ST. MARY'S UNIVERSITY COLLEGE
FACULTY OF BUSINESS
DEPARTMENT OF MANAGEMENT

FACTORS THAT AFFECT THE SIZE OFNON-PERFORMING LOANS ON THE CASE OF DASHEN BANK SHARE COMPANY

BY
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SMUC
Addis Ababa

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SHARE COMPANY

A SENIOR ESSAY SUBMITTED TO THE DEPARTMENT OF
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ACRONYMS

1. NBE	**National bank of Ethiopia**
2. NPL	**Non-performing loan**
4. FY	**Fiscal Year**
5. S.C	**Share Company**

ABSTRACT

As it is known, lending is the principal function of banks through extending of loans out of the deposit they collected from depositors. In the course of their operation however, banks may face the risk of getting loss because of uncollectible loans. Due to this, the loan portfolio will be dominated by non-performing loan (NPLs).Therefore, the main purpose of this study is to identify factors that contribute to increase the size of non-performing loans in banks.

The study used both primary and secondary data collection methods to answer its research questions. Among primary ones, 51 self-administered questionnaires were distributed to the staffs who are engaged in loan processing and approving at head office and branch level of Dashen bank. The response rate of the questionnaire is 94 %(48). In order to make the study complete, 60 questionnaires were also distributed to borrowers of the bank at different branches. The response rate is 42 %(25), due to the customers not coming regularly. In addition, some selected loan officers and branch managers were interviewed to justify the answers given in the questionnaire. Secondary data also gathered from publications of the bank, loan procedure manuals, journals, websites and books. Then, the data collected from questionnaire was analyzed using descriptive statistical method such as percentages in order to make the paper simple to understand. In addition, tables were used to present the results of the study.

The result of the study indicates that diversion of the borrowed fund to other purpose, lack of adequate knowledge and experience on how to use the granted loan by the borrower, un-planned and ambitious business expansion, unwillingness and carelessness of borrowers to pay their debt and providing falsified financial statements to the bank are considered by the staff members of the bank as significant factors to make borrowers in default and increase the balance NPLs in the bank. In addition to these factors, borrowers reveal that lack of adequate market to sell their goods and services, economic and political environment of the country are the major causes of the problem. On the other hand, not taking timely action by the bank when borrowers start to default, competition among banks to attract borrowers and lack of strict follow-up and loan workout procedure, are regarded as significant factors that contribute to increase the size of NPLs from the bank side.

To conclude, the study identifies various factors that contribute to increase the size of NPLs in the bank, and hence most of the reasons emanate from the borrowers' side. By strengthen the existing loan processing procedures together with creating credit awareness to borrowers; the bank can reduce the chance of loan loss to the large extent. Therefore, in order to improve its credit processing quality, the bank should have competent and trained staffs by providing adequate and up to date training as a continuous basis.

CHAPTER ONE
INTRODUCTION

1.1 Background of the study

Banks are financial institutions licensed by a government and play a very important role in the economic development of every nation. They are mainly engaged in mobilizing idle funds from the public in the form of saving and demand deposit and deploy the fund back to the public in the form of loans and there by earn income in the form of interest and charges. They have control over a large part of the supply of money and circulation.

Non-Performing Loan (NPL) is a loan that is default or close to being in default. Many loans become Non-performing after being in default for 3 months, but this can depend on the contract terms." A loan is non - performing when payments of interest and principal are past due by 90 days or more, or at least 90 days of interest payments have been capitalized, refinanced or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons to doubt payments will be made in full*"(www.wikipedia.com).*

Dashen Bank is one of the oldest private banks in Ethiopia specifically designed to further the capital formation process through the attraction of deposits and extension of credit. However, there are several challenges that the bank have been facing in its day to day activities. One of the main challenges facing Dashen Bank is the problem of Non- performing Loan NPL. Even though, the bank can collect more than 95% of its outstanding loans each year, currently it has categorized about 90 million birr as non-performing loan (Dashen Bank Audit Financial Result from year 2004-2008).

The accumulation of non-performing loans creates a problem by making provisions for them out of the profit earned by the bank. At the extreme case, when the value of NPLs becomes greater than the capital of the bank, the bank will face a series liquidity problem that could be turned out to solvency problem. Therefore, it is essential for banks to identify the various factors that can increase the size of non-performing loans and take corrective measures to drop the balance.

1.2. Background of the organization

The new economic policy introduced in November, 1991 G.C caused the culmination of the command economic heralding the establishment of a market oriented one. This policy change created an opportunity and a conducive environment for the emergence of private financial institutions aimed at the bringing a meaningful economic role in the development efforts of the country (*www.dashenbanksc.com*).

Dashen Bank was established as per the intent of the new policy and the Ethiopian investment code. It came into existence on September 20, 1995 G.C according to the commercial code of Ethiopia, 1960, and the licensing and supervision of banking business proclamation No. 84/1994 (*www.dashenbanksc.com*).

The first founding members were 11 businessmen and professional that agreed to combine their financial resources and expertise to form this new private bank.

"Ras Dashen" is the highest mountain of Ethiopia. It is also the habitat of rare wild animals such as the" Wali Ibex" and Gelada Baboon. These unique characteristics of the mountain coincided with the interest of the founders of the Bank and prompted them to adopt this great name and epitomize their aspiration. Rightly, reaching the top of banking business in dynamic and competitive business environment symbolized the highest peak, while the unique and efficient services the bank caters for the public through state -of-the-art computer technology and carefully selected and trained man-power equated with the rare wild animals. Today, indeed, reliability, efficiency and modernity are the hallmark and the bank's distinguishing features which make them synonymous with Dashen Bank as much as the rare animals are synonymous with Ras-Dashen Mountain (*www.dashenbanksc.com).*

Vision of Dashen Bank

“In as much as mount Dashen excels all other mountains in Ethiopia, Dashen bank continues to prove unparalleled in banking service.”

Mission of Dashen bank

“Provide efficient and customer focused domestic and international banking services/overcoming the continuous challenges for excellence through the application of appropriate technology.”

1.3. Statement of the problem

In order to be competitive and profitable in the banking industry, for any bank, the balance of NPL should be kept at minimum level as much as possible.

The Dashen Bank’s audit financial result from year 2004-2008 demonstrates that the percentage proportion of Non-performing Loans NPL with that of outstanding loans has been decreasing. This shows that among the total outstanding loans granted, the bank has collected more than 95% of them each year. However, the bank on average could not collect about 3.28% of its outstanding loans each year during the last five years period. Therefore, identifying the root causes for the uncollected money is very crucial in order to increase the profitability of the bank.

There may be so many reasons for customers not to pay their debt timely as they promised. The reasons may be from borrowers' side or creditors' side or from both of parties. Therefore, this study identified and analyzed various causes for the amount of NPL in Dashen Bank and provides constructive suggestions to minimize the balance.

Table 1.1: Outstanding Loan Vs NPL

Year	Outstanding Loan	Total NPL	Percentage proportion
2004	1,627,369,234	95,908,208	5.89 %
2005	2,160,632,436	99,853,270	4.62 %
2006	3,080,263,248	105,582,459	3.42 %
2007	3, 889, 003, 61	102,839,781	2.64 %
2008	4,291,704,476	89,715,336	2.09 %

Source *:(Dashen Bank Audit Financial Result from year 2004-2008)*

1.4. Basic Research questions

The current study is intended to answer the following research questions

- ✓ What are the types of credit facilities offered by Dashen bank?
- ✓ How the bank follows up its borrowers after granting the loans?
- ✓ To what extent the bank's loan processing steps contribute towards the customers' failure to pay?
- ✓ What are the major causes of non-performing loans (NPLs) from borrowers' (customers) side?
- ✓ What are the major causes of non-performing loans from creditors' (bank) side?

