conditions and trends of NPLs.

3.1.4 Factors believed to be the causes of the NPLs

In the analysis part we will try to see the trend and current condition of NPLs in accordance with the objective stated in the research report. According to the observation through questionnaires, discussion and interview with the concerned employees there are many causes of the NPLs but the major category factors are listed below.

1. Bank's Internal Factors
2. Customers Related Factors
3. External Factors

Table 3.1.4 Causes of NPLs

Causes of NPLs		No of Respondents	%age
Internal Factors	Adequate training given to concerned staff	10	27%
	Poor forecasting knowledge and System of credit analysts	5	14%
	Poor follow up	5	14%
	Average		18%
Customers factors	Diversification of funds by borrower	36	100%
	Inadequate collateral	0	-
	Personal problem of the borrower	10	27%
	Average		42%
External Factors	Business fluctuation	18	50%
	Instability of government policies	5	14%
	Natural climate	2	6%
	Average		23%

Source: Primary Data

NB: The reason for total percentage of the respondent is differing from 100% is the respondents are allowed to select more than once for a single question.

The above table shows that the cause of the NPLs through questionnaire and interview. In general from the total number of respondents 18% believe that the causes rose from internal factors, 42% believed that customer factors and 23 % believed that External factors, as a result, most respondents believed that customer factors are the main causes of NPLs.

3.1.5 The negative consequences of nonperforming loan in the bank.

Table 3.1.5 the negative consequences of nonperforming loans in the bank.

Consequence of NPL	No of Respondents	% age
Reduction of profit	21	58%
High reserve requirements by the NBE	27	75%
Loss of public confidence on the bank	15	42%
Instability of employees	9	25%

Source: Primary Data

NB: The reason for total percentage of the respondent is differing from 100% is the respondents are allowed to select more than once for a single question.

Table 3.1.5 shows the consequences of NPLs in the bank. 58% respondents think reduction of profit is the adverse effect of the NPLs, 75% of respondents believe that

nonperforming loans results high reserve requirements by the NBE, 42 % of respondents believe the nonperforming loans causes Loss of public confidence on the bank and finally the 25% of respondents believe non-performing loans leads the employees instable. In general as can be observed the nonperforming loans are adversely affected the bank position.

3.1.6 Measurements taken to protect the occurrence of NPLs in the bank.

According to the observation through questionnaires, discussion and interview with the concerned employees there are two mechanism of preventing of nonperforming loans. These methods are:

1. Pre-granting of loans: Methods used to protect the occurrences of NPLs before disbursement of Loan.
2. Post granting of loan: Methods used to protect the occurrences of NPLs after disbursement of Loan.

Table: 3.1.6 Methods of preventing NPLs

Important kind of measurements helps to protect the occurrence of NPLs.		No of Respondents	%age
Pre –granting of loans	Assigning of committed and knowledgeable loan officers and credit analysts	36	100%
	Assigning of committed and knowledgeable Follow-up officers	25	69%
	Creating good forecasting knowledge of business	18	50%
	Granting of loans based proper assessment and analysis	30	83%
	Acquiring of adequate collateral	21	58%
	Presentation of cash flow	19	53%
	Collecting updated credit information	34	94%
	Average		72%
Post –granting of loans	Follow-up on already granted loans	36	100%

Source: Primary Data

NB: The reason for total percentage of the respondent is differing from 100% is the respondents are allowed to select more than once for a single question.

As we can see from the above table both pre and post granting preventing mechanism are important to protect the occurrence of NPLs in the bank. 72% of the respondents

believe pre-granting preventing methods are important and 100 % of the respondents believe post-granting preventing mechanisms is important.

3.2 Analysis of the Interview

In order to get deep understanding about the factors that causes nonperforming loans, in-depth interview was conducted with loan officers, managers and credit analysts of the bank. The respondents have so many in common as to what they believed cause occurrence of nonperforming loans. The section that follows present factors believed to cause occurrences of non-performing loan by the interviewees. Besides, the factors that are thought to be most critical for the occurrences of non-performing loan are pinpointed.

