ST. MARY'S UNIVERSITY

FACULTY OF BUSINESS

DEPARTMENT OF MANAGEMENT

AN ASSESSMENT ON CAUSES AND CONSEQUENCES OF NON-PERFORMING LOANS IN THE CASE OF UNITED BANK SHARE COMPANY

BY:

BETHLEHEM TADESSE

JUNE 2014

SMU

ADDIS ABABA

AN ASSESSMENT ON CAUSES AND CONSEQUENSES OF NON-PERFORMING LOANS IN THE CASE OF UNITED BANK SHARE COMPANY

A SENIOR ESSAY SUBMITTED TO THE
DEPARTMENT OF MANAGEMENT
BUSINESS FACULTY
ST. MARY'S UNIVERSITY

IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF BACHELOR OF ARTS IN MANAGEMENT

BY:
BETHLEHEM TADESSE

JUNE, 2014

SMU

ADDIS ABABA

ST. MARY'S UNIVERSITY

AN ASSESSMENT ON CAUSES AND CONSEQUENCES OF NON-PERFORMING LOANS IN THE CASE OF UNITED BANK SHARE COMPANY

BY:

BETHLEHEM TADESSE

FACULTY OF BUSINESS

DEPARTMENT OF MANAGEMENT

APPROVED BY THE COMMITTEE OF EXAMINERS

Department Head	**Signature**
Advisor	**Signature**
Internal Examiner	**Signature**
External Examiner	**Signature**

ACKNOWLEDGMENTS

TABLE OF CONTENTS

Content	Page

CHAPTER ONE

1. INTRODUCTION

CHAPTER TWO

2. REVIEW OF RELATED LITERATURE

LIST OF TABLES AND GRAPHS

LIST OF TABLES

LIST OF GRAPHS

LIST OF ABBREVIATIONS/ACRONYMS

BC: Building & Construction

DTS: Domestic Trade and Service

LC: Letter of Credit

NBE: National Bank of Ethiopia

NPD: Non-Performing Debt

NPL: Non-Performing Loan

OTL: Outstanding Loan

SD: Standard Deviation

UB: United Bank

UBSC: United Bank Share Company

UCC: Universal Commercial Code

CHAPTER ONE
INTRODUCTION

1.1. Background of the Study

"Non-Performing Loan" means loans or advances whose credit quality has deteriorated such that full collection of principal and/or interest in accordance with the contractual repayment terms of the loan or advance is in question. For purposes of these, loan or advances with pre-established repayment programs are non-performing when principal and/or interest is due and uncollected for 90 (ninety) consecutive days or more beyond the scheduled payment date or maturity (NBE, 2008:2).

Furthermore, according to Rajiv Ranjan and Sarat Chandra Dhal (2003:103), a non-performing loan entails that the borrower does not renege from the loan contract but fails to comply the repayment schedule due to evolving unfavorable conditions.

United Bank was incorporated as a Share Company on 10 September 1998 in accordance with the Commercial Code of Ethiopia of 1960 and the Licensing and Supervision of Banking Business Proclamation No. 84/1994. The Bank obtained a banking services license from the National Bank of Ethiopia and is registered with the Trade, Industry and Tourism Bureau of the Addis Ababa City Administration. (UB, 2010:6)

United Bank is a full service Bank that offers its customers a full range of commercial banking services with a network that includes 79 branches. These branches render all type of banking services with the uncompromised commitment of service quality to the utmost satisfaction of the customers. The operation of the bank is, therefore, fully conducted through its branches. (UB, 2010:6)

The bank renders deposit services including demand deposit, savings deposit and time/fixed time deposit; a credit service like DTS, OD and International

Banking services like; opening letters of credit (LC) for importers, handling of incoming LCs 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. (UB, 2010:6)

The loan disbursement and collection practice has required considerable attention by senior management and the banks credit committee. The student researcher believes that accepting customers' deposit and giving loans are most valuable activities in banks to run a business and accomplish its objectives (goals).

To this end, the student researcher inspired to conduct an assessment on causes & consequences of Non-Performing Loans in United Bank S.C.

1.2. Statement of the Problem

Under The Ethiopian banking business directive, non-performing loans are defined as "Loans or Advances whose credit quality has deteriorated such that full collection of principal and/or interest in accordance with the contractual repayment terms of the loan or advances in question" National Bank of Ethiopia. (NBE, 2012: 4)

Non-performing loans are loans or advances whose credit quality has deteriorated such that full collection of principal and/or interest in accordance with the contractual repayment terms of the loan or advances are in question; or when principal and/or interest is due and uncollected for 90 (Ninety) consecutive days or more beyond the scheduled payment date or maturity. (NBE, 2008:2)

Effective liquidity management requires maintaining sufficient cash reserves on hand (to meet client withdrawals, disburse loans and fund unexpected cash

shortages) while also investing as many funds as possible to maximize earnings (putting cash to work in loans or market investments). (GTZ, 2000).

Causes for non-performing loans are merely varied from bank to bank but in United Bank S.C. some of the causes are lack of continuous follow up of repayment, overstating the collateral value at the time of estimation, diversion of the borrowed fund to other purposes and poor follow-up and others (UB, 2010:17).

Beginning from its establishment United Bank S.C. has now over 364,883 customers through its 79 branch offices in Addis Ababa and in regions (Source: Bank's Weekly Deposit Report from Dec. 2, 2013 – Dec. 7, 2013). However, the rate of the growth in loans and advances is not keeping pace with the fast growth of deposits on which the bank incurs cost. The Bank's annual progress report (FY 2012/13:9) shows that the ratio of non-performing loans of the bank at the end of June, 2013 was 2.53% which is higher from the banks plan 1.61%. An increase in the non-performing loan is an indication of the deterioration to the total portfolio. It is clear that banks are issuing credits not on their own money, but money belonging to other depositing customers. With this in mind, the banks must be careful in handling credit facility since lending is the major cause of banks losses and failure.

In addition to the above facts, years of experience in United Bank, the student researcher observed that there are also problems over the years faced by the bank with regard to credit such as complain of customers, lack of adequate client guidance and advisory service and follow up, collateral related problems.

Therefore, this study intends to assess the causes and consequences of NPL in United Bank S.C.

1.3. Research Questions

- What does the credit policy of United Bank S.C. looks like?
- What are the major causes of Non-Performing Loans?

- What are the consequences of Non-Performing Loans (NPL) in the bank's liquidity and profitability?

1.4. Objectives of the Study

1.4.1. General Objective

The general objective of the study is to identify causes and consequences of NPL in United Bank S.C.

1.4.2. Specific Objective

The specific objectives of this study are:-
- To describe the practice of credit policy in UB
- To investigate the causes associated with the non-performing loans (NPL) in United Bank S.C.
- To explore the consequences of non-performing loans in the profitability of the bank to provide appropriate recommendations.
- To evaluate the effect of NPL in the banks liquidity

1.5. Significance of the Study

Among the various financial services given by banks, lending is the most important and principal activity which generate higher profit and existence of the bank. The optimum utilization of efforts to increase the bank's loan portfolio is unquestionable. Following this, the significance of this paper emphasized on the following points.
- Tries to highlight the factors in the credit system, which causes non-performing loans.
- After assessing the problems in lending activity of the bank, this study has given recommendations that can provide possible solution to the problems.
- The research may also serve as a reference for other researchers who are interested to conduct research in the same/related topic.

1.6. Delimitation of the Study

This study was delimited to investigate causes and consequences of non-performing loans in United Bank S.C. Student researcher gathered data only during the period from years 2008/2009 – 2011/2012. This period was selected because of its nearness and readily availability of data. In addition, this research investigated data related to non-performing loan from the bank's head office and three selected branches. These branches were: Beklobet Branch, Bole Medhanialem Branch and Lideta Branch. These branches were selected for the reason that they take the highest share of NPL rate from the total NPL rate of the bank. (UB annual progress report, 2011/12: 6).

1.7. Research Methodology
1.7.1. Research Design

To seek answers for the research questions and to meet the objectives, the student researcher used explanatory research method. Furthermore, this method enabled the student researcher to identify the causes and consequences related to non-performing loans.

1.7.2. Population, Sampling Techniques and Sample Size

To address the research questions the target population was confined to those involved in credit managers, credit analysis and appraisal, credit monitoring and branch credit committee members of the bank. For United Bank employees the total population size were 86 out of which 30 staffs were selected based on their relevance to the study objectives, through purposive sampling from UB head office credit department and from the three branches. This selection included 1 Credit manager, 5 credit analysts, 2 branch managers, 2 assistant branch managers, 1 loan supervisor, 6 loan officers, 6 loan clerks and 7 other clerical staffs who have taken loan from the bank.

In addition, 15 loan customers who are having NPL were selected from the three branches, a census data were collected from customers from the three branches through self administered questionnaire.

1.7.3. Type of Data Collected

The types of data that were used for this study were primary and secondary.

Primary Data:- The primary data was collected through self-administered questionnaire distributed to the selected employees of the bank and interview. The questionnaires included open and close ended questions.

Secondary Data:- The sources for secondary data was policies, procedures, annual reports, publications, journals, articles, books and web-sites/internet.

1.7.4. Method of Data Collection

In the investigation of this research, questionnaires were handed out to the respondents by hand so that threat of getting low response rate is totally eliminated. Questionnaire respondents were 15 customers from the selected three branches and 30 staffs of the bank who are mentioned above. From those staffs 5 of them were also participated in the interview.

1.7.5. Method of Data Analysis

Data collected through questionnaire and interview was presented in tabulations whenever appropriate. The student had analyzed and interpreted the data collected through percentages, graph, mean, standard deviation, and ratio methods.

1.8. Limitation of the Study

The student researcher had encountered problems in finding related literature review during secondary data collection for this research paper.

The student researcher also had faced problems while collecting data from customers in which most of the time they were not willing to fill the questionnaire due to various reasons.

1.9.   Organization of the Study

This study is organized in to four chapters. The first chapter deals with the introduction part composed of background of the study, statement of the problem, research questions, objectives of the study, significance of the study, scope of the study, research design and methodology, and limitation of the study. The second chapter focuses on the review of related literature; the third chapter focuses on data presentation, analysis and interpretations. The last chapter presented the summary, conclusions and recommendations of the study.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

Among the functions of a modern bank, lending is one of the most important activities. It is evident that a substantial proportion of the total revenue of all banks in Ethiopia comes from interest on loans and advances. Loans and advances comprise a very large portion of a bank's total asset, and they also form one of the most essential operations of a bank. The strength of a bank is thus judged by the soundness of its advances. Wise and prudent policies and procedure in regard to credit management are considered important factors inspiring confidence in depositors and prospective customers of a bank (UB, 2010:1).

2.1. Definition and Meaning of Nonperforming Loans

Loan becomes non-performing when it cannot be recovered within certain stipulated time that is governed by some respective laws. So, non-performing loan is defined from the institutional point of view, generally from the lending institutions side. (Mohammed Islam et al, 2005:3).

Currently, there is still no standard on loan classification which has been uniformly adopted by all countries in the world, so the meaning of NPLs largely depends on the regulatory framework of loan classification mechanism in different countries (Angklomkliew et al, 2009:70). Although ninety days is normally considered the watershed of dividing line between loans that are classified as performing and loans that are classified as non-performing, (Cortavarria et al, 2000:11)

According to Xiao (2006:65), loans can be either performing or nonperforming depending on their level of profitability. If the enterprises are making profits, the quality of their debts (more specifically their total liabilities) are termed "performing." If they are making losses, their debts are regarded as "nonperforming." The amount of non performing debt (NPD) for a specific

enterprise group is then the sum of the total liabilities in the loss-making enterprises for that group. The NPD ratio for the group is simply the ratio of the sum of total liabilities in the loss-making enterprises divided by the sum of total liabilities in both the loss-making and profit making enterprises in the group. These simple definitions of NPD and the NPD ratio make our NPD statistics objective, easy to measure, and easy to understand.

According to Nobuo et al (2003:106-107) there are at least three definitions that are referred to, and these definitions have been changed over time.