1.5. Objectives of the study

General objective

The primary objective of the study is to identify various factors that determine the size of non-performing loans in the bank.

Specific objectives

Specifically, the current study has the following detailed objectives:

- ✓ To describe how Dashen bank S.C offers the different types of credit facilities for its customers.
- ✓ To evaluate the loan granting procedures of the bank.
- ✓ To assess the bank's follow-up effort regarding loan settlement.

1.6. Significance of the study

This study identified several causes for the existence non-performing loans in banks. Therefore, the study will inform the bank's credit department on how to minimize the balance of non-performing loans in the loan portfolio. It will also contribute some knowledge to the existing loan management practices of the bank. Moreover, this study will serve as an input to further study in the area of bank's credit management.

1.7. Scope of the study

The study focused on identifying different factors that contribute towards the borrowers to default. To this effect, the study will only request staffs who work in loan processing activity and some branch managers who are engaged in approving loans. In addition, the study will be conducted on few branches of the bank that are found in Addis Ababa and at the head office credit department. These branches have been selected based on their rank in loan amount. The branches are Dashen Main, Messalemia , Golla, Tana, Tikur Anbesa , and Kera which are ranked them on up to seven. Furthermore, the study will be conducted based on the NPL data provided by the bank that covered 2004-2008.

1.8. Limitation of the study

Wholly conducting study, the student researcher has faced same problems regarding to obtain the right information. to this effect, the absence and unwillingness of borrowers to fill the questioner, the response of staff numbers of the bank and borrowers as 'neutral for most of the questions are sum of them

1.9. Research Design and Methodology

1.9.1. Research design

The researcher will use descriptive approach, because even though the study will be conducted on the case of Dashen bank it will not analyze each factor in detailed manner.

1.9.2. Population and Sampling Techniques

There are 25 branches of Dashen bank S.C in Addis Ababa. In each branch, there are on average six employees who work in the loan sections as loan officers, loan clerks, loan section heads, and credit follow-up personnel and one branch manager. From the total 25 branches, 6 branches will be selected based on the rank in loan amount, which is 25%. At head office level, there are about 15 employees who are engaged in handling, processing and approving the loan requests of customers, all of them will be candidates for this study.

The study will used purposive /Judgmental sampling technique which is one type of non probability sampling method. This method allows the researcher to select targeted employees that can provide relevant information to answer the research questions. Therefore, the total target population of the study is estimated to be fifty one employees. To this end, from six branches, 36 employees and form head office, 15 employees will be candidates for this study. Thus, staffs who are currently working in loan processing activities will be good candidates for the study.

In order to make the study complete and meaningful, the student researcher will also gather opinions of borrowers regarding the causes of their delay to pay their debt on the agreed time. In the selected six branches, there were about 612 customers on overage. Since it is very difficult to get customers in the bank's premises and collect their opinion as they come once in a month to pay their debt or for some other reason, questionnaires will be distributed to only 10% of them randomly to borrowers, i.e., 60.

1.9.3. Types of Data collected

The study will use both primary and secondary data collection methods to meet its objectives. The primary data includes questionnaire and interview. The secondary data includes annual reports of the bank, Loan procedure manuals, magazines, book etc.

1.9.4. Methods of data collection

Among primary ones, the study will mainly use apply self administered questionnaire using five point likert- scales. The questionnaires will be distributed to the fifty one employees and sixty borrowers to be completed individually on the questionnaire, respondents will be asked to express their opinion regarding the level of significance each factor contribute to increase the size of NPLs in the bank as very relevant, relevant, average, irrelevant and very irrelevant. In addition, some selected staffs will also be interviewed un structurally to fill the gap of answers provided in the questionnaire.

Secondary data also gathered from publications of the bank and other financial institutions, the bank's loan management manuals, journals, magazines, websites and books.

1.9.5. Methods of data analysis

The data collected from questionnaire will be analyzed using descriptive method such as percentages in order to make the paper simpler to understand. In addition, tables were used to present the results of the study.

1.10. Organization of the study

The study will have four chapters. The first chapter will state background information, problem statement, objectives of the study and method of data collection and analysis. The second chapter will reveal sufficient literatures that are relevant to the study. The third chapter will show the analysis of data collected and findings of the study. Finally, the last chapter will conclude the paper by summarizing the major findings of the study and forwarding constructive recommendations.

CHAPTER TWO

LITRATURE REVIEW

2.1 Concepts of Non-Performing Loan (NPL)

The lending function is considered by the banking industry as the most important function for the utilization of funds. Since, banks earn their highest gross profits from loans; the administration of loan portfolios seriously affects the profitability of banks. Indeed, the large number of non-performing loans is the main cause of bank failure.

According to Wikipedia definitions, a non-performing loan is a loan that is in default or close to being in default. Many loans become non-performing after being in default for 3 months, but this can depend on the contract terms. "A loan is nonperforming when payments of interest and principal are past due by 90 days or more, or at least 90 days of interest payments have been capitalized, refinanced or delayed"

As per the National Bank of Ethiopia (NBE) directive no. SBB/32/2002, a loan is identified and segregated as non-performing loan depending up on the number of days the repayment is delayed or if discontinued at least for ninety days. Accordingly, a loan is categorized as NPLs if its repayment is delayed or discontinued for at least ninety days.

A loan whose repayment is not discontinued /delayed is included either in pass or special mention category. Loans and advances under pass category are those being repaid regularly as per the agreement made between the borrowers and the bank. In addition, loans and advances secured against cash or cash substitutes are also classified under this category regardless of the past due status. Special mention category includes any loans and advances that past due 30 days or more but less than 90 days (NBE directive no. SBB/32/2002).

2.2 Classification of non-performing loans (NPLs)

According to the NBE directive mentioned above, non-performing loans (NPLs) are classified under three categories: as substandard, doubtful and loan loss. The substandard category includes any loans and advances that past due 90 days or more but less than 180 days with a 20% minimum provision to be maintained against the outstanding principal amount. Other than this criteria, sufficiency of cash flow to meet current maturing debts, adequacy of financial information and collateral documentation are also considered to categorize the loan

The doubtful category consists of any loans and advances that past due 180 days or more but less than 360 days with a 50% minimum provision to be maintained. In addition, this group includes loans that have insufficiency of cash flow to meet short- term liabilities, insufficiency of capital, unbalanced security defect and deterioration of the financial position of the borrower.

The third category of non-performing loan is loan loss. This category comprises any loans and advances whose repayment is delayed or discontinued for more than 360 days and overdue loans. A 100% provision is to be maintained against the outstanding principal amount under this category.

In trucking out loan losses, the presence or absence of one or more of the following conditions needs to be considered. The first condition might be if the borrower is bankrupted and has no other resource to cover the debt. The second condition could be if the security offered for the loan has no value or very small to settle the debt. The last situation may be if the proceed from disposing collateral is insufficient to cover the debt and the balance of the loan is thought to be not covered by other means (NBE directive no. SBB/29/2002).