3.2.1 Factors believed to be the causes of NPL by the interviewees

Respondents indicated that several factors contribute to loan default. As per the outcome of the interview the factors can be categorized as banks' internal situations, the external environment and borrowers related. The factors are organized and presented under the respective subtitles.

i. Bank's internal factors

These are factors relating to internal inefficiencies due to systems, governance, and human resource issues. Under this theme most of the interview participants raised the following issues:

- ❖ Poor monitoring and follow up
- ❖ Poor collateral valuation(over estimation of collateral)
- ❖ Bank's aggressive lending to maximize profit
- ❖ Bankers lack of integrity
- ❖ Credit analysts' capacity limitation,
- ❖ Not understanding and seeing critically the macroeconomic environment

ii. Customer related factors

These are factors that emanate from borrowers and have strong bearing on occurrences of loan default. Under this the following were raised:

- ❖ Fund being directed to unintended purpose,
- ❖ Borrowers not making competitive analysis before engaging in a particular sector,
- ❖ Business management problems- most of family owned businesses don't have good management,
- ❖ Poor record keeping by businesses,

iii. External factors

These are factors that were beyond the influence of banks and borrowers. They are presented as follows.

- ❖ Poor credit culture,
- ❖ Macroeconomic factors like inflation, market problems.
- ❖ Capacity limitation of the supervisory organ.

3.3. Document analysis of Non-performing loans

The primary objectives of business enterprises include its survival. Survival of business organization is assured at the first place when profit is generated. Non-performing loans have adverse impact on banks profitability. National Bank of Ethiopia has issued directive No SBB /43/2008 which requires banks not to book income on Non – performing loans and also forces banks to make provision on such loan, to maintain financial stability.

Table 3.3.1 Analysis of trends of loan portfolio quality of Wegagen Bank S.C. from year 2009/10-2012/13

	2009/10	2010/11	2011/12	2012/13
Pass	2,555,601,393	3,305,857,630	3,334,398,806	3,901,246,603
Special Mention	171,971,713	192,690,018	221,231,149	261,052,755
Substandard	162,237,465	183,514,303	185,142,647	259,199,705
Doubtful	126,968,451	144,468,706	146,097,050	187,004,224
Loss	63,484,226	62,472,954	64,101,298	73,716,492
Total NPL	352,690,142	390,455,963	395,340,995	519,920,422
Total Portfolio	3,080,263,248	3,889,003,611	3,950,970,950	4,682,219,781
Ratio(Total NPL/Total Portfolio)	11.45%	10.04%	10.00%	11.1%

Source: Annual reports of Wegagen Bank S.C.

As can be seen from table 3.3.1 above, the total number of nonperforming loans is increasing time to time.

CHAPTER FOUR

4. SUMMARY, CONCLUSION AND RECOMMENDATIONS

4.1. Summary of Findings.

This study was intended to assess the cause of nonperforming loans in Wegagen bank S.C.

To conduct the study the researchers used both primary and secondary data collection method through questionnaire, interview and referring of annual report and different related books.

The analysis shows the causes of nonperforming loans which are internal factors, customer related factors and external factors. In general from the total number of respondents 18% believe that the causes rose from internal factors, 42% believed that customer factors and 23 % believed that external factors, as a result, most respondents believed that customer factors are the main causes of nonperforming loans.

Based on the data collected, nonperforming loans puts the bank in so many problems which are Reduction of profit, High reserve requirements by the NBE, Loss of public confidence on the bank and Instability of employees out of which the 75% respondents believe high reserve requirements by the NBE are the main negative impact that the bank suffer from it.

As we can see from the analysis there are two mechanisms to protect the occurrence of nonperforming loans in the bank which are pre and post granting preventing mechanisms all the respondents believe that both mechanisms are important but the majority believes that post granting preventing mechanism is more effective mechanism to protect the occurrence of nonperforming loans.

4.2. CONCLUSION

The following points are drawn as conclusion based on the analysis made on primary and secondary data.