- ***Risk management loans*** and ***loans disclosed under the Financial Reconstruction Law (FRL) classification*** are officially published NPLs in the sense that they are based on the criteria specified by a law or by law. Although they have different breakdowns, their two definitions broadly coincide, and hence produce similar figures for outstanding loans.

- ***Loans subject to self-assessment*** are classified, depending upon borrower creditworthiness, in line with guidelines (the "Inspection Manual") produced by the Financial Services Agency (FSA):

- These definitions have substantially changed over time. The criteria became tougher and their coverage became wider in response to public demand for better disclosure.

Under the Ethiopian banking business directive, non-performing loans are defined as "loans or advances whose credit quality has deteriorated such that full collection of principal and/or interest in accordance with the contractual repayment terms of the loan or advances in question (NBE, 2008:2)." It further provides that:

> *"…, **loans or advances with pre established repayment programs are nonperforming when principal and/or interest is due and uncollected for 90 (ninety) consecutive days or more beyond the scheduled payment date or maturity (NBE, 2008:2).***

In addition to the above mentioned category of non- performing loans, overdrafts and loans or advances that do not have pre-established repayment program shall be non-performing when:

- The debt remains outstanding for 90 (ninety) consecutive days or more beyond the scheduled payment date or maturity;
- The debt exceeds the borrower's approved limit for 90 (ninety) consecutive days or more;
- Interest is due and uncollected for 90 (ninety) consecutive days and more; or for the overdrafts,

  I. The account has been inactive for 90 (ninety) consecutive days or
  II. Deposits are insufficient to cover the interest capitalized during 90 (ninety) consecutive days or
  III. The account fails to show the 20% of approved limit or less debit balance at least once over 360 days preceding the date of loan review. (NBE, 2008:2)

2.2. Classification of Loans

According to NBE (2012: 7-9), finance institutions shall classify all their loans, into the following classification categories using the criteria described below:

2.2.1. Pass

Loans in this category are fully protected by the current financial and paying capacity of the borrower and are not subject to any criticism. Notwithstanding the generality of this statement, the following loans shall be classified pass:

a) Short term loans past due for less than 30 (thirty) days.

b) Medium and long term loans past due for less than 180 (one hundred eighty) days; and

c) Any loan, or portion thereof, which is fully secured, both as to principal and interest, by cash or cash-substitutes, regardless of past due status or other adverse credit factors.

2.2.2. Special Mention

The following loans at a minimum shall be classified special mention:

a) Short term loans past due for 30 (thirty) days or more, but less than 90 (ninety) days;

b) Medium and long term loans past due 6 (six) months or more, but less than 12 (twelve) months;

2.2.3. Substandard

The following non-performing loans at a minimum shall be classified substandard:

a) Short term loans past due 90 (ninety) days or more, but less than 180 (one-hundred-eighty) days;

b) Medium and long term loans past due 12 (twelve) months or more, but less than 18 (eighteen) months;

2.2.4. Doubtful

The following non-performing loans at a minimum shall be classified doubtful:

a) Short term loans past due 180 (one-hundred-eighty) days or more, but less than 360 (three-hundred-sixty) days;

b) Medium and long term loans past due 18 (eighteen) months or more, but less than 3 (three) years;

2.2.5. Loss

The following non-performing loans at a minimum shall be classified loss:

a) Short term loans past due 360 (three-hundred-sixty) days or more;

b) Medium and long term loans past due 3 (three) years or more;

Table 2.1. Provisioning Requirements for Loans

Article	Classification Category	Minimum Provision for Short, Medium and Long Term Loans
8.3.1	Pass	1%
8.3.2	Special Mention	3%
8.3.3	Substandard	20%
8.3.4	Doubtful	65%
8.3.5	Loss	100%

2.3. Reasons of Loans Being Non-Performing

As cited by Mohammad Islam et al. (2005: 3-6), in developing and under-developed country, the reasons of being default have a multidimensional aspect. Various researches have concluded various reasons for a loan to be default. Some of them are discussed below that are very much pertinent to the study.

A. Reduced Attention to Borrowers

Workers perceptions that someone is paying attention to them get better result that perception of inattention, of being ignored. Borrowers may also perform in this manner.

B. Moving Along the Risk Curve

This means that risk increases and are always to some degree unknown as the low risk situations become saturated.

C. Increasing Loan Size Increases Risk

As the sizes of the loans granted to companies increased the risk level increased by the same proportion.

D. Lenders Lack Plans to Deal with Risk

Donor-funded credit programs are usually designed without a clear focus on risk. In micro finance promotion there seems to be no clear vision of risk or no industry-wide concern about means of addressing it, other than running a tight ship.

E. Borrowers Probe a Credit Operation's Weaknesses

Credit programs have no special claim to infallibility. A borrower may be determined repay on time but because of some unexpected events fail to do so. If the lender does not follow up promptly with a query, the borrower will take note. A second way in which borrowers are tempted to probe a credit program's weaknesses is when some borrowers blatantly refuse to pay on time or skillfully avoid payment.

F. Rent-Seekers Capture the Credit Program

Credit programs attract rent seeking of all sorts, especially when some subsidy is involved. In certain cases hijacking is blatant, as when the patterns of funding follow election year cycles.

G. Lenders and Project Designers have Low Expectation

In some cases credit is provided by donors because it is the easiest thing to offer, it makes many people happy and it corresponds to a certain view of development and the conditions required for it to occur. In this case repayment is not terribly important to donors because the objective is almost overwhelmingly to get the money working in order to stimulate development.

H. The Lender is Unwilling to Collect

Unwillingness may arise from a number of factors, but almost always requires soft funds that the lenders can afford to lose. Unwillingness to collect may result from the realization that the credit program was poorly designed, destined to fail. It may also reflect a view that the beneficiaries are poor while the sponsors are not, and that a sense of fairness precludes any serious action against defaulters.

I. Lack of Good Models

Lenders are simply not familiar with successful examples of dealing with bad and doubtful debts.

J. Loan Sanctioned by Corruption

Sometimes loan sanctioning authority sanctions loans for satisfying their self-interested behavior. This is the result of too much politicization and power-relatedness in the institutional system.

K. Donors give Loans to Dominate

The strategies that most donor country follows are to weaken countries system so that they can hold the bargaining option to ensure their dominance.

L. Weak Follow-Up Weaken the System

People five more importance on current consumption. So they do not mind to spend the borrowed fund to spend for consumption if they are not strictly followed up. People hold a very short vision of thinking for today leading sufferings tomorrow.

2.4. The Determinants of Non-Performing Loans

The literature identifies two sets of factors to explain the evolution of NPLs over time. One group focuses on external events such as the overall macroeconomic conditions, which are likely to affect the borrowers' capacity to repay their loans, while the second group, which looks more at the variability of NPLs across banks, attributes the level of non-performing loans to bank-level factors. (Klein, 2003:4)

2.5. Causes of Non-Performing Loans

According to IMF working paper (Adriaan M. Bloem and Cornelis N. Gorter, 2001:4-5), there are some causes of loans to become doubtful.

The first one is wrong economic decisions by the individual and plain bad luck (inclement weather, unexpected price changes for certain products, etc). Under such circumstances, the holder of loans can make an allowance for a normal share of non performance 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 nonperforming on granted loans.

The amounts involved in nonperforming loans may rise considerably as a result of less predictable incidents, such as when the cost of fuel, prices of key export products, foreign exchange rates, or interest rate change abruptly.

- A fall in the prices of loan collaterals(often real estate) m cause more loans to become classified as doubtful;
- Large bad loan portfolios will affect the ability of banks to provide credit, and the resulting liquidity crunch may suffocate otherwise good creditors,
- Depositors and foreign investors may start a run on the banks, pushing them into liquidity problems.

The chances for the financial sector to derail are usually considered to be much higher under conditions of deficit bank management, poor supervision, and overoptimistic assessments of credit worthiness during boom economies, and moral hazard that results from (too) generous government guarantees or the expectation of assured bailouts. (Adriaan M. Bloem and Cornelis N. Gorter, 2001:4-5)

Major Banks crises are common, and they may be very costly for the taxpayer. This is particularly costly tend to be guarantees provide by the government in the forms of blanket deposit insurance.

2.6. Market Discipline as a Mechanism to Curb

According to Adriaan M. Bloem and Cornelis N. Gorter, (2001:60-67) unsustainable borrowing and its conditions unsustainable borrowing, that is, borrowing without the means or even the intention of repaying, directly leads to NPLs. Market discipline is one force that may limit such abuse of financial markets: market discipline implies that lenders penalize excessive borrowing, first, by requiring a higher interest rate spread and, ultimately, by excluding the borrower from the market.

2.6.1. Open and Competitive Capital Markets

This is required so that unsustainable borrowing will face the borrower with increased interest rates or exclusion from the market. In the case of financial institutions, if legal restrictions that limit competition for deposits - such as geographic scope of activities, or on the activities permitted to particular categories of institutions - give particular institutions a degree of market power, this may reduce the market's ability to discriminate between prudent and imprudent financial intermediaries, and thereby render market discipline in- effective. (Adriaan M. Bloem and Cornelis N. Gorter, 2001:60-67)

2.6.2. Information

A second requirement for effective market discipline is to allow lenders to obtain relevant information about the borrower's outstanding debts. Due to the imperfect accounting rules, financial institutions can conceal their losses from both creditors and regulators. This seriously undermines the market discipline. The weaknesses identified by the IMF include: (1) High corporate leverage was hidden by related-party transactions and off-balance sheet financing; (2) High-level foreign exchange risk exposure by corporations and banks resulting from large, short-term borrowing in foreign currency was not evident; (3) Disclosure of loan classification, loan loss provisioning, and accrual of interest was weak. Although most banks disclosed the accounting policy for loan loss provisioning, they did not disclose in the balance sheet the aggregate amount of loans and advances for which they had stopped accruing interest; (4) In Korea, the practice of cross- guarantees made it hard to assess the solvency of the largest borrowers; (5) Consolidation of accounts was generally absent; (6) Detailed information on sector concentration was largely absent, even though all countries had large exposure limits in place; (7) Disclosure regarding derivative financial instruments was weak; and (8) Contingent liabilities of the parent of conglomerate, or of financial institutions, for guaranteeing loans (particularly foreign currency loans) were generally not reported. Andrew Sheng, the chairman of the Hong Kong Securities and Futures Commission, summarized

the information problem as " 'Bad accounting = bad information = poor decision-making = bad risk management = financial crisis.'   (Adriaan M. Bloem and Cornelis N. Gorter, 2001:60-67)

2.6.3. Borrower's Response Market Discipline takes two Forms:

Initially, the borrower faces a rising interest rate spread and eventually access to further credit is denied. Because the second stage is often associated with a financial crisis, it is not a normal form of market discipline. Thus, a condition for the smooth operation of market discipline is that borrowers respond to the signals provided by the market in time to avoid a crisis. A rational agent, when faced with a higher interest rate, would respond by reduced borrowing in order to get back onto a sustainable path. In fact, if a rational agent possessed as much information as the lender did, it would not wait for a market signal: a rational borrower would anticipate that further borrowing would lead to a higher interest rate spread, and, taking that knowledge into account, would refrain from unsustainable borrowing. Borrowers who believe that there is a high probability of insolvency, however, will not respond to market signals or anticipate them: they have nothing to lose by borrowing, even at a high interest rate.67 In other words, market discipline does not work through interest rate spreads if borrowers are already near insolvency; it can only work by excluding insolvent borrowers from the market. (Adriaan M. Bloem and Cornelis N. Gorter, 2001:60-67)

Issues of non-performing loans and cost efficiency are related in several important ways. First, a number of researchers have found that failing banks tend to be located far from the best practice frontier. (Adriaan M. Bloem and Cornelis N. Gorter, 2001:60-67)

2.7. Evaluation of Borrowers Creditworthiness

Table 2.2. The Six Basic Cs of Lending
Source: Peter S. Rose, "Loans in a Troubled Economy," The Canadian Banker 90, no. 3 (June 1983), p. 55.