2.3 Credit Risk

Credit risk is a risk where the borrower may not be able or willing to repay the debt owed to the bank, or to honor other contractual commitments. Credit risk factors include various factors which may affect the ability of borrowers to repay loans in full as well as factors which affect the bank's ability to resolve non-performing loans. As a result of these factors, actual losses incurred toward the end of the problem debt recovery process may also affect the bank's capital adequacy. The significant credit risk factors are the size of Non-performing loans, economic growth of the country, problems of political uncertainty and violence sensitivity of export businesses where there is intensifying competition in international markets as well as exchange rate volatility. All these factors may affect businesses and the debt repayment capacity of the Bank's customers (Bangkok Bank annual report, 2006)

For most banks, loans are the largest and most obvious source of credit risk.
However, there are other pockets of credit risk both on and off the balance sheet, such as the investment portfolio, overdrafts, and letters of credit. Many products, activities and services such as derivatives, foreign exchange, and cash management services also expose a bank to credit risk (Comptroller's Handbook, 1998)

The risk of repayment, i.e., the possibility that an obligor will fail to perform as agreed, is either lessened or increased by a bank's credit risk management practices. A bank's first defense against excessive credit risk is the initial credit-granting process-sound underwriting standards, an efficient, balanced approval process, and a competent lending staff. Because a bank cannot easily overcome borrowers with questionable capacity or character, these factors exert a strong influence on credit quality. Borrowers whose financial performance is poor or marginal, or whose repayment ability is dependent upon unproven projections can quickly become impaired by personal or external economic stress. Management of credit risk, however, must continue after a loan has been made, for sound initial credit decisions can be undermined by improper loan structuring or inadequate monitoring (Comptroller's Handbook, 1998).

2.4 Causes of bad loans

If a bank fails to collect its outstanding loans because of bad loans, it may encounter liquidity problem and loans might be written off as un-collectibles. This will reduce the reserve, profit and capital of the bank. This is also may erode public confidence & lead the bank to be closed due to excess abnormal withdrawals of money by customers (Koch and W.Timothy, 1995, p137).

Whenever a loan is not paid accordingly to the terms of the initial agreement or in an otherwise acceptable manner, it is classified as bad loan. Loan losses are natural by products of extending credit. Loans become problem credit as a result of controllable & uncontrollable factors. Controllable factors are those that reflect through the overall bank credit policy as well as inadequate credit analysis, loan structuring, and loan documentation. Uncontrollable factors typically reflect adverse economic conditions; adverse changes in regulations globalize changes surrounding the borrower's operations & catastrophic events (Koch and W.Timothy, 1995, p137).

While there is little that can be done to prevent uncontrollable problems, effective credit granting can significantly reduce other sources of losses. Sometimes the credit analyst may have been faulty because it was based on inadequate information or incomplete analytical procedures. Economic conditions may change adversely after the loan is granted so that the borrower cannot meet debt service requirements (Koch and W.Timothy, 1995, p138).

2.5 Preventing and handling of bad loans

Safety is the watchword in commercial bank lending activities. Bankers want to feel reasonably sure that the principals of their loans will be repaid, even though they may have to be satisfied with relatively low rates of interest because of their selection of only the better risks.

Banks deal with problem loans in a variety of ways. The eventual path to collect problem loans depends on how early the problems are discovered. Problems that are discovered early enough can frequently be corrected by restructuring the borrower's operations and repayment schedule. As cited by Rose (1999, p243) there are useful warning signals of a weak loans and poor bank lending policies. The signals of weak loans include irregular or delinquent loan repayment, frequent request for alternations in loan, rising debt to net worth and not fulfilling documents like financial statements. In addition, requests for reappraisal of assets to increase net worth and applying for loan on poor quality collateral are signal of problem loans. The customer may also rely on non-recurring sources of funds, such as selling of buildings and equipment to meet loan repayments.

On the other hand, poor selection of risks among borrowing customers, lending money on contingent future events, lending money because a customer promises a large deposit, failure to specify a plan for liquidation of each loan are indicators of poor lending policies. In addition to this, substantial loans to insides including employees, directors, or shareholders, tendency to overreact to competition, like making poor loans to keep customers from going to other banks is dangerous attitude. Lending money to support speculative purchases and lack of sensitivity to conditions are also good indicators of inadequate or poor bank lending policies (Koch & W.Timothy, p 157-58).

Lending difficulties can be reduced if management establishes and adheres to loan policy guidelines that restrict unacceptable activity. Such guidelines specify quantitative goals. The procedures document, the format for obtaining loan application, grading loan, approving loans and systematically reviewing loan performance and quality (Daniela.et.al, 1996).

Once the bank comes to the realization that it has a problem loan on its books, the first thing it should do is to contact the debtor. This helps to assess the attitude of the borrower and to find solutions to the problem. If the bank expects a debtor's cooperation, it is usually necessary to give him assurance that the bank wishes to cooperate with him and that is advantageous to both the bank and the debtor. At this instance, the bank must hope to achieve a two-fold effect. It must be forceful enough to convince the debtor that the situation is serious and those positive steps of correction must be taken immediately. But it must also be reasonable and conciliatory enough that the debtor will believe that all is not lost, and that cooperating with the bank in instituting plan for correction may be beneficial to him. In no case the bank's officer should make unrealistic demands for immediate payment, unless obvious fraud or gross misrepresentation exists, nor should they threaten legal action at this time (Daniela.et.al, 1996).

The second step in handling the problem loan, as described by the same author is searching solutions. Achieving workable solution is rarely easy, and in some cases impossible. Where a workable solution can be found, the bank has no alternative but to collect the loan, either through the voluntary liquidation of assets by the debtor or by forced liquidation. The benefits that accrue to the debtor, if the plan for correction is successful are rather obvious. For the bank as well, if it can help the borrower solve his problems and become a successful businessman, it will have a loyal customer for many years to come. The bank ordinarily gains the goodwill of the customer, as well as the business community as a whole. Remedial actions should be sought to recover problem loans using various workout strategies. Each problem is different, and no routine is universally applicable. Some of the most common approaches to be considered include:

- Developing a debt structuring program
- Agreeing on additional documentation and guarantees
- Calling on a guarantees
- Arranging for joint partnership and capital contribution
- Working with management to define problems and potential solution
- Developing a retrenchment program with closely monitored budgets
- Arranging the sale of the operating company to a third party
- Replacing management

When all the above methods fail to be effective in the recovery process, the bank has no option but to forego the dues by writing them off. Write off should, however, be permitted as the last resort after exhausting all other opportunities (Daniela.et.al, 1996).

As a solution, the creditor may seek to solve the borrower's problem of inadequate cash flow to meet loan obligations through the extension of loan terms. Extensions and renewals however; should be considered only after a thorough examination of a cash flow projection, and only if there is adequate evidence that repayment will actually materialize at a later time. Any renewals should be for a short period of time, & the bank should carefully re-examine its position before granting additional renewals or extension. There are several dangers involved in the granting of an extension. The debtor may fell relieved from the pressure, and may reduce his efforts to repay the debt, or divert available cash to the repayment of other debts, which are more pressing. Therefore; when dealing with prospective renewal request, the lender should carefully analyze the credit in the same manner as would analyze a new application (Daniela.et.al, 1996).

2.6 Principles of good lending

When evaluating loan requests, bankers can make two types of errors. The first is extending credit to a customer who ultimately defaults; the second is denying a loan request to a customer who ultimately could repay the debt. In both cases, banks lose a customer and its profits (Koch & Timothy, 1995, p101).
To minimize such errors and to prevent problem loans before their occurrences, there are few general principles of good lending that should be noted while considering an advance proposal. These include safety, liquidity, and purpose of loan proceeds, profitability and diversification (Rose, 1999).