- ❖ Most of the staffs working in loan section have not been given adequate training, which could help them handle loan processing and loan collection effectively and efficiently.
- ❖ Branches are unable to get fair and true financial statements from borrowers because most borrowers consciously and unconsciously brings fake financial statement. The reason for borrowers to bring fake financial statements consciously is they want to get banks attention to get the loan facilities and some customers prepare fake financial statement unconsciously because they are semi-literate to keep records, their business is small to maintain accounting system by employing trained accountant and do not know the advantage of accounting records..
- ❖ The study also revealed the possible causes of non-performing loans that include slackness in macro economy and technological obsolescence.

In general, the factors that lead to high non-performing loan can be summarized and grouped in to the following:

- ❖ Internal problem of the borrower such as inappropriate financial structure, failure in auditing their financial statements, lack of

adequate knowledge about loan, unwillingness to pay and carelessness, etc.

- ❖ The mismanagement of the bank such as inadequate analysis and inappropriate follow up and supervision, inadequate customer guidance and advisory, etc.
- ❖ Poor macro-economic conditions and weak macro policies.

All these factors lead to increase levels of the bank's non-performing loan. It is expected that higher non-performing loan levels affect the Bank in particular and the country's economy in general in various ways. Initially, if the bank is burdened with high non-performing loan, it will suffer from high liquidity problem. This will affect the ability of the bank in providing further credit. Existence of uncollected loans and loss of value upon sale of pledged collateral would erode profits of the bank. At the extreme cases when the bank becomes unable to meet the day-to-day cash and deposits withdrawal needs of its customers the problem may turn out to solvency problem. At this time, the bank cannot pay all of its depositors and the loss will pass to depositors, creditors and shareholders. This situation causes bank failure. A bank failure is usually believed to be transmitted to other banks because the failure of one bank is associated in the public's mind with the failure of all the banks and this process if not controlled results in a system wide failure in the economy.

4.3. RECOMMENDATIONS

Based on the literature review described and by examining and analyzing the data collected from different sources, the following recommendations were forwarded. And the study attempts to give highlight for some points that deserve due attention by the Bank for good performance of the organization.

- ❖ In order to ascertain the likelihood of loan repayments, business risks need to be adequately examined (undertaking both quantitative and qualitative assessment) in view of financial statement skills and experience. Equally important, a critical assessment of the collateral offered is expected; which basically is a secondary source of repayment in case of default.
- ❖ With regard to loan supervision and follow-up it is advisable to underscore that once a loan is on the books of the Bank, it must be actively supervised and managed to ensure that it is timely paid. Branches in charge of managing client loan accounts are known to delay in reporting delayed payment of loans often due to reluctance to expose themselves to possible criticism for having involved the Bank in a problematic situation
- ❖ Loan supervision requires monitoring borrowers closely to detect early signs that the borrower may have difficulties in repaying the loans. Such early warning signs are necessary to maximize the effect of

corrective action and to minimize potential losses. Among the common warning signs include: undue delays in submission of financial statements by clients, customers reluctance to provide detailed explanations of items in financial statements, sudden changes in customer's business plan, violations of loan covenants (restrictive clauses, attempt by customers to hide unpleasant facts concerning their businesses).

- ❖ The bank better to exert a maximum effort to enhance the capacity of branches through training, workshops, refreshment courses, and seminars so as to optimize efficiency in loan processing since branches play a direct role in generating the Bank's principal assets via loan initiation, recommendation as well as loan recovery activities, optimizing staff efficiency in branches has high benefits, and is a worthwhile investment to the bank.
- ❖ To control loan diversion from other than they are intended for. The bank recommended paying loan proceeds directly to purpose of the loan. Even though most borrowers are not able to support their loan request by providing proper financial statements, banks expected to teach and encourage borrowers consistently to establish proper accounting system and it is better to play a teaching role in this regard. Stressing on such requirement is not only from the benefit of banks, but also has equal benefit to the

borrower as an informational tool in succeeding the management of their enterprises. The government also recommended enforcing all formally established business, such as private limited company to maintain accounting records, like that of share companies.