Character	Capacity	Cash	Collateral	Conditions	Control
Customer's past payment record	Identity of customer and guarantors	Take-home pay for an individual; the past earnings, dividends, and sales record for a business firm	Ownership of assets	Customer's current position in industry and expected market share	Applicable laws and regulations regarding the character and quality of acceptable loans
Experience of other lenders with this customer	Copies of Social Security cards, driver's licenses, corporate charters, resolutions, partnership agreements, and other legal documents	Adequacy of past and projected cash flows	Vulnerability of assets to obsolescence	Customer's performance vis-à-vis comparable firms in the same industry	Adequate documentation for examiners who may review the loan
Purpose of Loan	Description of history, legal structure, owners, nature of operations, products, and principal customers and suppliers for a business borrower	Availability of liquid reserves	Liquidation value of assets	Competitive climate for customer's product	Signed acknowledgements and correctly prepared loan documents
Customer's track record in forecasting		Turnover of payables, accounts receivable and	Degree of specialization in assets	Sensitivity of customer and industry to	Consistency of loan request with lender's written

business or personal income credit rating		inventory Capital structure and leverage	Liens, encumbrances, and restrictions against property held	business cycles and changes in technology Labor market conditions in customer's industry or market area	loan policy Inputs from non credit personnel (such as economists or political experts) on the external factors affecting loan repayment
Presence of cosigners or guarantors of the proposed loan		Expense controls Coverage ratios Recent performance of borrower's stock and price-earnings (P/E) ratio Management quality Recent accounting changes	Leases and mortgages issued against property and equipment Insurance coverage Guarantees and warranties issued to others Lender's relative position as creditor in placing a claim against borrower's assets Probable future Financing needs	Impact of inflation on customer's balance sheet and cash flow Long-run industry or job outlook. Regulations, political and environmental factors affecting the customer and/or his or her job, business, and industry	

2.8. Consequences of Non-Performing Loans

Capital Formation-Investment-Recovery Loop Extended

Capital formation has at least two dimensions, i.e., domestic and international. The attraction should be institutionalized so that the saving can be utilized in economic process. Households should be motivated to save and to deposit the same so that the idle savings can be used economically. Sometimes, they are self-motivated. Economists have identified at least three broad reasons for saving (Frank, Bernanke, 2001); life cycle saving: savings to meet long-term objectives, such as retirement, college attendance, or for the purpose of a home; precautionary saving: savings for protection against unexpected setbacks, such as the loss of a job or a medical emergency; bequest saving: savings done for the purpose of leaving an inheritance. But, sometimes they require external inducement that is basically done by the financial institutions or government. Along with household savings, there is another form of investment that basically comes from corporation. (Mohammed Islam et al, 2005:6).

Saving can be held in different forms, as financial assets, as stores of value, as well as informal financial assets such as savings in informal financial institutions. The financial liberalization paradigm maintains that savings in the informal sector are as a result of inefficient and repressed financial markets. The lack of access to financial saving instruments and the market fragmentation means that people have to resort to non-financial savings. (Gupta, 1985:7). The prevalence of non-financial savings in rural households of East African countries, Where financial savings at times constitute only 5-6% of total household savings. Getting the small savings from the households, financial institutions form large capital so that it can be invested in the development of various sectors like industry, business, development and others. When savings get investing status, it works for the economic development provided that the investment is rightly done. In an article entitled "The vice of

Thrift, Samuel et al, 2001:85 states, "It has become clear that the surge in investment in East Asia in the 1990s was a sign of weakness, not strength. Much of the money was wasted on speculative property deals or unprofitable industrial projects.

The consequences have both positive and negative dimensions to the investing authority though in the economy it always should have a positive result up to a limit. If the invested funds can be captured timely, it can again form new capital creating a good option of reinvestment or consumption. Both of these reinvestment and consumption functions create a positive impact on the economy. Because, economy gets some value added jobs to do. But, in case of non-recovery, the investing party should have to go a long way that is not expected and sometimes this unexpected happenings cause a great harm to the economic framework and structure. (Mohammed Islam et al, 2005:7).

Assurance of a timely recovery of the invested fund ensures societal economic development as these funds again flow into the economy in the form of either investment or consumption. The fast the loop moves, the fast the economy develops.

Low Saving and Investment Leads Low Income

Source: (Mohammed Islam et al, 2005:9)

21
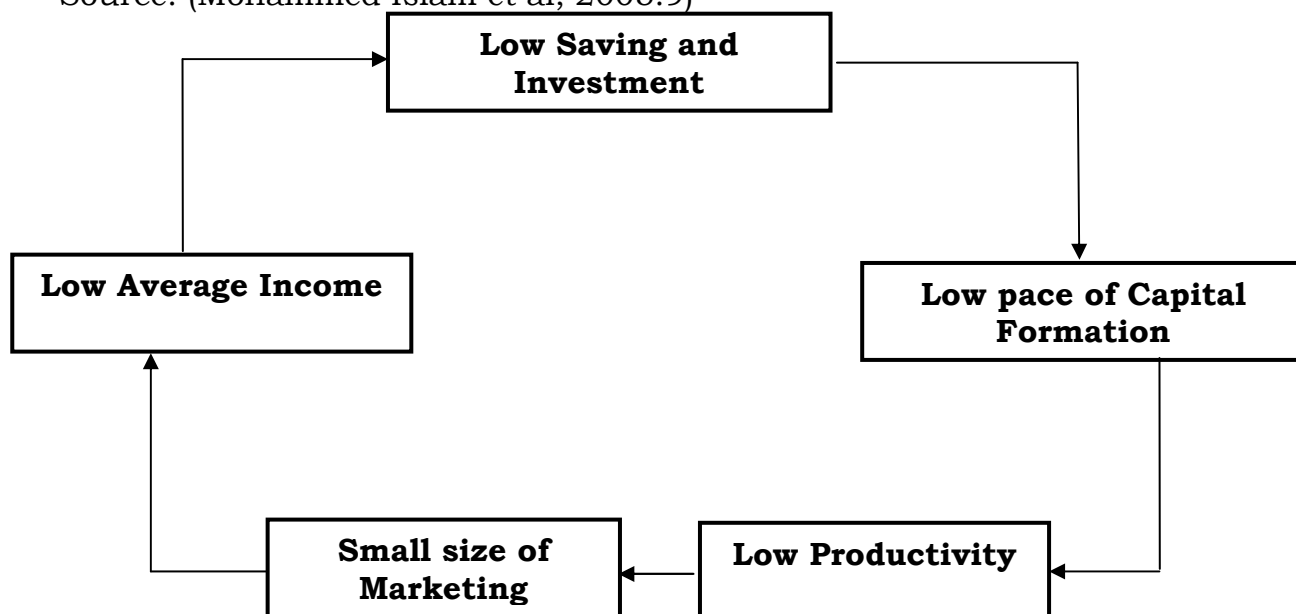
In case of a different consequences, when the loop breaks, economy experiences a different look like the above where the rate of savings and investment declines leading to lower the income that hamper the process from both perspective; at one side, standard of living declines (by lowering the expenditure for living), and on the other, by saving nothing as the total earnings are expensed to continue the livelihood. (Samuel et al, 2001:85).

CHAPTER THREE

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

This chapter deals with data presentation, analysis and interpretation. The findings are presented in consideration with the respondents profile and on each of the investigation questions that the survey sought to answer. Accordingly, the collected data from employees and customers are analyzed and interpreted as follows.

Among the questionnaires distributed to 30 employees, all of them were returned and that makes the response rate 100%. In addition to this, the questionnaires which were distributed to 15 customers, 12 of them were returned which makes the response rate 80%.

In addition, interview has been made with 5 employees of the bank to gather detailed information on the issue.

3.1 General Characteristics of Respondents

Table 3.1: Characteristics of Respondents

№	Item	Respondents	Employees Frequency	Employees Percentage (%)	Customers Frequency	Customers Percentage (%)
1	Sex	Male	21	70	-	-
		Female	9	30	-	-
		Total	**30**	**100**	**-**	**-**
2	Age	< 30	-	-	4	33.33
		31-40	-	-	6	50
		41-50	-	-	2	16.67
		>51	-	-	-	-
		Total	**-**	**-**	**12**	**100**
3	Educational Background	12th Grade	-	-	1	8.33
		Certificate	-	-	-	-
		Diploma	5	16.67	2	16.67
		1st Degree	22	73.3	6	50
		Above 1st Degree	3	10	3	25
		Total	**30**	**100**	**12**	**100**
4	Working Experience in UB	< 1 year	-	-	-	-
		1-3 year	14	46.67	-	-
		4-6 year	11	36.67	-	-
		7-9 year	5	16.67	-	-
		Total	**30**	**100**	**-**	**-**
5	Current position in the UB	Credit Mgr.	1	3.33		
		Credit analyst	5	16.67		
		Branch Manager	2	6.67		
		Asst. Branch Manager	2	6.67	-	-
		Loan Supervisor	1	3.33		
		Loan Officer	6	20	-	-
		Loan Clerk	6	20	-	-
		Clerical Staff	7	23.33	-	-
		Total	**30**	**100**	**-**	**-**
6	Type of trade you engaged in	Domestic	-	-	10	83.33
		Foreign	-	-	2	16.67
		Total	**-**	**-**	**12**	**100**

Table 3.1 shows the general characteristics of UB employees and customers of the bank. As indicated in item no. 1, 21(70%) of the respondents were male and

4(30%) of them were female. This indicates that most of the respondent employees working in the bank's credit area were males.

Item No. 2 shows that, the customer respondents age, 4(33.33%) of them were young less than 30, 6(50%) of them were between 31 and 40, 2(16.67%) of them were between 41 and 50 and there is no customer whose age is above 51 years. This implies that majority of customer respondents are matured and have the capacity to engage in different businesses in order to repay debts.

Item No. 3 on the other hand shows the educational background of employees and customers as follows:- 1(8.33%) of the customers has educational background of 12th grade, neither the employees nor the customers respondents have certificate, 5(16.67%) and 2(16.67%) of the employees and customers have diploma respectively. In addition, 22(73.3%) and 6(50%) of the employees and customers have degree respectively. Moreover, 3(10%) of the employees and 3(25%) of the customers have above 1st degree. This implies that respondents have well enough knowledge in the area of the study and they are professional in their respective fields.

Item No. 4 indicates that, 14(46.67%) of the respondents had working experience of between 1 to 3 years, 11(36.67%) of them have working experience of between 4 to 6 years and 5(16.67%) of them have between 7 to 9 years experience. From this data, one can infer that majority of the employees have long years of experience. As a result, employees have better knowledge in their professional competency and accordingly they have the ability to discharge their responsibilities.

As indicated in item no. 5, respondent employees current position in UB, Credit Manager 1(3.33%), Credit Analyst 5(16.67%), Branch Manager 2(6.67%), Assistant Branch Manager 2(6.67%), Loan Supervisor 1(3.33%), Loan Officer

25

6(20%), Loan Clerk 6(20%) and clerical staff 7(23.33%). This implies that the respondent employees current position will have a positive impact on the information gathered to the student researcher.

On the other hand, item no. 6 shows that 10(83.33%) of the customers are engaged in domestic while 2(16.67%) in foreign operation. This shows that most of the customers have experience of domestic trade and fear of risk on foreign trade.

3.2 Analysis of Major Findings

Table 3.2: Practice of Credit Policy

№	Item	Respondents	Frequency	Percentage (%)
1	How do you rate the overall credit policy of the bank?	Very good	13	43.33
		Good	15	50
		Fair	2	6.67
		Poor	-	-
		Very Poor	-	-
		Total	**30**	**100**
2	How long will it take to process a given loan application?	1 week	4	13.33
		2 weeks	5	16.67
		3 weeks	5	16.67
		One month	9	30
		Above one month	7	23.33
		Total	**30**	**100**
3	Does the bank grant loan without taking collaterals?	Yes	17	56.67
		No	13	43.33
		Total	**30**	**100**
4	Do you believe the procedure followed by the bank for loan approval is satisfactory?	Yes	23	76.67
		No	7	23.33
		Total	**30**	**100**
5	Does the bank assess its borrowers past historical financial information (i.e. credit worthiness, detailed financial analysis) before extending any loans to customers?	Yes definitely	25	83.33
		Yes to some extent	5	16.67
		Not at all	-	-
		I am not quite aware of it	-	-
		Total	**30**	**100**

Item 1 of table 3.2 concerns about the overall credit policy in UB, 13(43.33%), 15(50%) and 2(6.67%) of the employee respondents rated the overall credit policy of the bank as very good, good and fair respectively. This assignment implies that since the respondents are UB employees who are exercising the day to day operation of loan, there exists a workable policy at the ground which dwell the credit practice of the bank.