"Safety First" is the most important principle of good lending. When a banker lends, he must feel certain the advance is safe. That is the loan is undoubtfully collectable. If for example the borrower invests the money in unproductive or speculative venture or if the borrower himself is dishonest, the advance would be in problem. Similarly if the borrower suffers loss in his business due to his incompetence, the recovery of the money may become difficult. The banker ensures that the money advanced by him goes to the right type of borrower and is utilized in such a way that it will be safe at the time of lending but will remain so throughout and after serving useful purpose in the trade or industry where it is employed, and is repaid with interest (Rose, 1999).

The other important task faced by bankers is ensuring adequate liquidity. It is simply defined as the ability of a bank to convert to a sufficient amount of assets in cash readily and at favorable price to satisfy at any time both the normal and abnormally high withdrawal demand of its operation. A bank is said to be liquid if it has immediate access to funds at reasonable cost at precise time as the funds are needed. In order to ensure liquidity of the bank, it is necessary to check liquidity of the loan to be granted. Therefore, it is not enough that the money will come back, it is also necessary that it must be collected on demand or in accordance with agreed terms of re-payment. The borrower must be in a position to repay within a reasonable time after a demand for repayment is made. This can be possible only if the money is employed by the borrower for short-term requirement and not locked up in acquiring fixed assets, or in schemes that take long time to pay back (Rose, 1999).

The source of repayment must also be definite. The reason why bankers attach much importance to liquidity as to safety of their funds in that bulk of their deposits is repayable on demand or at short notice. If the banker lends a large portion of his funds to borrowers from whom repayment would be coming in but slowly, the ability of the banker to meet the demands made on him would be seriously affected in spite of the safety of the advances (Rose, 1999).

Assessing liquidity of the borrower is measuring his repayment ability without disrupting to normal operation of his business (Daniela et, al, 1996 p345)

Another principle of good lending that must be looked into is **the purpose of the loan proceeds**. The range of business loan needs is unlimited. Firms may need cash for operating purpose to pay overdue suppliers, to make a tax payment or pay employees salary. Similarly they may also need funds to pay off debt obligations or to acquire new fixed assets. Frequently a firm recognizes that it is short of cash but cannot identify why. The first issue facing the credit analyst is what the loan proceeds are going to be used for legitimated business operating purposes, including seasonal and permanent working capital needs, for the purchase of depreciable assets, physical plant expansion, acquisition of other firms, and extra ordinary operating expenses. Speculative asset purchases and debt substitutions should be avoided. The true need and use determines the loan maturity, the anticipated source and timing of repayment, and the appropriate collateral (Rose, 1999).

Profitability is also equally important principle in bank activities as other commercial institutions, banks must make profits. Firstly they have to pay interest on the deposits received by them. They incur expenses on establishment, rent, stationary, etc. they make provision for depreciation of their fixed assets and also for any possible bad or doubtful debts. After meeting all these items of expenditure, a reasonable profit must be made, otherwise it will not be possible to carry anything to be reserved or pay dividends to shareholders. It is after considering all these factors that a bank decides upon its lending rate (Rose, 1999).

Another important principle of good lending is **the diversification of advances**. An element of risk is always present in every advance whatever security might appear. In fact, the entire banking business is one of taking calculated risk and a successful banker is an expert in assessing such risks. He/she is keen on spreading the risks involved in lending over a large number of borrowers, over large number of industries and areas, and over different types of securities. For example if he or she has advances of large proportion of his funds against only one type of security he will run a big risk if that class of security steeply depreciates. If the bank has numerous branches spread over the country, it gets a wide assortment of securities against the advances (Rose, 1999).

2.7 Steps in the process of commercial and industrial (C&I) loans

The activities in the process of commercial and industrial (C&I) loans follow eight steps. These steps are application, credit analysis, decision, document preparation, closing, recording, servicing and administration, and collection (Wei-Shong and Kuo-Chung (2006)).

The first step of the C&I loan process is the application, which is conducted by a loan officer. This step covers the initial interview and screening of a loan request. Initially, the loan officer obtains as much information as possible about the situation of the borrower, for example, his or her previous credit history, current outstanding loans, and current financial statement. The loan officer gathers company information, including legal status, principal employees, main products or services sold, production techniques employed, important competitors, and directors of the company.

The second step is the credit analysis conducted by the credit department. First, the analyst in the credit department receives the financial information of the borrower gathered by the loan officer; then he or she conducts a comparative and historic analysis of the company's financial data. After finishing the financial comparative analysis, the analyst prepares a recommendation report for the loan officer about whether the loan should be granted, rejected, or qualified.

In the third step, the loan officer obtains the credit analysis report and determines whether the report accurately describes the borrowing capacity and characteristics of the borrower. The loan officer then grants the loan with or without considerations of collateral. The loan officer notifies the borrower of his or her decision and proceeds to negotiate loan terms if the loan is to be granted.

When the loan officer and the borrowing company are in agreement, the **fourth step** is the loan operation. Here it is necessary to prepare primary notes, agreements, collateral or non-collateral agreements. If collateral is required, the amount of collateral and additional collateral documentation are indicated.

In the fifth step, the loan officer obtains the borrower's signatures and receives collateral; then the loan operation is closed and the loan proceeds.

The sixth step is the recording of the loan conducted by the loan operation and credit department staff. A loan operation clerk classifies and codes the loan for entry into the commercial loan system, and he or she reviews the loan for compliance with the bank's loan policies. Finally, the loan operation clerk and credit department staff member file the loan notes, authorization, and receipts in designated files.

The seventh step is loan servicing and administration conducted by a loan operation operator, a loan officer, a credit department staff member, and a financial analyst. The loan operation staff person prepares the loan payment notices to notify the borrower and is responsible for receiving periodic payments. The loan officer makes periodic visits and customer calls to obtain new financial statements from the borrower and provides that information to credit department and reviews the loan for compliance with the loan agreement. A credit department financial analyst also receives and reviews the borrower's periodic financial statements.

In the eighth stage, the loan officer may receive periodic delinquency information and need to follow up on this with borrowers. The loan officer also needs to adjust loan terms and conditions as deemed necessary, and to take legal action if non-collectible procedures and foreclosure on the loan are required.

2.8 Collateral Security

In the employment of funds, a banker generally attaches great significance to the consideration of security. Collateral is the security a bank has in assets and pledged by the borrower against a debt in the case of default. Banks look to collateral as a secondary source of repayment when primary cash flows are insufficient to meet debt service requirements. Banks can lower the risk of loss on a loan by requiring back up support beyond normal cash flow. This can take the form of assets held by the borrower or explicit guarantees by a related firm or key individuals (Koch &W.Timothy, 1995, 116)

Virtually any asset can be used as collateral. From lenders perspective however, collateral must exhibit three features. First, its value should always exceed the outstanding principal of the loan. Any lender that must take possession of the collateral can then sell it for more than the balance due, and losses are reduced. Let us assume lending for the purchase of an automobile, where the value the car is less than the outstanding loan balance. The borrower may have a financial incentive to default on the loan. Second, a lender should be able to easily take possession of collateral and have a ready market for sale. Highly liquid assets are worth for loss because they are not portable and often are of real value to the original borrower. Third, a lender must be able to clearly move collateral as its own. This means that the claim must be legal and clear (Koch&W.Timothy, 1995, 116-117)

It is incorrect, however, to consider an advance proposal from the point of view of collateral alone. An advance is granted by a good banker on its own merits, that is to say, with due regard to it’s safely, likely purpose etc, and after looking in to the character, capacity and capital of the borrower and not because the collateral is good (Koch&W.Timothy, 1995, 117).