- ❖ Even though there are different causes of loan problems, banks better to avoid at least the controllable causes of such problems as over lending, poor evaluation and analysis, inadequate supervision and follow up. If injecting additional loan or extending terms are believed to improve the borrowers' situations, banks are advised to help borrowers accordingly. In Addition to the above, as banks are owners of the indebted business, the banks recommended interfering in the decision-making and management of bankrupted businesses.

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St Mary's University
Faculty of Business
Department of Accounting

(Questionnaire Designed to be filled by respondents)

Dear Sir/Madam:

This survey is conducted as a partial fulfillment for requirement of BA degree in Accounting.

The objective of this questionnaire is to assess the causes of Non-Performing Loans (NPLs) in commercial banks for the case of Wegagen Bank S.C. This questionnaire is expected to gather relevant data/information that serve as an input for addressing the causes of NPLs. The quality of information you provide determines the ultimate reliability of the study. Therefore, your cooperation and honest response are of dominant importance to the attainment of the overall objective of the study.

Your response shall be kept confidential.

Thank you in advance.

Note:-

- I. For closed ended questions, please put a tick (✓) mark in the boxes given.**
- II. Respondents are allowed to tick more than once for a single question.**
- III. No need of writing your name.**

Part-I

Personal Information:

- | | | |
|---------------------------|---|--|
| 1. Gender | <input type="checkbox"/> Male | <input type="checkbox"/> Female |
| 2. Age | <input type="checkbox"/> (20-30) | <input type="checkbox"/> (31-40) |
| | <input type="checkbox"/> (41-50) | <input type="checkbox"/> (above 50) |
| 3. Educational Background | <input type="checkbox"/> Certificate | <input type="checkbox"/> Diploma |
| | <input type="checkbox"/> BA/BSc Degree | <input type="checkbox"/> MA/MSc Degree |
| | <input type="checkbox"/> PhD Degree | Other _____ |
| 4. Work Experience | <input type="checkbox"/> Below 2 years | <input type="checkbox"/> 2-5 years |
| | <input type="checkbox"/> 5-10 years | <input type="checkbox"/> 10-15 years |
| | <input type="checkbox"/> Above 15 years | |
| 5. Working Position | <input type="checkbox"/> Loan Clerk | <input type="checkbox"/> Loan Officer |
| | <input type="checkbox"/> Credit Analyst | <input type="checkbox"/> Follow-up Officer |
| | <input type="checkbox"/> Branch Manager | <input type="checkbox"/> Division/Section Head |
| | <input type="checkbox"/> Department Manager | |
| | Other, _____ | |
-

Part-II

- ❖ To evaluate the existing credit processing and approval procedure and to find out any drawbacks in the credit processing and approval procedure of the bank.
- ❖ To evaluate the credit follow up procedure.
- ❖ To assess the inspection with regards to credit availed to its customers.
- ❖ To suggest to the management the methods that they may have overlooked in improving the bad/sick loans.

1. Does NPLs bring any negative consequence in your bank?

- Yes No
 To some extent

2. If your answer is "yes" for Qn. 2 What do you think the consequences might be?

- Reduction of profit
 High reserve requirements by the NBE
 Loss of public confidence on the bank: both customers and investors
 Instability of employees

If any other _____

3. Are there any methods of preventing NPLs in your Bank?

- Yes No

4. If the answer is "yes" in Qn. 3, what kind of method is applying your Bank?

- Pre-granted of loans Post-granting of loans

If any other _____

5. Do you think those methods are successful?

- Yes No
 To some extent

If the answer is "No" why? _____

If any other _____

6. What could be the role of private banks in preventing the occurrence of NPLs?

- Assigning of professional loan officers and credit analysts
 Assigning of professional credit follow-up officers
 Granting of loans and advance based on proper analysis
 Acquiring of adequate collateral
 Collecting updated credit information
 Ability to forecast the business
 Organizing committees to approve the loans
 Creating awareness within the borrowers to pay their liability at a time
-