With regard to time taken to process a given loan application, item no. 2 of table 3.2 shows that, of the respondent employees 4(13.33%) of them said 1 week, 5(16.67%) of them said 2 weeks, 5(16.67%) of them said 3 weeks, 9(30%) of them said one month and 7(23.33%) of them said above one month. From the majority of the respondents replied as well as the bank's credit procedure manual, the time period to give loan is very long and against the bank's credit policy and procedure manual. The policy states that the maximum number of days required to process loan in 15 days. The implication of this is that, the loan process time needs improvement in order to satisfy customers need and the banks efficiency.

According to item no. 3 of table 3.2, the majority of the respondents 17(56.67%) said the bank grant loan without taking collaterals. As per the employees response in the open ended question, the conditions which the bank grant loans without taking collaterals for such facilities is based on the type of loan i.e. LC, export pre-shipment loans, employee emergency loan and employee personal loan type A are granted without taking collateral. Moreover, for prominent customers and on borrowers' credit worthiness as well as clean base with the bank. In contrary 13(43.33%) of the respondents said the bank does not grant loan without taking collaterals. From the above information one can infer that granting loan without taking collateral entails the trust that banks have on their customers. This in turn can reinforce the connection between the bank and the customers.

Table 3.2 of item no. 4 shows that, majority 23(76.67%) of the respondents believe that the procedure followed by the bank for loan approval is satisfactory. This shows that most of the staffs or respondents recognized that the procedure followed by the bank for loan approval is according to order and successful. But, 7(23.33%) of the respondents believe that the procedure followed by the bank for loan approval is not satisfactory and reason out that the procedures of loan process & approval that the bank apply are too long and time taking and most of the customers are time sensitive so, this will make them dissatisfied.

According to table 3.2 of item no. 5, 25(83.33%) of the respondents believe that over all the vast majority of the respondents claim that UBSC assesses borrowers past financial history, credit worthiness and perform detailed financial analysis frequently before extending any loans. In addition, respondents indicate in the open-ended question that some of the mechanisms that the bank used to assess borrowers past experience by requesting the customer to bring audited financial statements, gathering credit information from NBE and by observation. This implies that there is a good procedure that the bank implements to prevent NPL. On the other hand, 5(16.67%) of the respondents replied that the bank assesses borrowers past historical financial information to some extent. This implies that there are some cases which doesn't need deep assessment of borrowers past financial information (i.e. which doesn't use financial statements rather uses its own format which the bank call it CCR or customer request records.)

On the other hand, interviewees responded that united bank grant a credit facility in Construction, Hotel & Tourism, Manufacturing, Import, Export and Domestic Trade sectors. As all interviewees response, the requirements of borrowers to get loan are loan application letter, License for the business engaged, TIN certificate, Tax Clearance certificate, Financial Statement (Audited), Marriage certificate (if married), or unmarried certificate, Company

profile, Articles of Association and Memorandum (for Private Limited Companies), Ownership certificate of a collateral to be held i.e. Carta, Libre. Moreover, interviewees point out that the bank considers the 5C's as follows:-

- **Collateral**:- Consider how strong the collateral offer is to repay the loan in case of default since it is the last option to recover the loan, even if it is not advisable for the bank's image. Thus it has to be carefully checked and the value has to be assessed.
- **Condition**:- Considering how profitable & successful the business is in line with the existing economic conditions of the country and in competing with other businesses in surviving for long.
- **Capital**:- Considering the capital that the business initially and currently has and the extent of needed capital to expand the business.
- **Character**:- Considering the applicants relationship with the bank and other areas, pervious history of the borrowers repayment ability and past settled loans (if any).
- **Capacity**:- Considering the businesses capacity to run the specified activity, to overcome its liabilities and to repay bank loans and survive the business.

As per the information gathered from interview in relation to policy and procedure of the bank's estimating collaterals, the bank has its own policy and procedure of estimating collaterals. This techniques includes Rental Value Method, Assessing location, material used, insurance estimation, assesses marketability of the collateral.

Table 3.3: Sectors that are Exposed to NPL

№	Item	Very High (5) %	High (4) %	Moderate (3) %	Low (2) %	Very Low (1) %	Mean	SD
1	Transportation Sector	16.67	16.66	26.67	30	10	3	1.02
2	Manufacturing Sector	10	33.33	46.67	6.67	3.33	3.4	0.92
3	Export Sector	6.67	6.66	20	6.67	60	1.93	1.53
4	Domestic Trade & Services Sector	6.67	6.67	30	33.33	23.33	2.4	1.28
5	Building and Construction Sector	33.33	6.67	36.67	3.33	20	3.3	0.93
6	Import Sector	3.33	3.33	13.34	6.67	73.33	1.57	1.81

Item no. 1 of table 3.3 shows that, with average mean value of 3 and SD 1.02, (16.67%+16.66) =33.33% of the respondents believe that transportation sector has a higher tendency of being default loan. In addition, 26.67% of the respondents have a moderate response. On the other hand (30%+10%) = 40% of the respondents believe transportation sector has a lower tendency of being default loan. The average value of mean shows that the majority of the respondents response lay between moderate(3) and low(2) and their answer deviate by 1.02. This implies that transportation sector have a medium/low tendency of being default and customers have the capacity to repay their loans.

On the other hand, table 3.3 of item no. 2 states that with average mean value of 3.4 and SD 0.92, (10%+33.3%)=43.33% of the respondents think that manufacturing sector has a higher tendency of being default loan. Similarly, 46.67% of the respondents are in-between higher and lower tendency of manufacturing sector being default loan. In contrary, (6.67%+3.33%)=10% of the respondents think that manufacturing sector has a lower tendency of being default loan. From the above analysis the average value of mean shows that the majority of the respondents response lay between high(4) and moderate(3) and their answer deviate by 0.92. This implies that there isn't sufficient competency

in dealing with the manufacturing sector loans which is more complex than other sectors.

Moreover, item no. 3 of table 3.3 shows that, with average Mean value of 1.93 and SD of 1.53, the majority of the respondents (6.67%+60%)=66.67% of the respondents believe that export sector have the lower tendency to become default loan. On the other hand 20% and (6.67%+6.66%) of the respondents believe that export sector have moderate and lower tendency of being default loan respectively. From the above analysis the average value of mean shows that the majority of the respondents response lay on low(2) and their answer deviate by 1.53 which make the responses very low and moderate. This implies that export sector isn't that much exposed to NPL and have the ability to regulated by both the national regulatory i.e. NBE and the international regulations such as UCC.

With regard to table 3.3 of item no. 4, with average responses of Mean value 2.4 and SD of 1.28, (33.33%+23.33%)=56.66% of the respondents think that domestic trade & service sector have a lower tendency of being default loan. Moreover, 30% of the respondents are in-between that domestic trade and service sector has neither higher nor lower tendency of being default loan. In contrary, (6.67%+6.67%)=13.34% of the respondents thinks that domestic trade and service sector has a higher tendency of being default loan. From the above analysis the average value of mean shows that the majority of the respondents response lay between moderate(3) and very low(1) and their answer deviate by 1.28. Thus, one can infer that domestic trade and service sector has a lower tendency of being default loan so, banks should encourage customer in this sector in order to prevent the bank's lending status from having higher NPL rate.

According to item no. 5 of table 3.3, with average responses Mean value of 3.3 and SD of 0.93, (33.33%+6.67%)=40% of the respondents believe building and construction sector has a higher tendency of being default loan. In addition, 36.67% of the respondents think that building and construction sector has a moderate tendency of being default loan. In contrary, (20%+3.33%)=23.33% of the respondents believe that building and construction sector has a lower tendency of being default loan. From the above analysis the average value of mean shows that the majority of the respondents response lay on moderate(3) and their answer deviate by 0.93. Therefore, the bank should create credit facility in order to encourage its customers to get loan on this sector which have lower exposure of NPL.

Item no. 6 of table 3.3 shows that, with average responses Mean value of 1.57 and SD of 1.81, the majority of the respondents (6.67%+73.33%)=80% of the respondents believe that import sector has a lower tendency of being default loan. On the other hand 13.34% of the respondents think that import sector has a moderate tendency of being default loan and (3.33%+3.33%)=6.66% of the respondents think that import sector has a higher tendency of being default loan. From the above analysis the average value of mean shows that the majority of the respondents response lay on low(2) and their answer deviate by 1.81 which make the responses very low and moderate. This implies that import sector is a highly encouraging sector for both the customer and the bank in order to prevent themselves from default loans.

Table 3.4: Factors that Cause NPL

№	Item	Strongly Disagree (1) %	Disagree (2) %	Neutral (3) %	Agree (4) %	Strongly Agree (5) %	Mean	SD
1	Rapid Loan Growth by banks	60	20	10	10	0	1.7	1.67
2	High Interest Rate	20	6.67	13.33	23.33	36.67	2.5	1.23
3	Lenient Credit Terms	13.34	36.67	36.67	6.67	6.67	2.57	1.19
4	Credit Culture /Orientation/	13.33	26.67	16.67	33.33	10	3	1.02
5	Poor Monitoring /Follow-up/	16.67	23.33	10	30	20	3.13	0.98
6	Poor Risk Assessment	23.33	23.33	16.67	20	16.67	2.83	1.08

Table 3.4 of item no. 1 shows that, with average responses Mean value of 1.7 and SD of 1.67, 80% of the respondents disagreed that rapid loan growth by banks is one of the factors that cause NPL. In contrary, 10% of the respondents agreed that rapid loan growth by banks is one of the factors that cause NPL. 10% of the respondents are not taking sides with this regard. From the majority of the respondents response, one can infer that rapid loan growth by banks is not the factor that cause NPL.

With regard to item no. 2 of table 3.4, with average responses Mean value of 2.5 and SD of 1.23, (23.33%+36.67%)=60% of the respondents agreed that high interest rate is other of the factor that cause NPL at large. In addition 13.33% of the respondents neither agree nor disagree in this view. In contrary, 26.67% of the respondents disagreed on the view that high interest rate is also factor that cause NPL. From this analysis and the responses of the majority respondents one can infer that, high interest rate is one of the factors that cause NPL and banks should give attention and consider the interest rate while scheduling repayment period.

Table 3.4 of item no. 3 on the other hand shows that, with average responses Mean value of 2.57 and SD of 1.23, (13.34%+36.67%)=50.01% of the respondents disagreed that lenient credit terms are factors that cause NPL. Moreover, 36.67% of the respondents are neutral that lenient credit terms are factors that cause NPL. In contrary, (6.67%+6.67%) of the respondents agreed that lenient credit terms are factors that cause NPL. This implies that, lenient credit terms are not the factor that cause NPL in UB.

Item no. 4 of table 3.4 states that, with average responses Mean value of 3 and SD of 1.02, (33.33%+10%)=43.33% of the respondents agreed that credit culture /orientation/ is one of the factors that cause NPL. On the other hand, 16.67% of the respondents neither agree nor disagree on credit culture /orientation/ is factor that cause NPL. In contrary, (13.33%+26.67%)=40% of the respondents disagreed that credit culture /orientation/ is factor that cause NPL. This implies that, credit culture /orientation/needs to be given to customers in order to minimize NPL and to make customers get the knowledge about loan.

With regard to item no. 5 of table 3.4, with average responses Mean value of 3.13 and SD of 0.98, (20%+30%)=50% of the respondents agreed that poor monitoring /follow-up/ is one of the factor that cause NPL. In this view 10% of the respondents are neutral and (16.67%+23.33%)=40% of the respondents disagreed on the view which state that poor monitoring /follow-up/ is one of the factors that cause NPL. Form the majority of the respondents response, one can infer that poor monitoring /follow-up/ is one of the factors that cause NPL due to this, to minimize causes of NPL, the bank should follow-up its customers that they use the borrowed fund to the specified purpose and pay their debt as per the schedule.