In explaining the advantage of having collateral behind a loan, Rose (1999, p 214) puts two purposes as follows.

> If the borrower cannot pay, the pledge of collateral gives the lender the right to seize and sell those assets designated as loan collateral, using the proceeds of the sale to cover what the borrower did not pay back. Secondly, collateralization of the loan gives lender a psychological advantage over the borrower. Because specific assets may be at states (such as the borrowers automobile or home), a borrower feels more obligated to work hard to repay his loan and avoid losing valuable assets.

Even though collateral serves as secondly source of repayments, in general loan shouldn't be approved on the basis of collateral alone. Liquidating collateral is clearly a second best source of repayment for three reasons. First, there will be significant transaction costs associated with foreclosure so banks must often allocate considerable employee time and pay large legal expenses that reduce the collateral net value above the anticipated loan amount. Second, bankruptcy laws allow borrowers to retain possession of the collateral long after they have defaulted. During that time the collateral often disappears or deteriorates in value. Third, when the bank takes possession of the collateral, it deprives the borrower's opportunity to salvage the company. The bank must hire new managers or manage the firm temporarily with its own personnel until sale, which is poor alternative (Rose, 1999, p 215).

Different types of assets can be used as collateral to guarantee repayments. Some of them are accounts receivable; inventories, share certificates, plant and machinery, motor vehicles, building property, life insurance policies and personal guarantees. Normally, all properties movable or immovable held, as security for advances must be insured against fire, unless the risk has been generally or specifically waived. Sometimes the securities should also be insured against strike, riot, theft, flood, earthquake, explosion, storm and tempest in addition to the risk of fire (Bedi & Hardikar 1993.p.235).

In considering assets for loan securities, there are certain qualities which a good tangible security should posses. The attributes such as its marketability, easy ascertainment of its value, stability of its value, its storability, the cost and labor of supervision, its transportability, its durability, the ascertainment of title, easy transfer of title, the absence of contingent liabilities with the asset and its yield (to be source of repayments) are important in collateral consideration (Bedi & Hardikar 1993 p. 235). The need for security in lending is understandable. There is always an inherent risk in credit extension, especially over a relatively long period of time. Besides, no bank can claim that all its loans and advances will be performing portfolios. Therefore, the need for security to safeguard a bank against risk is almost always a must.

Bank loans generally should be well secured by pledge or mortgage or properties .However, sometimes clean (unsecured) advances are granted for short periods after proper consideration of the net liquid resources of the borrowers. Since there is no security to fall back upon, credit, capital and capacity should be carefully assessed before granting clean loan granting facilities. The extent of free resource of the borrowers has to be examined and the reasons for not furnishing security also must be examined (Bedi & Hardikar 1993 p. 236). Generally collateral supports bankable credit requests. Non-bankable credit requests could be rejected even if it is supported by high value of collateral relative to the amount of loan requested. The safety of an advance, when on a secured basis, depends to a considerable extent on the quality of the security in question.

2.9 Evaluation of a Credit request

The basic objective of credit analysis is to assess the risks involved in extending credit. When evaluating loans, bankers consider the four “C”s namely, character, capital, conditions and collateral. These determine to meet obligation and willingness to cooperate with the lender. The banker should have complete confidence in the integrity and ability of the customer to use the money to advantage and to repay it within a reasonable period. In the absence of such confidence, it is preferable to decline to lend, no matter how much security is available. Confidence in the borrower is the first essential and one can lend happily to another borrower without security instead of feeling uncomfortable about lending to a dishonest man with much security (Robinson R, 1962, p 309).

Capital and net worth is the amount of funds the individual borrower or owner has invested to support both fixed asset (permanent capital) and the day-to-day operation of the business working capital. The equity position is the best single indicator of the strength of the business and the commitment of its owners. A business with sufficient equity has the ability to change adverse situations or to take advantage of growth opportunities (Robinson R, 1962, p 309).

Capacity is the ability of the borrower to generate cash and the customer requesting credit must have the legal standing to sign a binding loan agreement. The customer who is requesting the loan is representative of a corporation; he must have a proper authority from the board of directors. The recent trends in the borrower's line of work or industry shows how changing economic condition might affect the loan and evaluated under condition study. In assessing the collateral aspect of loan request, the quality, value and market ability is considered (Robinson R, 1962, p 310).

While evaluating credit request collecting status report of credit information about a customer is important, banks get information on borrowers from income tax statements, trade and other reports in the press, interview from banks etc. (Robinson R, 1962, p 310).

Although banks are business competitors in the granting of credit, they recognize their interdependence in making credit judgments. The credit information is used to evaluate the honesty, ability, stability, managerial capacity, operation efficiency and financial history of the prospective borrower (Robinson R, 1962, p 310).

Financial ratio analysis also helps to evaluate loan request. The purpose of financial statement analysis is to determine the ability of the borrower to meet the credit obligation. The purpose of applying analytical technique however is not necessary to calculate a definite answer rather it is to provide a more informed basis on which to make a decision. There are at least four commonly used categories of ratios as stated by Koch and W.Timothy (1995, p 169)

I. Liquidity ratios: - indicate the firm’s ability to meet its short term obligations and continue operation.
II. Activity ratios: - it is a signal how efficient a firm is using its assets to generate sales.
III. Leverage ratios: - indicate the needs of the firms financing between debt and equity, hence potential earnings volatility. The greater a firms leverage volatility, the higher its net profit (loss).
IV. Profitability ratios: - provide evidence of the firm’s sales and earnings performance.

A credit analyst should evaluate these ratios with a critical eye and try to identify the firms’ strengths and weaknesses. All these ratios should be compared with the `industry average` or related business lines or typical competitor and its own historical facts (EAFS, 2008)

CHAPTER THREE

DATA PRESENTATION ANALYSIS AND INTERPRETATION

3. 1. Major Types of Credit Facilities

Overdraft (For Working Capital)":-An overdraft (O/D) is a credit facility by which customer can withdraw in excess of her/his its current account balance up to the limit approved by the Bank. The loan is intended to finance the day-to-day operational needs of a viable business. Lending Rate=7.5%

Term Loan (Short & Project Finance):- A term loan is a loan granted to customers to be repaid with interest within a specific period of time.

- The loan can be repaid in periodic installments or in a lump sum on the due date of loan, as the case may be.
- The loan is granted in three forms, i.e.,short-term, medium term and long term loan. Lending Rate=7.5% -9.5%

Short term loan: - is a loan that has a maturity period of one year or twelve months from the date the loan contract is signed. The loan is extended to finance the working capital needs and/or to meet other short term financial constraints of customers.

Medium-and Long –Term Loan (Project Loan)

A **medium –** term loan is a loan which has a maturity period exceeding one year but less than or equal to five years from the date the loan contract is signed.

A **long –term** loan is a loan that has a maturity period of five to fifteen years.

The purpose of the loan is to finance new project, support the expansion of existing projects, investment and meet working capital needs.

Merchandise Loan*:*-is a credit facility provided by the Bank against which the merchandise is held as collateral for the loan. Lending Rate=8%
The purpose of the loan is to overcome the cash –flow problem of customers when money is tied up in merchandise. The loan is approved for a period of three months (90 days) or it may be approved on renewable basis.