Proper and continuous follow-up on granted loans

If any other _____

7. Which one of the following is more sensitive for preventing the occurrence of NPLs? Please grade them.

Sr. No.	Roles of Private Banks in Preventing the Occurrence of NPLs	Grade Interval				
		1	2	3	4	5
1	Assigning of professional loan officers and credit analysts					
2	Assigning of professional credit follow-up officers					
3	Granting of loans based on proper study					
4	Acquiring of adequate collateral					
5	Collecting updated credit information					
6	Ability to forecast the business					
7	Organizing committees to approve the loans					
8	Creating awareness within the borrowers to pay their liability at a time					
9	Proper and continuous follow-up on granted loans					

8. Do you believe there are committed and qualified loan officers and credit analysts assigned in your bank?

Yes No
 Neutral

9. How much effective is the directive of National Bank of Ethiopia (NBE) to prevent the occurrence of NPLs?

Low Medium High

If the answer is "low" what do you think might be the reason? _____

10. Which type of loans is highly subjective to the appearance of NPLs?

Long term loans Medium term loans
 Short term loans

11. What do you think the reasons for the occurrence of NPLs?

- Business fluctuation
- Knowledge and commitment of loan officers and credit analysts
- Poor business forecasting knowledge and system of credit analysts
- Diversion of fund by the borrower
- Inadequate Collateral
- Personal problems of the borrower like marital conflicts
- Natural Calamities
- Instability of government policies
- Poor follow ups for granted loans

If any other _____

12. Which one of the following is more subjective for the occurrence of NPLs? Please Grade them.

Sr. No.	Reasons for the occurrence of NPLs	Grade Interval				
		1	2	3	4	5
1	Business fluctuation					
2	Knowledge and commitment of loan officers and credit analysts					
3	Poor business forecasting knowledge and system					
4	Diversion of fund					
5	Inadequate Collateral					
6	Personal problems of the borrower like marital conflicts					
7	Natural Calamities					
8	Instability of government policies					

13. Focusing on the approving organs, who is more liable to the occurrence of NPLs?

- Branch Credit Committee
- Head Office Credit Committee
- Executive management Credit Committee
- Sub-Board Credit Committee
- Board Credit Committee

14. Do you think customer use fund being directed to unintended purpose?

- Yes No

15. Do you believe the bank loan is intentional or willful default by the customer?

- Yes No

16. Is there any macroeconomic factor like inflation market problem etc

- Yes No

17. Is there any capacity limitation of the supervisory organ?

- Yes No

18. Do you think poor credit culture?

- Yes No

19. Is there any training given for the loan officers and credit analysts in relation with NPLs?

- Yes No

20. What kinds of measurements are taken in your bank to protect the occurrence of NPLs?

- Assigning of committed and knowledgeable loan officers and credit analysts
- Assigning of committed and knowledgeable Follow-up officers
- Creating good forecasting knowledge of business
- Granting of loans based proper assessment and analysis
- Acquiring of adequate collateral
- Presentation of cash flow
- Collecting updated credit information
- Follow-up on already granted loans

If any other _____

21. Are there any continuous follow-up systems on already granted loans in your bank?

- Yes No

22. If your answer is "yes" for Qn. 18 how much strong is it?

- Low Medium
 High

If the answer is "Low" why? _____

23. Through which one or more of the following systems does the bank employees its follow-up activities?

- Based on current status of the loan
 - Through follow-up of the borrowers' business
 - Reminding the borrower through telephone/verbally
-

Through written reminder to the borrower if the loans are not paid at a given time
If any other _____

24. Do you think the follow-up activities on granted loans reduce the appearance of NPLs?

Yes No

25. Do you believe there are committed and qualified officers are assigned on the follow-up division?

Yes No
 Neutral

26. Are there any special treatments on unhealthy loans (NPLs) in order to regularize them?

Yes No
 To some extent

If the answer is "No" why? _____

27. How much successful is the treatment of those NPLs?

Low Medium
 High

If the answer is "Low" why? _____

28. What do you think of the better ways to regularize them?

- Determination of the track records of the borrower
- determining the adequacy of documentation of collateral
- Identifying the problem from the customer side for the failure
- Identifying the problem from the bank side too
- Identifying the asset of the borrower

If any other _____