On the other hand, table 3.4 of item no. 6 shows that, with average responses Mean value of 2.83 and SD of 1.08, (23.33%+23.33%)=46.66% of the respondents disagreed that poor risk assessment is one of the factor that cause NPL. In contrary, (20%+16.67%)=36.67% of the respondents agreed that poor risk assessment is one of the factors that cause NPL. In addition, 16.67% of the respondents are neutral. This implies that poor risk assessment is not the factor that cause NPL for UB and the bank has its own risk assessment techniques.

In general, from table 3.4's over all responses one can infer that the bank should give emphasis on interest rate, credit culture /orientation/ and poor monitoring /follow-up/ in order to minimize the factors that cause NPL.

Table 3.5: Problems Associated with NPL

№	Item	Respondents	Frequency	Percentage (%)
1	Please specify the major causes of non performing loans at borrower side	Lack of proper business plan	16	53.33
		Diversion of the borrowed fund to other purpose	20	66.67
		Insufficient credit awareness	10	33.33
		Unwilling customer to disclose the information required	3	10
		Willful default/ unwillingness to pay	-	-
		Total	**49***	**163.33**
2	Please specify your level of agreement or disagreement about mistake on estimation of collateral and evaluation of the borrowers' financial report are one of cause of non performing loan in united bank	Strongly agree	3	10
		Agree	10	33.33
		Disagree	9	30
		Strongly Disagree	6	20
		Neutral	2	6.67
		Total	**30**	**100**
3	Please specify your level of agreement or disagreement about excessive government intervention is the major causes of non performing loan at economic level	Strongly agree	8	26.67
		Agree	8	26.67
		Disagree	5	16.67
		Strongly Disagree	4	13.33
		Neutral	5	16.67
		Total	**30**	**100**
4	Please specify your level of agreement or disagreement about weak economic plan and strategy implementation is the major cause of non performing loan at economic level	Strongly agree	3	10
		Agree	14	46.67
		Disagree	5	16.67
		Strongly Disagree	4	13.33
		Neutral	4	13.33
		Total	**30**	**100**

NB: * Number of respondents became 49(163.33%) due to respondents chosen multiple choices at a time.

According to item no. 1 of table 3.5, 16(53.33%) of the respondents believe that lack of proper business plan is the major cause of NPL at borrower level. Moreover, 20(66.67%) of the respondents believe that diversion of the borrowed fund to other purpose is the major cause of NPL at borrower level. In addition, 10(33.33%) and 3(10%) of the respondents believe that insufficient credit awareness and unwilling customer to disclose the information required is the major cause of NPL at borrower level respectively. This implies that diversion of the borrowed fund to other purpose is the one which needs greater attention by the bank thus, the bank should follow-up and monitor customers in order to prevent the bank from higher NPL rate to make customers use the borrowed fund for the specified purpose.

Item no. 2 of table 3.5 on the other hand shows that, 13(43.33%) of the respondents agreed that mistake on estimation of collateral and evaluation of borrowers' financial reports are one of the causes of NPL in UB. In contrary, 15(50%) of the respondents disagreed that mistake on estimation of collateral and evaluation of borrowers' financial reports are one of the causes of NPL in UB. Moreover, 2(6.67%) of the respondents were neutral in this view. From the above analysis one can infer that mistake on estimation of collateral and evaluation of borrowers' financial reports are to some extent causes of NPL but there are not the causes of NPL in UB.

With regard to item no. 3 of table 3.5, 16(53.34%) of the respondents agreed that excessive government intervention is the major causes of NPL at economic level. In contrary, 9(30%) of the respondents disagreed in this issue. In addition, 5(16.67%) of the respondents were in-between in the same issue. This implies that there is a high level of government intervention in the economy and this has an impact on the bank's loan default.

Respondents indicated that there are several factors that contribute to loan default. As per the outcome of the interview the causes can be seen from two perspectives as follows:-

From the customer side:- diversion of borrowed fund to other purpose, lack of proper business plan, the nature of the business that the customer is engaged, unexpected economic condition, lack of credit knowledge, financial statements which are not reliable, and bankruptcy of the business can be the causes of NPL.

From the bank side: - Lack of proper credit follow-up, poor risk assessment, improper collateral estimation, and lack of detail data analysis specially the qualitative information can be considered as causes of NPL that emanate from the bank side.

Moreover, interviewees' indication on consequences of NPL for the bank and for the customers are presented as follows:-

For the Bank:-
- Poor Credit performance
- Liquidity problem
- High level of provision
- Decline in income & profitability
- Government strict interventions
- Reduction in loan provided to customers
- Create bad image of the bank in the society
- When percentage of NPL becomes more than the provision rate of NBE (more than 5%) the bank will be penalized

For the borrowers:-
- Leads the business to more depression financially;
- The borrower will become banned to entertain loan in to other banks.

- The customer will be forced to loose his/her collateral to be sold by the bank and leads the business man for failure.
- They will have bad historical records at NBE and this will make it harder for the customer to reestablishment of the business.

<u>For the Government</u>:-
- Cannot get tax and other benefits due to the NPL

From this one can infer that consequences of NPL from both the bank and borrowers need attention in order to prevent both parties from situations that cost them.

Meanwhile, item no. 4 of table 3.5 shows that, 17(56.67%) of the respondents agreed that weak economic plan and strategy implementation is the major cause of NPL at economic level. Moreover, 4(13.33%) of the respondents are neutral on the above mentioned issue. Nevertheless, 9(30%) of the respondents disagreed that weak economic plan and strategy implementation is the major cause of NPL at economic level. From the majority of the respondents reply one can infer that weak economic plan and strategy implementation cause NPL and the bank needs strong economic plan and strategy implementation to become competitive in the economy.

Table 3.6: Procedure that the Bank has used to Reduce the Amount of NPL

№	Item	Respondents	Frequency	Percentage (%)
1	Is there any credit follow up techniques and procedures designed and implemented by the bank to reduce the level of bank's NPL	Yes	25	83.33
		No	5	16.67
		Total	**30**	**100**
2	When the borrowers face a certain problem and unable to pay the loan, what procedural mechanisms does the bank apply in order to collect the loan at most efficiency	Extension of the life of the loan	8	26.67
		Injection of additional loans	10	33.33
		Rearrangement of loan repayment structure	3	10
		Combination of the above	30	100
		Total	**51**	**170**

NB: * Number of respondents became 51(170%) due to respondents chosen multiple choices at a time.

The above table 3.6 of item no. 1 shows that, 25(83.33%) of the respondents believe that there are credit follow-up techniques and procedures designed and implemented by the bank to reduce the level of NPL. In contrary, 5(16.67%) of the respondents think that the bank has no credit follow-up techniques and procedures designed and implemented by the bank to reduce the level of NPL. From the respondents response one can deduce that the bank has its own credit follow-up techniques and procedure in order to reduce the level of NPL. As a result, this will help the bank as a means of competitive edge in line with NPL.

As indicated in table 3.6 item no. 2, 8(26.67%) of the respondents the life of the loan is applied by the bank when borrowers face a certain problem and unable to pay the loan. In addition, 10(33.33%) of the respondents states that injection of additional source of capital is one of the procedural mechanism applied by

the bank when borrowers face a certain problem and unable to pay the loan. Furthermore, 3(10%) of the respondents state that rearrangement of loan repayment structure is one of the procedural mechanism applied by the bank when borrowers face a certain problem and unable to pay the loan. Besides, 30(100%) of the respondents stated that the combination of the above mentioned mechanisms are used by the bank in order to collect the loan at most efficiency. From this analysis one can infer that the bank used procedural mechanisms to prevent NPL and to support borrowers in order to repay their loan as per the schedule before applying any administrative actions (i.e. sell the collateral for the repayment of the loan).

Based on their experience and observation, majority of the respondents suggested that follow "Know your Customer" principle, establish a well mechanized advisory system for the customers, strict credit analysis techniques as additional effective mechanism for the bank to implement. The respondents also indicate measures that can be taken by the bank while borrower stops loan repayment as per the schedule. These may include:-

- Extension of the life of the loan
- Injection of additional loans
- Rearrangement of loan repayment structure
- Inform via Telephone to clear the arrears
- Issuing 1st, 2nd and 3rd reminder letters if it doesn't work follow other legal procedures
- Finally foreclosure /sale/the collateral in order to cover the borrowed money

Therefore, the credit follow up technique and the other rearrangements used by the bank should continue and consistently adhered in the future to prevent or avoid NPL.

The respondents also addressed open ended questions and indicate some strong and weak point about the credit management and practice of the bank as follows:-

Strong Point

- The bank formulated prudent lending policy
- Each credit organ has its own delegated power
- Look so deeply the loan application and choose the type of loans as per the market and background of the borrower
- Starts by approving lower amount of loan, then by assessing the progress of the borrower, will approve higher amount of loan
- Use as many as possible mechanisms to make the borrower pay the borrowed money before deciding to foreclose the collateral

Weak Point

- The bank heavily relying on collaterals
- Unwilling to finance project loans that have significant impact on national economy
- Improper estimation of collateral by the bank's engineers
- Unfair collateral estimation fee
- Lengthy procedures to approve loan to customers
- Focus on limited sectors while approving loans

In an endeavor to ascertain the survey response through interview, the interviewees were asked of their view on the credit follow-up methods used by the bank. They deduced that there are credit follow up methods that the bank use. Some of them are:-

- Field (Business) visit
- Follow up each step that the borrower invests its credit facility to the intended purpose.
- Communicating the client who have two consecutive outstanding repayments
- Making portfolio analysis of the loan

- Issuing Reminding letters to the borrower … etc

This implies that failure to strictly adhere with the monitoring and follow-up procedure may lead to the default in the loan which means higher risk of NPL.

On the other hand, the interviewees also indicate mechanisms used by the bank to minimize NPL and its consequences. Some of them are:-

- Detail review of financial statement
- Evaluate past performance of the applicant
- Site review
- Continuous follow-up
- Assess other source of the business to pay the amount of the repayment, when business fails.
- Extension of the expiry date of the loan
- Additional short term funding
- Rescheduling the loan repayment such as from monthly to quarterly
- Give advice to customers how to use the loan
- Proper risk analysis
- Knowing the customers very well
- Make detail analysis on the cash flow, sales (growth rate), liquidity, current and fixed assets, capital, profitability, liabilities, etc prior to credit facility approval.

Table 3.7: Impact of NPL on the Goal of the Bank

№	Item	Respondents	Frequency	Percentage (%)
1	Do you believe that non performing loans affect the bank efficiency?	Yes	23	76.67
		No	7	23.33
		Total	**30**	**100**
2	The impact of non performing loan on the liquidity of the bank is	Very high	13	43.33
		High	11	36.67
		Moderate	-	-
		Low	5	16.67
		Very low	1	3.33
		Total	**30**	**100**

Table 3.7 presents the impact of NPL on the overall goal of UB. As indicated in item no. 1 of table 7, 23(76.67%) of the respondents believe that NPL affect the bank's efficiency. Nevertheless, 7(23.33%) of the respondents did not believe that NPL affect the bank's efficiency. From the majority of the respondents' response, one can infer that NPL has a negative impact on the bank's efficiency and this will result dissatisfaction of customers, reduction the bank's liquidity through holding more money and this leads the bank to cash shortage. Furthermore, it increases the provision amount of the bank, retain its borrowing capacity and tied up the bank's capital.

Those who believe NPL affect the bank efficiency explain that it affects the efficiency as follows:-

- Since the lion share of the bank's profit is generated from loan it has considerable effect;

- The end result of NPL is collecting the loan disbursed through selling the collateral held in public market which in turn dim the image of the bank has in the societies mind;

- NPL increases the provision amount of the bank which can be given to customers and get interest instead;

- NPL reduces the bank's liquidity

- Reduce loan provided to customers

- The bank cannot compete with other banks

Item no. 2 of table 3.7 shows that, 23(80%) of the respondents believe that the impact of NPL in the bank's profitability is high. Nevertheless, 6(20%) of the respondents believe that the impact of NPL in the bank's profitability is low. From the majority of the respondents' response, one can infer that the bank's profitability is highly affected by NPLs.