Letter of Credit Facility

A Letter of Credit is a credit instrument issued by a bank at the request of an importer through which the bank commits itself to a payment undertaking to an applicant (importer) to pay a seller (exporter) a given amount of money upon presentation of specified documents representing the supply of goods within specific time limits, the documents conforming to the terms and conditions agreed by the importer and exporter.

- **Advance on import bills**
- **Revolving overdraft (for export bills)**
- **Trade bills discounted**
- **Export credit guarantee scheme**
- **Letter of guarantee (Advance, Performance and Bid Bonds)**

Typical Loan Catagories

Dashen Bank grants loans and advances to various sectors of the economy on the strength of assessment of concentration risk. Thus, all loans of all types and terms need to be spread among the categories of loans recognized by the bank. Economic sectors which are beneficiaries of Dashen's credit assistance are:

Domestic Trade and service loans:- Include wholesale trade, retail trade, services other than transport such as hotels, schools, hospitals, tour agencies, etc. Financing trade and services helps in the smooth flow of goods and services in the economy and serve as an intermediary between producers and consumers. Therefore, trade in essential goods whether imported or locally produced is to be encouraged by Dashen Bank through working capital financing. Among others, goods traded include outputs of manufacturing industries, cottage and handicraft, mining activities and agricultural products.

International Trade (Import/Export loan):- Foreign Trade plays a key role in the development of an economy and has always been the major force behind the economic relations among nations. In view of its paramount importance and the bank's role to promote the growth of the Ethiopian economy, international trade financing in the form of import and export transactions is one of the priority areas of the bank.

Manufacturing Loan (small, medium & large)

- Loans availed to facilitate the manufacturing activities of small, medium and large-scale industries are classified under this category
- Enterprises utilizing agricultural inputs (agro-based industries and other local raw materials)
- Business establishments producing commodities that will improve agricultural productivity
- Enterprises producing consumption goods.
- Small scale industries owned by individuals and cooperative ventures.
- Industries engaged in the production of capital goods.
- Industries geared to export market and import substitution.
- Labor-intensive industries.
- Industries producing goods having value added.
- Expansion programs of already existing establishments.

Agricultural Loans:- Agricultural loans include loans granted for purchase of agricultural inputs like selected seeds, fertilizers, agro-chemicals, rental or purchase of agricultural machinery and equipment; for crop collection, processing and marketing of agricultural products, projects aiming at producing exportable products like flowers, fruits, and vegetable and agro-industry developments like dairy farming, cattle fattening etc.

Transport: - All loans to be availed for the purchase of transport vehicles like trucks, tankers and public transport buses to licensed transport operators are to be classified here. Additionally, loans availed to facilitate smooth operation of trucking companies or loans to cover custom duty charges or modification costs are also included.

Building & construction loan:- Dashen Bank avails loan to this category for building contractors, investors engaged on road and water projects under construction, civil workers and business persons who seek financial assistance to construct commercial or residential buildings.

Loans can be provided to license building contractors to cover working capital shortages i.e. to mobilize materials required to construct buildings, roads, dams etc. Based on contracts conclude with employer.

3.2. Opinions of staff members and borrowers about the major factors

The student researcher collected relevant information from staff members of the bank who have relevant work experience in loan area and borrowers of the bank through questionnaire and interview methods. These groups of individuals were selected because their opinion was found to be essential to analyze the root causes of the problem. Accordingly, self administered questionnaires were prepared and distributed to six city branches and head office to be filled by the selected staff members of the bank. Interview was also conducted with few chosen branch managers and loan officers to fill the gap of answers given in the questionnaire.

A total of 51 questionnaires were distributed to the staff members but only 48 questionnaires were properly filled and returned, i.e, the response rate is 94%. In order to make the study complete and meaningful, the student researcher also gathered opinions of borrowers regarding the causes of their delay to pay their debt on the agreed time. It was very difficult to get customers in the bank's premises and collect their opinion as they come once in a month to pay their debt or for some other reason. During the period of this study, 60 questionnaires were distributed to the selected branches of the bank in Addis to be filled by their borrowers. However, only 25 questionnaires were filled and returned properly due to the customers not come to the bank regularly i.e., 42%.

Demographic characteristics of the respondents

As it can be shown in the Table 3.1, a total of 48 staff members of the bank who are engaged in loan handling, processing and approving activities were participated by filling the questionnaire. From the total respondents, about 65% of them are male employees and the rest are females whereas, majority of customers are males (23) from the 25.

When we see age category of respondents, 79.17% of staff members are found in the age category of 26 to 35 years. This result demonstrates that the bank has many young professionals who are engaged in loan processing and approving activities. On the other hand, majority of customers are more than 36 years old (Table3.1).

Table 3. 1: Demographic characteristics of the respondents

No.	**Factors**	**Number of Respondents**		**Percentage**	
		Staffs	Borrowers	Staffs	Borrowers
1	**Sex**				
	Male	31	23	64.58%	92%
	Female	17	2	35.42%	8%
	Total	**48**	**25**	100%	100%
2	**Age**				
	Below 25years	4	0	8.33%	0
	26 to 35	38	6	79.17%	24%
	36 to 45	4	12	8.33%	48%
	46 above	2	7	4.17%	28%
	Total	**48**	**25**	100%	100%
3	**Service year**				
	Less 2 years	4		8.33%	
	3 to 5 years	19		39.58%	
	6 to 10 years	21		43.76%	
	11 years and above	4		8.33%	
	Total	**48**		100%	
4	**Educational back ground**				
	Grade 12 and below	0	15	0	60%
	Diploma	5	7	10.42%	28%
	Degree	42	3	87.5%	12%
	Masters and above	1	0	2.08%	0
	Total	**48**	**25**	100%	100%

The study also gathered information about the work experience of staff members in banking industry. As a result, majority of the respondents have worked more than two years in bank industry. Table 3.1 shows that 19 employees are found in 2 to 5 years category, 21 of them have worked for about 5 to 10 years and only 3 of them have work experience of less than 2 years. This result shows that the bank has relatively many experienced workers who can process and follow up loan activities.

Attempt was also made to see whether the staffs have the necessary educational back ground or not. Accordingly, Table 3.1 shows the educational back ground of staff members, to this effect, majority of the respondents have bachelor degree (42) and there is one Credit analyst who has masters' degree as well and only 5 employees are diploma holders. This result shows that the bank has assigned qualified personnel to process and approve loan requests of customers to achieve its objectives. On contrary to this, majority of borrowers are found in the age category above 36 years.

3.2. 1 Analysis of basic variables

There were five questions in part II of the questionnaire that include open ended questions. Majority of the respondents wrote their opinions briefly. The following paragraphs and tables summarize the answers for each question.

3.2.2 Assessment made by the bank before granting loans

Table 3.2 summarizes the responses on the level of assessment that the bank has been done towards the borrower's financial strength and credit worthiness before providing the loan to borrowers.

Table 3.2: Assessment made by the bank before granting the loan to borrowers

To what extent the bank assess borrower's credit worthiness before extending the loan?	Frequency	Percent	Cumulative Percent
Very strong	22	45.83	45.83
Strong	24	50.00	95.83
Average	2	4.17	100.00
Weak	0	0	
Very weak	0	0	
Total	**48**	**100.00**	

From the Table 3.2 one can confirm that, the bank strongly assess the borrower's past financial history, credit worthiness and perform detailed financial analysis before extending the loan. As it can be seen from the table, about 96% of the respondents replied as very strong and strong, only 4% of the respondent, said average, and even no employee replied as weak or very weak.