Respondents also requested open-ended question in relation with the consequences of NPL on the bank's credit efficiency and overall performance and their responses are presented as follows:-

- It spoils the public image of the bank

- It tied up the bank's capital

- It will lead to unnecessary cost

- It reduce the credit efficiency through late payments and reduce profitability, liquidity and income of the bank

- It reduces the bank's credit efficiency

Table 3.8: Relation of the Borrowers in Doing Business with United Bank

№	Item	Respondents	Frequency	Percentage (%)
1	How many times have you got loan from UB?	One time	1	8.33
		Two times	8	66.67
		Above two times	3	25
		Total	**12**	**100**
2	Which type of loan facility are you in the bank?	Short Term Loan	3	25
		Medium Term Loan	3	25
		Long Term Loan	1	8.33
		Over draft	3	25
		Letter of Credit	2	16.67
		Total	**12**	**100**

To have a general view about the bank's clients, customers were asked to give information about their relationship with UB, the type of loan facility they are in the bank and for how long they have worked with the UB. Accordingly their responses were analyzed and interpreted as follows. Table 3.8 of item no. 1 shows that, 1(8.33%) of the customer respondents have got loan from UB one time. Moreover, 8(66.67%) and 3(25%) of the respondents got loan from UB two times and above two times respectively. The above information implies that the majority of the respondents got loan from UB two and above times. This infers that the borrowers have a significantly positive relationship with the bank and the bank is encouraging its customers by granting loans repetitively.

According to item no. 2 of table 3.8, the type of loan facilities the customers were engaged with UB are Short term loan, Medium Term Loan, Long Term Loan, Over draft and Letter of Credit were mentioned by 3(25%), 3(25%), 1(8.33%), 3(25%) and 2(16.67%) of the respondents respectively. From this analysis one can infer that the bank is encouraging clients who need in short term, medium term and over draft loan which requires less detailed analysis and short period of payback. This entails the bank's ability to reduce the level of non-performing loans.

Table 3.9: Some Question that Assess about the Loan

№	Item	Respondents	Frequency	Percentage (%)
1	During estimation do you think the bank give value for the collateral you presented fairly	Yes	3	25
		No	9	75
		Total	**12**	**100**
2	For what purpose you borrowed money from the bank	Working capital	11	91.67
		Project Expansion	1	8.33
		Other	-	-
		Total	**12**	**100**
3	Does the bank follow whether the borrower use the fund to their proposal appropriately or not?	Yes	6	50
		No	3	25
		I Don't Know	3	25
		Total	**12**	**100**
4	Do you repay the loan according to the schedule	Yes	11	91.67
		No	1	8.33
		Total	**12**	**100**
5	Do you believe that non performing loans have an affect on the bank's profitability	Yes	11	91.67
		No	1	8.33
		Total	**12**	**100**
6	Do you belive that if the borrower fails to pay the loan the bank should sell the collateral for the repaymet of the loan?	Yes	10	83.33
		No	2	16.67
		Total	**12**	**100**

For the purpose of this study paper customers of the bank were required to answer their loan status and practice with UB. Thus, the data collected from

respondents were analyzed and interpreted as follows. As indicated on table 3.9 item no. 1, some respondents 3(25%) believe that during estimation, the bank fairly gives value for the collateral they presented. Most of the respondents 9(75%) don't believe that during estimation, the bank fairly gives value for the collateral they presented. Mean while, as stated on table 3.5 item no. 2, 13(43.33%) of the employee respondents believe that mistake on collateral estimation is one of the cause of non-performing loan in UB. Therefore, from this analysis one can deduce that the bank's engineering department must work on this as collateral is the major component in order to assure the debt recovery method.

Item no. 2 of table 3.9 on the other hand states that, 11(91.67%) and 1(8.33%) of the customer respondents borrow money from the bank for the purpose of working capital and project expansion respectively. This implies that, majority of the respondent, as their loan is considered as NPL, borrowed money from the bank for working capital purpose. Thus, from this, one can infer that loan granted by the bank for its borrowers for the purpose of working capital is highly exposed to NPL.

Accordingly, table 3.9 item no. 3 shows that, 6(50%) of customer respondents said that the bank follow whether the borrowed fund is used for the specified purpose or not. Nevertheless, 3(25%) of the respondents said that the bank doesn't follow whether the borrower use the fund for the specified purpose or not. 3(25%) of the respondents doesn't know whether the bank follow-up or not. This implies that even if the bank has its own credit follow up techniques, it's not applied and this will encourage borrowers to use the fund to other purpose, which will cause the disability to pay the debt. So, the bank has to work on this issue so as to prevent the bank from having higher NPLs.

Customer respondents, on item no. 4 of table 3.9 stated that, 11(91.67%) of them replied that they repay their loan as per the schedule and 1(8.33%) of the

respondents doesn't repay the loan according to the schedule. As customer respondents status shows NPL, they believe that they are paying as per the schedule. This implies that majority of the customer respondents doesn't know their loan repayment schedule. Therefore, the bank needs to have a better attachment with its borrowers in order to make them aware in what situation they are in.

On the other hand, as indicated on item no. 5 of table 3.9, majority of respondents 11(91.67%) believe that NPL affects the bank's profitability. In contrary, 1(8.33%) of the respondents doesn't believe NPL affect the bank's profitability. This implies that, customers also identify that NPL has a negative effect on both the bank and the customer.

With regard to item no. 6 of table 3.9, 10(83.33%) of the customer respondents believe that if the borrower fails to pay the loan, the bank should disclose their securities through foreclosure procedures. Nevertheless, 2(16.67%) of the customer respondents believe that the bank should not sell their collateral if they fail to repay the loan, rather needs to use other mechanisms to make them get the capacity repay. From this analysis one can deduce that customers have the knowhow about failing to repay will cost them their collaterals to be disclosed and banks reduce the amount of their NPL through guarantying the recoverability by getting the proceeds of the asset sold in the foreclosure procedure. Furthermore, the bank has to use other mechanisms of repayment before foreclosing customers' property.

Table 3.10: Ratio of Outstanding Loan to Deposit

Deposit by Type	08/09	09/10	10/11	11/12
Demand	674,005,399	1,106,187,593	1,502,109,946	2,044,020,612
Saving	1,364,415,813	1,984,477,422	2,856,888,878	3,598,373,996
Time deposit	404,930,698	525,087,081	365,856,417	423,432,374
Total Deposit	**2,443,351,910**	**3,615,752,096**	**4,724,855,241**	**6,065,826,982**
OTL	1,859,662,020	2,152,975,918	2,613,609,548	3,276,958,639
Percentage	76.11%	59.54%	55.32%	54.02%

*Source: Annual Report 2009-2012 United Bank*

The above table 3.10 shows that total deposit in United Bank increased by about 1.2 million on average every year from 2008/09 up to 2011/12. OTL on the other hand showed a linear increment during the same period. This implies that the proportion of the loan and advance increases as the total deposit increased. More or less the proportion has showed an increasing trend from year to year.

Graph 1: A Line Graph Showing the Growth Rate of Outstanding Loan and Deposit in United Bank
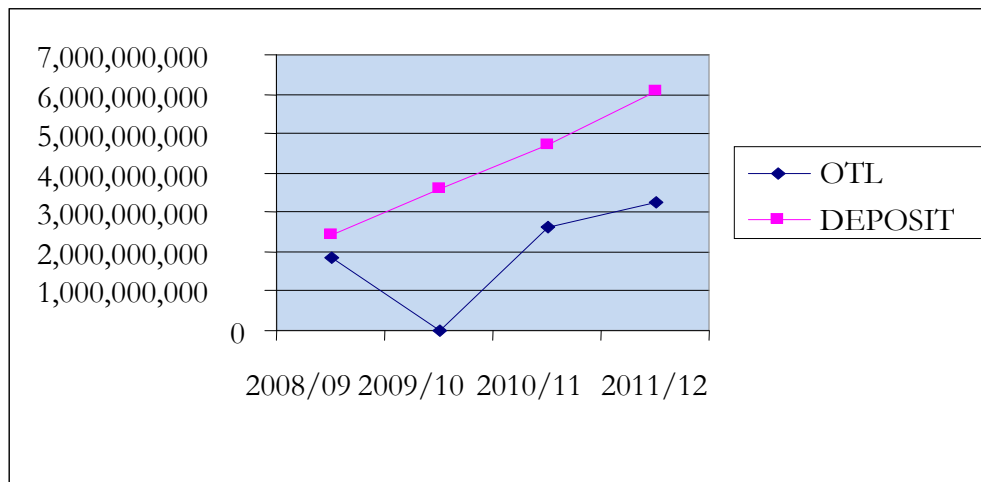
Source: Annual Report 2009-2012 United Bank

As graph 1 presents on what rate outstanding loans and total deposits have been growing from year to year. The outstanding loan went up from 1,860 million in year 2008/09 to 3,274 million in year 2011/12 depicting a growth of 76%. Similarly, the total deposit increased from 2,443 million in the year 2008/09 to 6,066 million in the year 2011/12 with a growth of 148%. According to the annual report of UBSC (2009-2012) total deposit has increased by over two fold between 2008/09 and 2011/12. The percentage (OTL Vs total deposit) decreased from 76.1% in 2008/09 to 54% in 2011/12. This implies that the growth of total deposit is not proportional to the OTL. This also indicates that the OTL for the bank is not linear implying that the bank needs to be consistent in the OTL level which have to be proportional to the bank's deposit.

Graph 2: Growth Rate of Outstanding Loan by Economic Sector
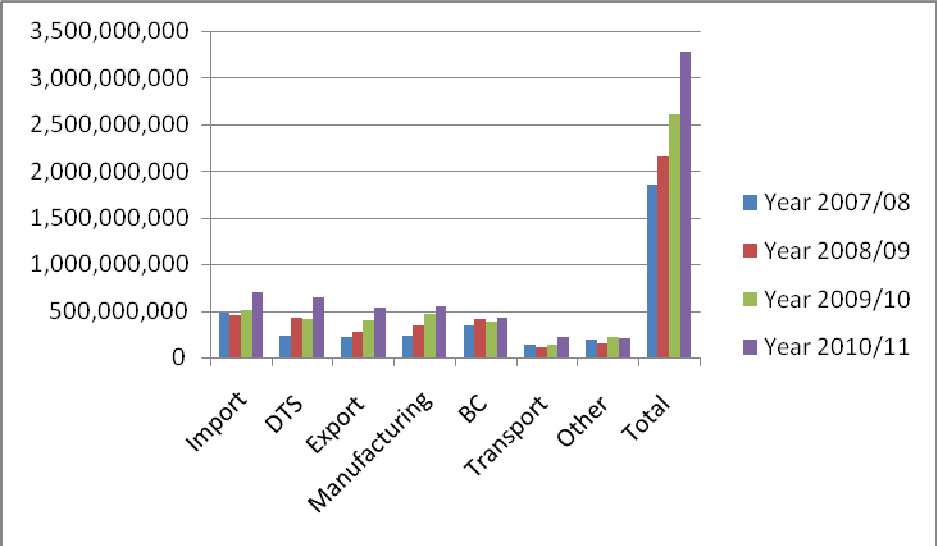
Source: *Annual Report 2009-2012 United Bank*

As presented above, the growth of loans are classified in to different categories depending on the economic sector for the period 2009-2012 based on OTL situation of the bank and disaggregated by economic sector for the period mentioned. Accordingly, the import sector takes the highest share followed by

DTS. Referring to the above graph, the Import sector remained to be consistently the most significant sector contributions to the bank's outstanding loan followed by DTS. These data imply the fact that the bank needs to give emphasis to borrowers working on the sector of BC, transport and other economic sectors in the loan processes. Moreover, as employee respondents states export sector has the lower rate of being exposed to NPL. From this one can deduce that, granting loans to export sector customers have a better advantage in order to reduce the banks risk of having growing NPL rate.

Table 3.11: Ratio of NPL to Outstanding Loan

Year	OTL	NPL	% PROPORTION
08/09	1,859,662,020	49,759,183	2.6:1
09/10	2,152,971,919	99,521,901	3.1:1
10/11	2,613,609,548	98,361,604	3.6:1
11/12	3,276,951,786	109,807,619	2.77:1

Source: Annual Report 2009-2012 United Bank

This research also tried to present the proportion of outstanding loans of UBSC and NPL in the period 2008/09 up to 2011/12. According to table 3.11, with in the mentioned times period, the proportion showed an increasing trend from 2.6% to 2.7%. This implies that as the outstanding loan increases more or less the level of NPL increases. Mean while, the loan and advance grants have grown considerably over the years under consideration. This increment indicates that bad loan processing and follow-up, weak customer oriented debt recovery mechanisms can make a favorable condition to higher the level of NPL position of the bank.

CHAPTER FOUR

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter is the last part of the study which deals with summary of major findings, conclusions and recommendations made by the student researcher.

4.1. Summary of the Major Findings

This study tried to address the four basic questions stated earlier in chapter one of this study. Accordingly, all the necessary information was collected from respondents by raising specific questions and the major findings are summarized as follows.

- 21(70%) of the respondents were male and the remaining 9(30%) were female.

- 5(16.67%) of the employee were diploma holders, 22(73.3%) and 3(10%) have 1st degree and above 1st degree respectively. Whereas 2(16.67%) of the borrowers have diploma, 6(50%) and 3(25%) of the borrowers have 1st degree and above 1st degree respectively.

- As per 13(43.33%), 15(50%) and 2(6.67%) of the employee respondents rated the overall credit practice of the bank as very good, good and fair respectively. With regard to loan processing time majority the respondents 19(63.34%) claim that it takes from two week to one month and 7(23.3%) of respondents claim that it will take above one month to process a given loan application.

- According to the majority of the respondents 17(56.67%), there are loans granted by the bank without taking collaterals depending on the type of loan for its employees and reliable customers. The conditions which banks grant loans without taking collaterals for such facility the borrower credit worthiness as well as clean base with bank has been key points.

- This research also tried to identify the problem associated with the NPL in UB. Thus, 20(66.67%) of employee respondents specified that diversion of borrowed fund to other purpose is the major cause of NPL at borrower side.

- According to the majority (50%) of employee respondents of UBSC, lack of continuous follow-up is the major cause of NPL in UB. In addition, 60% of the respondents agreed that high interest rate is also the major cause of NPL. On the other hand, for the majority of the respondents (53.34%) excess government intervention is the major cause of NPL at economic level.

- According to 13(43.33%) of employee respondents, mistake on estimation of collateral and evaluation of the borrowers' financial report are causes for loan being default. Furthermore, 9(75%) of customer respondents think that during estimation the bank doesn't give fair value for the collateral presented by the customer.

- Majority of employee respondents (56.67%) agrees that weak economic plan and strategy implementation is the major cause of NPL at economic level.

- One objective of this research was to identify the procedure that the bank has used to reduce the amount of NPL in the past. UB use different mechanism to collect loans. These are:- 8(26.67%) of the respondents said that rearrangement of loan repayment structure, 10(33.33%) extension of the life of the loan, 3(10%) injection of additional loan and 30(100%) said combination of the above mechanisms.

- Majority 23(76.67%) and 23(80%) of the employee respondents believe that NPL affects the bank's efficiency and have impact on its liquidity respectively. Moreover, 11(91.67%) of customer respondents believe NPL affect the bank's profitability.

- From the bank's customer respondents, 8(66.67%) and 3(25%) of them got two times and above two times respectively. In addition, those customers 3(25%), 3(25%), 1(8.33%), 3(25%) and 2(16.67%) have got loan facility of short term, medium term, long term, overdraft and letter of credit respectively.

- This research also tried to examine the effort that the credit department of the bank extends to assure the repayment of loans. Both respondents of UB staff and customers anonymously mentioned that if the borrower stops the loan repayment as scheduled the bank contacts the borrower with telephone and personally and then write three consecutive reminders for its customers and then after goes to foreclosure in stepped procedure.

- As per the annual progress of the bank, the total deposit of the bank increased by about 1.2 million on average every year from 2009 up to 2012; the OTL also showed a linear increment during the same period.

- According to the annual report of UB (2009-2012) total deposit has increased by over tow fold between 2008/09 and 2011/12.

- Within the above mentioned time period, the proportion of NPL to OTL showed an increasing trend from 2.6% to 2.77%, which implies that as the OTL increases more or less the level of NPL increases.

4.2. Conclusions

Based on the respondents answer and summary of major findings, the student researcher has drawn the following conclusions.

- The overall credit practice of the bank is in good position.

- The time which takes to process the requested loan almost takes one month.

- The bank grants some type of loans without taking of collaterals to its employees and customers depending on the type of facility and credit worthiness of the customer.

- The procedures followed by the bank to approve the loan is believed to be in a satisfactorily position.

- The bank assesses all the necessary information like financial information (i.e. credit worthiness, detailed financial analysis) before approving a given loan.

- From the types of loans granted by the bank, sectors that have higher tendency of being defaulted or being NPL are: manufacturing sector, building and construction sector, transport sector, domestic trade and service sector, export and import sector respectively.

- There are different factors to cause NPL among the major ones the following have their own impact to default the loan: high interest rate, credit culture/orientation/, poor monitoring /follow-up/, poor risk assessment, lenient credit terms, and rapid loan growth from the higher NPL factor to the lowest respectively.

- The major causes of NPL at the borrower level are highly the diversion of the borrowed fund to other purpose. In addition, poor business plan and insufficient credit awareness are some of the causes of NPL at borrower side.

- Depending on financial report and collateral evaluation in order to approve loan, government intervention and implementation of weak economic plan and strategy are also the cause of NPL in UB.

- United bank has its own credit follow-up techniques and procedures designed and implemented in order to reduce the level of NPL.

- When the borrower faced certain problem and unable to pay the loan, the procedural mechanisms the bank apply in order to collect the loan at most efficiency are combination of extension of the life of the loan, injection of additional loans, rearrangement of loan repayment structure of the loan are used to reduce NPLs.

- The impact of NPL highly affects the goal, efficiency and liquidity of the bank.

- Majority of the borrowers get loan from the bank two and above. This means there is a positive relationship between the borrowers with the bank.

- The bank's estimation of the collateral is not fair.

- Most of the borrowed fund is for the purpose of working capital.

- The bank follows the borrower proposal and accomplishment of the fund appropriately.

- NPL have an effect on the bank's profitability.

- When the borrower fails to pay the loan the bank sell the collateral for the repayment of the loan.

- The proportion of outstanding loans to the NPL is increased from the period 2008/09 to 2009/10 and decreased to 2010/11.

4.3. Recommendations

In light to the outcomes of the data analysis made and conclusion drawn, it would be sound and convincing to forward the specific recommendations in order to bring changes for the betterment and prosperity of the bank.

- The overall credit policy of the bank is in good position. But it must be practical in order to improve its efficiency to avoid dissatisfaction of customers.

- The time which takes to process the requested loan almost takes one month so, as much as possible it must decrease the time of loan processing.

- The bank grants some type of loans without taking of collaterals to its employees and customers depending on the type of facility and credit worthiness of the customer. But the bank should increase the type of facility granted to the customer to increase its competitive advantage and increase loan types.

- The procedures followed by the bank to approve the loan is believed to be in a satisfactorily position. But to some extent the customer are not satisfied so it must make some improvements towards the satisfaction of the customers.

- The bank should encourage sectors which are rarely exposed to NPL in order to improve the repayment habits or support and advice to take any important correction actions by the managers of the businesses.

- The bank should consider the factors such as: poor risk assessment, poor monitoring /follow-ups, lenient credit term and make any necessary adjustments to solve those kinds of causes.

- The bank should follow-up borrowers to minimize the major causes of NPL at the borrower level which is highly the diversion of the borrowed fund to other purpose is the main one. In addition, poor business plan and insufficient credit awareness are some of the causes of NPL at borrower side. So the bank must try to evaluate the customer reliability to what extent the disbursed loan is implemented to the intended purpose.

- Even if United Bank has its own credit follow-up techniques and procedures designed and implemented in order to reduce the level of NPL, its implementation and practice is not strong enough so the bank must give due attentions and care.

- When the borrower faced certain problem and unable to pay the loan, the procedural mechanisms the bank apply in order to collect the loan at most efficiency are combination of extension of the life of the loan, injection of additional loans, rearrangement of loan repayment structure of the loan are used to reduce NPLs. But this should also be practical in full not only be procedural to decrease the NPLs figure and to improve the image of the bank.

- The impact of NPL highly affects the goal, efficiency and profitability of the bank. Therefore, the bank should work on decreasing the figure of NPLs due to the fact that it affects the profitability of the bank.

- The bank's estimation of the collateral is not fair. So that the bank revise its estimation procedure depending on the current market situations in order to satisfy its customers and give collateral a fair value.

- When the borrower fails to pay the loan the bank sell the collateral for the repayment of the loan. However the selling of collaterals is an impact on the image of the bank. Therefore, before foreclosing collaterals the bank should give other opportunities to borrowers to repay their loans and this will protect the bank from having bad image in the public.

BIBLIOGRAPHY

Adriaan M. Blaem and Cornelis N. Gorter (2001), **The Treatment of Nonperforming loans in Macroeconomic statistics**, IMF Working Paper, WP/01/209, P:4-5

Adriaan M. Blaem & Russel Freeman (2005), **the treatment of Nonperforming loans, classification and elaboration of issue raised** by the Deemseel 2004 Meeting of the Advisory Expert Group of the Inter-secretariat Working Group on National Accounts 8, IMF BO PCOM-05/29

Frank H. Robert, Ben S. Bernanke (2001), **Principles of Economies**, McGraw Hill-Irwin.

Geng Xiaoc 2006, Nonperforming Debts in Chinese Enterprice: **Patterns, Causes, and Implications for Banking Reform**, Asian Economic Paper 4:3, ISSN 61-113

Gupta (1985), **Financial Intermidiation, Interest Rates and the Structure of Savings**: Evidence from "Asia", Journal of Economic Development, Vol.9. p:7-24

GTZ, **Risk Management**, 2000

Luis Cortavarria et al (2000), **Loan Review, Provisioning and Macroeconomic Linkage**, IMF WP/00/195, p: 11

Mohammed Shofiqul Isalm et al (2005). **Nonperforming loans-its causes, consequences and some learning, Munich personal RePEc Archive**, MPRX Paper No. 7708, Vol. 16, No. 15 ISSN 1:13

NBE (2008), **Ethiopian Banking Business Directives** P: 2

NBE (2012), **Ethiopian Banking Business Directives** P: 4-9

Nir Klein (2003), **Non-performing Loans in ESSE; Determinants and Macroeconomic Performances**, IMF Working Paper WP/13/72

Nobuo et al (2003). **Nonperforming loans and the real economy**, London School of Economics, BIS paper No. 22, ISSN 106-107

Peter S. Rose (1983), **Loans in a Troubled Economy**, The Canadian Banker Vol 90, No. 3 P. 55

Rajiv Ranjan and Sarat Chandra Dhal (2003). **Non-Performing Loans and Terms of Credit of Public Sector Banks in India**: An Empirical Assessmen, Reserve Bank of India Occasional papers, Vol.24 No. 3 pp.103

Samuelson, Paul A. and William, D. Nordhaus (2001) **Economies**, MCGraw Hill-Irwin, Seventeenth Edition.

St. Mary's University (2009-2011). **Graduated Students Senior Research paper**. Addis Ababa.

United Bank S.C., **Annual Progress Report** (2008/09), P:8-9

United Bank S.C., **Annual Progress Report** (2009/10), P:6-8

United Bank S.C., **Annual Progress Report** (2010/11), P:5-6

United Bank S.C., **Annual Progress Report** (2011/12), P:6

United Bank S.C., **Annual Progress Report** (2012/13), P:4-9

United Bank S.C., **Credit Procedure**, 2010:1-17

UBSC, **Weekly Branches Deposit Report** (Dec. 2, 2013 – Dec. 7, 2013)

St. Mary's University

Faculty of Business

Department of Management

Questionnaires to be filled by Staff of United Bank

This questionnaire is developed by graduate student of St. Mary's University for research paper to be done for partial fulfillment of the academic requirements of B.A degree in Management in order to assess "Causes and Consequences of Non-Performing Loans", a case study on United Bank Share Company.