This fact demonstrates that the bank strictly assess the borrower's loan request before disbursement. The implication of this result is that the bank strongly assesses requests of borrowers whether the customers fulfill the necessary requirements or not before issuing the loan amount. Through such types of assessment the bank could minimize the size of NPLs as it enables to select prominent customers who can pay their debt.

3.2.3 Follow-up mechanism of the bank after granting loans to customers

All respondents confirm that the bank have its own follow up mechanism after granting loan to customers. The following paragraphs explain the major methods of controlling borrowers after disbursement, which the loan section staffs wrote in the questionnaire.

Some respondents indicated that the follow-up mechanism is dependent on the type of loan. If it is for construction, the loan shall be granted phase by phase up on the bank's engineering assessment. If it is for the purchase of items or machinery, the loan proceed is directly paid to the suppler. If it is for working capital, the bank's staff will visit the customer's business premises.

After disbursement of the loan, the branch manager and the loan section head committee visit the borrower's business premises spontaneously. Visiting is done to make sure that the availed fund has properly been spent for the targeted purpose or as per the approval of the bank. Employees of the loan department together with internal auditors might visit the borrower's business site at any time so as to have adequate information to control and direct the customers.

In addition to visiting, the staffs checks whether the granted loan is being repaid as per the loan agreement. If the borrower failed to pay as a regular basis, different actions will be taken since one month's default. Some of the reminding mechanisms are. Telephone call, formal letters, fax, email, contact in person, etc. When needed discussion with customers also made to look for normalizing mechanisms when there is a delay in periodic loan repayment or potential for default is observed. The discussion might include advices on how to develop their business in order to generate much cash that enable them paying their debt.

Sometimes, depending on the type of loan, the bank will require customers to offer different reports that reveal their day to do day business operations, balance sheet, monthly activities etc to assess the condition of the customer.

If the various actions that have been described before can not regularize the loan repayment, the case will be transferred to legal department of the bank for further follow up and legal actions. Therefore, the bank can get its money by selling the collateral pledge.

During the interview also, some loan section heads revealed that the bank has its own credit follow up mechanisms to control borrowers and minimize the banks' NPL, some of them are described below.

In practicing proper follow up, once funds are disbursed the concerned loan officer cannot afford to rest and expect that all repayment will be collected as scheduled. Therefore, the loan officer prepare schedule which contain the repayment date and telephone address of the borrowers in order to make the follow up task easy. After this, the officer is expected to call when payment delay. Even if the payment is done regularly, follow-up by visiting customers' business or factory is necessary to create long lasting friendly relationship. Sometimes borrowers seem to ignore repayment for one reason or another. In such case, Dashen bank undertakes the following activities to follow-up.

- Giving verbal reminder after calling the customer and discussing the matter. If this fails and no payment is made then the bank choose to the second step. Personal visit is more productive than telephone calls. This should be performed within one week after the installment is due.

- Sending first written reminder using language of general persuasion and explaining that the bank is accountable. This should be done if installment is over due by a month.

- If the first reminder fails, second written reminder will be sent that shows the bank is legally and morally bound to collect the debt would follow. The reminder will be worded in such a way as to show the bank's determination to proceed with further measures if repayments are not forth coming. It is very important that the bank use every mean to make the borrower come up with alternative proposal until the bank make fairly certain that payments will be made.

As it can be seen from the explanations so far, the bank has its own procedures that enable itself to follow up its borrowers after providing the loan. Reminding of customers starts when installment payment overdue by one month, this should be appreciated. Thus, if the bank staffs strictly follow the bank's procedures after granting the loan, they can minimize the chance of loan loss or the size of NPLs in the bank.

3.2.4 The bank's mechanisms when borrowers failed to pay their debt regularly

According to the responses given on the questionnaire, when borrowers failed to pay their loan as per the agreement, the bank might apply one of the following methods depending on the condition of the borrower, structure of the loan and the nature of the problem.

- Extending the life of the loan
- Injection of additional loans
- Rearrangement of loan repayment structure
- Waive of arrears and repayment
- Foreclosure the collateral pledged, if any

Most of the respondents revealed that the bank has been using all of the above methods depending on the specific situation of the borrower. This usually done through discussion with the customer, but extending the life of the loan, rearrangement/rescheduling of loan repayment structures and foreclosure are the most common methods to re-collection.
Arranging such kinds of repayment mechanisms is very important for those borrowers who failed to pay their debt as per the agreement. In addition, the bank could collect its money with the consent of the borrower, this in turn enable the bank to minimize the size of NPLs in its loan portfolio.

3.2.5 Procedures to get loan from the bank.

Almost all respondents replied this question with brief writings, the summary of their words is discussed in the following paragraphs.

First of all the customer who wants to borrow money from the bank should make preliminary interview with concerned body such as branch manager, loan section head or loan officer. If the clients' interview makes him/her as prospective borrower, first the customer must open an account in Dashen bank and then he/she will come up with the written application letter accompanied with pertinent documents.

The borrower should offer various documents such as, renewed trade license to confirm whether the business is legal or not, company profile, business plan, feasibility study if any, NBE credit status reports, financial statement etc. Presenting audited financial statements is necessary if the loan amount is above 5 million birr if not, the applicant can get the loan by filling the credit form. If the customer or borrower is private limited company, credit information is gathered to assess the past financial history of the applicant. To summarize, the customer loan request should pass through the following five steps, from initiation to disbursement of the loan.

1. **Initiation:** Applicants should first approach the bank in person with their requests for loans.
2. **Screening** The bank discuss with the applicant the types of loans that the bank provides and the kind of loan the applicant asks for I If the bank finds the applicant's request eligible form their discussions visit the business premises and will require the potential borrower to present the necessary documents for loan processing.
3. **Processing:** the bank will process the request via loan approval form (LAF)
4. **Approval** The loan approval committee, depending on the size of the loan request and the potential of the applicant's business transaction, approves the loan with justification for only variation form recommended request. Loan amount up to 150,000 birr can be approved at branch level, but above this limit, the loan must be approved on the read office level.
5. **Disbursement** As per approval and fulfillment of the required conditions, the amount approved will be disbursed or credited to the customer account from borrower's side

As it can be explained so far, the customer loan request should pass through the five stages from initiation to disbursement. These procedures, if applied fairly and strictly, the bank could minimize the amount of sick loans in its balance.

3.2.6 The causes of NPLs from borrowers' side

The study collects opinions from staff members of the bank and borrowers concerning the level of relevance each factor contributes to increase the balance of NPLs in Dashen bank. The responses of staffs and borrowers presented together for ease of analysis by showing the percentages of each group responded to each of the factors in Table 3.3.