Since none of your response is forwarded to any 3rd party and is kept confidential, please answer each question with no fear of repercussion. Moreover, the success or failure of this case study entirely depends on your responses; hence please respond each question as appropriately as possible.

General Instruction:

- ➢ No need of writing your name.
- ➢ Put the mark "√" in the box you want to choose.

Thank you in advance for your utmost cooperation!

PART I: General Characteristic of the Respondent

1. What is your Position in the United Bank?

   ☐ Credit Manager   ☐ Branch Manager   ☐ Assistant B/Manager

   ☐ Loan Clerk   ☐ Credit Analyst   ☐ Loan Officer

   If other, please specify _____

2. Sex

   ☐ Male   ☐ Female

3. Educational Background

   ☐ Certificate   ☐ 1st Degree

   ☐ Diploma   ☐ Above 1st degree

4. How many years have you work in United Bank S.C?

   ☐ Less than One Year   ☐ 7 – 9 Years

   ☐ 1 - 3 Years   ☐ Above 9 Years

   ☐ 4 - 6 Years

PART II: Questions Directly Related with the Research

5. How do you rate the overall credit policy of the bank?

   ☐ Very good   ☐ Poor

   ☐ Good   ☐ Very Poor

   ☐ Fair

6. How long will it take to process a given loan application?

   ☐ One week   ☐ One month

   ☐ Two weeks   ☐ Above one month

   ☐ Three weeks

7. Does the bank grant loan without taking collaterals?

   ☐ Yes   ☐ No

8. If your answer to Q. 7 is yes, would you please explain it?

   _____

   _____

9. Do you believe the procedure followed by the bank for loan approval is satisfactory?

□ Yes   □ No

10. If your answer to Q. 9 is No, what are the possible reasons?

_____

_____

11. Does the bank assess its borrowers past historical financial information (i.e. credit worthiness, detailed financial analysis) before extending any loans to customers?

□ Yes definitely   □ Not at all
□ Yes to some extent   □ I am not quite aware of it

12. If your answer to Q. No 11 is yes, how frequently does the bank assess the borrowers past historical financial information and their credit worthiness.

_____

_____

13. What mechanisms does the bank use to assess borrowers past historical financial information?

_____

_____

14. Which sectors of loans and advances granted to customer have the tendency of default loan and advance? Please rate in their priority.

No.	Sectors that have the tendency to default loan	Rate 5=Very High 4=High 3=Moderate 2=Low 1=Very Low
1	Transportation Sector	
2	Manufacturing Sector	☐
3	Export Sector	☐
4	Domestic Trade & Services Sector	☐
5	Building and Construction Sector	☐
6	Import Sector	☐
	If Others, please specify it	☐

15. From the listed under, Please specify the major causes of non performing loans at borrower side.

☐ Lack of proper business plan

☐ Diversion of the borrowed fund to other purpose

☐ Insufficient credit awareness

☐ Unwilling customer to disclose the information required

☐ Willful default/unwillingness to pay

If other, please specify it _____

16. Please rate your level of agreement and disagreement on the causes of nonperforming loans in United Bank.

No.	Causes of NPL	Strongly Disagree (1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly Agree (5)
1	Rapid Loan growth by banks					
2	High interest rate					
3	Lenient credit terms					
4	Credit culture /Orientation/					
5	Poor Monitoring/Follow-up					
6	Poor Risk Assessment					

17. Please specify your level of agreement or disagreement about mistake on estimation of collateral and evaluation of the borrowers' financial report is one of cause of non performing loan in United bank.

☐ Strongly agree ☐ Disagree ☐ Strongly Disagree

☐ Agree ☐ Neutral

18. Please specify your level of agreement or disagreement about excessive government intervention is the major causes of non-performing loan at economic level.

☐ Strongly agree ☐ Disagree ☐ Strongly Disagree

☐ Agree ☐ Neutral

19. Please specify your level of agreement or disagreement about weak economic plan and strategy implementation is the major causes of non-performing loan at economic level.

☐ Strongly agree ☐ Disagree ☐ Strongly Disagree

☐ Agree ☐ Neutral

20. Do you believe that the level of non-performing loans have a highest impact on the overall bank's efficiency?

☐ Yes ☐ No

21. If your answer to Q. No 21 is yes, in what form does such non-performing loans affect bank's efficiency.

_____

_____

22. What are the effects of non-performing loans in terms of the bank liquidity?

_____

_____

23. The impact of non-performing loan on the bank's liquidity is _____

☐ Very high ☐ Moderate ☐ Low

☐ High ☐ Very low

24. What are the consequences of non-performing loans on the bank's credit efficiency and overall performance?

_____

_____

25. Is there any credit follow up techniques and procedures designed and implemented by the bank to reduce the level of bank's NPL?

☐ Yes ☐ No

▪ If yes, can you please explain about it?

_____

_____

26. When the borrowers face a certain problem and unable to pay the loan, what procedural mechanisms does the bank apply in order to collect the loan at most efficiency?

☐ Extension of the life of the loan

☐ Injection of additional loans

☐ Rearrangement of loan repayment structure

☐ Combination of the above

If other, please specify it _____

27. What other procedural mechanism do you advice or suggest for the bank to implement in order to reduce the level of NPL rate at a minimum level than before?

_____

_____

28. What measures are taken by the bank if the borrower stops the loan repayment as per the schedule?

_____

_____

29. If you have any strong or weak point about the credit management & practice of bank, please specify.

_____

_____

_____

_____

_____

_____

Interview Guideline

These interview questions are developed by a graduate student of St. Mary's University for research paper to be done for partial fulfillment of the academic requirements of B.A degree in Management in order to assess "Causes and Consequences of Non-Performing Loans", a case study on United Bank Share Company.

1) In what sectors does UB S.C entertain credit facility?

2) What are the requirements of borrower to get the loan?

3) How do you consider the Collateral, Condition, Capital, Character and Capacity when you analyze the loan request?

4) What techniques do the bank's use to estimate collateral estimation fairly?

5) What are the causes of non-performing loan?

6) What are the consequences of non-performing loan?

7) What credit follow-up methods does the bank use?

8) What mechanisms does the bank use to minimize NPL and its consequences?

i –^r MY¦N ¤}ßY\épí

Iœ}^ ×hⱯpí

M}ᴮL¿r r/ŒÙG

Iª¿I...v £MⱥOF

¨C L°¨i Ii –^r MY¦N ¤}ßY\épí pMV £pš¶¯ }' ⱥ: –FM' ⱥN EL¯LV¦ Ɑ· V £LLTf¦ ÎAⱥU MMℚ}r \ⱨD¿ የጥናቱም ዓላማ በሕብረት ባንክ ኢ.ማ. የሚገኙ ጤናማ ያልሆኑ ብድሮችን መንስኤዎችና በባንኩ ላይ የሚያሳድሩትን የወደፊት ተጽእኖ ማጥናትና የመፍትሔ ሃሳቦች መጠቆም ነው:: L°¨e¿ ILLⱥr Eᶆªᵀ· G„ rnnY~ ^Y«q Ii –Mⱨ ˆ¦L\µ¿Šⱥ L°¨e¿ I¼O~ IM¿In H]o¿ ˆ¿«ⱥ\°ⱥ„ ^°¨i £MⱯ°ⱥt' ⱥ L G_v E¼~pý' ᴾîr LPTr L D~t' ⱥ̠ IL·EÎ }' ⱥ:

- ^N LÑÙ †¦^ÔG· N
- Eˆ¦¿«¿«ⱦ ¼¦h Ip\°ⱥr]¼ v' ⱥ' ⱥ^¼ √ NGŒr ¦^dN°ⱥ

ŒÙG †¿–: £L Fcv †°gF¨ Aⱥ̠q

1. ˜–Mⱦ
   - [ ] Š30 –L r Iqv
   - [ ] 31-40
   - [ ] 41-50
   - [ ] Š51–L r IF¨

2. £rNCYr ªT±
   - [ ] 12ƒ ŒÙG
   - [ ] «ⱦ V
   - [ ] «ⱦÝEⱥ̠M
   - [ ] Š«ⱦ V IF¨

   EîF ‹E IⱥⱥEÎ _____

3. £p\MUIr £RW L^Œ
   - [ ] £AµY ' ⱥ^¼ ¿· –
   - [ ] £' ⱥÀ ¿· –

   EîF ‹E IⱥⱥEÎ _____

ŒÙG AÆr: Š¼~pɼ¶Y d¼pƒ · ¿₸}r ¦Ft' å ¼¦h• v

4. I J n Tr m¿Œ £n−Y †µG· Eør p°gMë }• r?

☐ †•¿   ☐ †¨ªEAåN

5. E4ƒ ¼¦h L Gስ𝒫r †•¿ ŠD} EN¿ ¦CG µếŝ ተጠቃሚ ሆነዋል?

☐ †¿− µếŝ   ☐ AÆr µếŝ   ☐ ŠAÆr µếŝ IF¨

6. £n−Y †µG· Eør p°gMë ŠD}å ££rƒ' å −¨}r £n−Y −¨}r p°gMë ነ𝒫r?

I †ÃY µếŝ £MⱮL E^ n−Y   ☐ I' À ¿ − \}®v ″^r~ £Mⱥ¼ n−Y

☐ በ𝑚ካከለኛ ጊዜ   ☐ £‰ßY−WÙr n−Y

☐ በረጅም ጊዜ   EîF ŠD} ¨· Eǐ ＿＿＿＿＿＿＿

7. n−Y \ɗªU I″^r~}r £Më̦ ስይዙት ¿nTr IrŒŒG ¨µL qG nE' å ¦L ~E፧

†N~EAå   †FN¿N

☐   ☐

8. ለ7ኛ ጥያቄ መልስዎት አላምንም ከሆነ ንብረቱ በትክክል እንዲገመት በባንኩ በኩል ምን መደረግ አለበት ብለው ያስባሉ?

＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿

＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿

＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿＿

9. £plªUr¿ n−Y EN¿ −FM p°dLål r?

☐ ERW M^Ŝî±   ☐ ÝZ⁻Œr M^×Ö¦

EîF ŠD} IɋEǐ ＿＿＿＿＿＿＿＿＿

10. £' \«èr¿ n−Y E' \«èr †FM M″Eør¿ m¿Šå ŒrrG ¦ªY¶G?

☐ ¦ªY¶G   ☐ †¦ªY· N   ☐ አላውቅም

11. I p\ጠ𝒫r ÝZ· WN L PTr n−U¿ ¨ŠÙFE፧

☐ እከፍላለሁ   ☐ አልከፍልም

12. E¼¦h e¼Y 11 L G_r †ልከፍልም ŠD} NŒ¿¦ትዎን ¨·Eì

_____

_____

_____

13. £pIF` n−Y Im¿Šå rY×M}r F¨ v· Y £Më¦^ŠrG ይL ^EøqG?

☐ ይመስለኛል   ☐ †¨መስለኝም

14. E¼¦h e¼Y 12 L G_r ይመስለኛል ŠD} ^¿¬r ችግር እንደሚያስከትል lɥGì

_____

_____

_____

15. pI«V n−U¿ L ŒÙG \é¦i p' å I"^r~ £p¦Š' å ¿nTr pb½ n−U L L E^ †EIr nE' å ¦N~E?

☐ †N~EAå   ☐ †FN¿N

16. በሕብረት ባንክ የብድር አከፋፈል ስርአት ላይ ተጨማሪ አስተያየት ወይም ቢስተካከል የሚሉት ካለ ቢገልጹ

_____

_____

_____

Declaration

I, the undersigned, declare that this student research paper is my original work, prepared under the guidance of Ato Zelalem Tadesse. All sources of materials used to this paper have been duly acknowledged.

Name: **Bethlehem Tadesse**

Signature: _____

Place of Submission: **St. Mary's University**

Date of Submission: **June 28, 2014**

This paper has been submitted for examination with my approval as University advisor.

Name: **Zelalem Tadesse**

Signature: _____

Date: **June 28, 2014**