Table 3.3 Causes of NPLs from borrowers' side

Description of factors	Very Relevant (%)		Relevant (%)		Average (%)		Irrelevant (%)		Very Irrelevant (%)		Total for each group
	Employees	Borrowers	Employees	Borrowers	Employees	Borrowers	Employees	Borrowers	Employees	Borrowers	
Lack of adequate knowledge and experience on how to use the loan amount	38	20	48	52	12	12	2	16	0	0	100
Diversion of the borrowed fund to other purpose	34	40	56	56	8	4	2	0	0	0	100
Failure of the investment project to generate enough cash to settle their debt	11	48	58	40	31	0	0	12	0	0	100
Un-planned and ambitious business expansion	32	24	56	48	10	20	2	8	0	0	100
Death, disability or insanity of borrowers	9	0	15	0	21	0	42	60	13	40	100
Unwillingness and carelessness of borrowers to pay their debt	17	40	46	52	37	8	0	0	0	0	100
Unwillingness of the debtor to disclose truthful information	20	0	63	32	17	20	0	40	0	8	100
High interest rate on loans	0	32	6	40	10	0	67	28	17	0	100

Lack of adequate knowledge and experience on how to use the loan amount

According to the perception of employees of the bank, lack of adequate knowledge and experience on how to use the granted loan by the borrower is the significant factor that makes them in default, i.e., a cumulative percentage of 86. Table 3.3 reveals that only 2% of the staff members said this factor irrelevant but the majority of them (86%) give their opinion as very relevant (38%) and relevant (48%). The result indicates that knowledge and experience of the borrower about better management of the borrowed funds is very crucial to repay his/her debt on the agreeable time. Furthermore, borrowers of the bank strengthens this fact, about 72% of them categorized this factor as very relevant (20%) and Relevant (52%).

In addition, employees during the interview discussion uncover that most of the borrowers are uneducated enough and unwilling to hire professionals to run their business. Due to this problem, they lack the necessary skill on how to manage the borrowed funds and this might make them in default.

Diversion of the borrowed fund to other purpose

As the employees' opinion in the questionnaire, diversion of the borrowed fund to other purpose is the major significant factor that contributes to increase the size of NPLs in the bank. Table 3.3 shows that there is only one employee who said this factor is irrelevant but, majority of them making it the major determinant or cause of the problem. About 90% of the respondents categorize this factor as Very relevant (34%) and Relevant (56%).In addition, about 96% of borrowers regarded this factor as very relevant(40%) and relevant(56%).

This answer also supported by few selected employees while conducting interviews. The bank has been made its effort to control the end use of the loan or pay loan proceed to the intended purpose especially for loans other than working capital loans. However, most of the time customers invest the borrowed fund in to another project by diverting the original purpose of the loan. For instance, they invest the business purpose loan to purchase automobile, house or any luxury goods. This situation shrinks their capacity to pay their debt including the interest of the loan.

Failure of the investment project to generate enough cash to settle their debt

Failure of the investment project to generate enough cash is also regarded as the significant factor that makes borrowers in default according to the employees' opinion. Table 3.3 demonstrates that about 69% of the employees considered this factor as Very Relevant (11%) and Relevant (58%). There is no any employee that said this factor irrelevant or very irrelevant. This result indicates that even though the investment project established with high capital, the borrower can not pay his or her debt if the project doesn't generate enough cash during its operation. Thus, according to some interviewees, poor quality project and lack of market study by the borrowers before they invest are some factors that create shortage of cash. This fact also supported by majority of borrowers (88%), i.e., about 48% of them regarded as very relevant and 40% as relevant.

Un-planned and ambitious business expansion

As it can be seen from Table 3.3, majority (88%) of the employees gave their opinion that un-planned and ambitious business expansion of the borrower is the major factor that makes them retard to return their loan amount. Only 2% of the respondents who considered this factor as irrelevant but, 32% of them take it as Very relevant and 56% of them regarded it as relevant. In connection to this, about 72% of borrowers considered this factor as very relevant (24%) and relevant (48%). From this result one can infer that if borrowers expand their business with out plan or ambitiously, they would face bankruptcy problem and they cannot pay their debt.

Death, disability or insanity of borrowers

On the other hand, contingencies on the part of the borrowers like death, disability or insanity were made very little contribution to make the balance of NPLs to increase. Table3.3 demonstrates that only 25% of staff members considered this factor as Very relevant (9%) and Relevant (15%) among the total of 48 employees. However, about

55% of borrowers regarded this factor as irrelevant (42%) and very irrelevant (13%).On the other hand, there is no any employee who said this factor as relevant. This result demonstrates that such factors like death disability or insanity of borrowers have no significant contribution towards the increment in NPLs since the collateral pledge will be sold to cover the outstanding loan balance when it happens.

Unwillingness and carelessness of borrowers to pay their debt

The study also attempts to collect opinions of staff members regarding the payment behavior of borrowers after they receive the money from the bank. Accordingly, Table3.3 describes that about 63% of the employees believe that unwillingness and carelessness of borrowers to pay their debt is a significant factor that contributes to increase the balance of NPLs in the bank. In addition, there is no any respondent who considered this factor as either irrelevant or very irrelevant. In relation to this, majority of borrowers (92%) regarded this factor as very relevant (40%) and relevant (52%).

To this connection, some loan officers described during the interview is that few borrowers are careless or unwilling to settle their debts and they believe that they have good collateral that can cover their entire debt if they are in default. This is a bad behavior of borrowers and increases the balance of NPLs in the bank.

Unwillingness of borrowers to disclose truthful information

In order to get maximum amount of loan, customers might provide falsified financial statements and other documents to the bank. This leads the bank to release large amount of money that might not be collected with in agreeable time. According to the opinions of staff members, about 83% of them consider this factor as very relevant (20%) and relevant (63%) to increase the balance of NPLs. On the other hand, only 32% of borrowers considered this factor relevant but, the majority (48%) of them take it as irrelevant.

In connection to this problem, some branch managers and loan officers gave their opinion regarding the financial statements provided by their customers. To this end, they said that most of the borrowers' business are small and do not have proper accounting records by hiring trained or qualified accountant. In addition, most borrowers maintain two types of financial statements one is for tax purpose the other one is for bank credit, therefore it may be unreliable document. Further, the financial statements provided by majority of borrowers are un-audited because the law forces only financial statements of share companies to be audited. All these reasons forces the bank to rely on the financial statements provided by borrowers whether falsified or not. Consequently, this situation may create credit risk of non-performing loans.

The interest rate of the bank

The study also attempted to collect opinions of employees concerning the effect of the current interest rate of the bank on borrowers' repayment capacity. In viewing this, majority of employees give their opinion as irrelevant (67%) and only 6% of them regarded this factor as relevant to make borrowers in default (Table3.3).According to employees' opinion, the interest collected by the bank is very small when compared with the money released to customers. If customers do their business wisely, the interest payment is not that much big issue. On the other hand, about 72% of borrowers perceived that the current interest rate charged by the bank has significant effect on the repayment capacity of borrowers.

From the above detailed presentation of facts, the student researcher ranks the causes of NPLs at the borrowers' level .To this end, diversion of the borrowed fund to other purpose, un-planned and ambitious business expansion, lack of adequate knowledge and experience on how to use the granted loan and unwillingness of borrowers to disclose truthful information are ranked first to fourth respectively. Because they are regarded as relevant and very relevant factors by more than 83% of the respondents. On the other hand, interest rate on loans and contingencies on the part of borrowers like death, disability or insanity are considered as irrelevant factor to increase the size of NPLs in the bank. However the effect of interest rate is considered as very significant factor to increase the size of NPL as it increases be loan outstanding balance to paid

3.2.7 The causes of NPLs from the bank side

Only staff members of the bank were asked to put their perception about the level of significance each of the following factors contributes to increase the size of NPLs in the bank. The results of the analysis are shown below in the following table and descriptions.

Table 3.4 Causes of NPLs from the bank side

No.	Description of items	Very Relevant	Relevant	Average	Irrelevant	Very irrelevant	Total
1.	Lack of strict follow- up and loan workout procedure	16.67%	20.83%	45.83%	8.33%	8.34%	100%
2.	Not taking timely action by the bank when borrowers start to default	33.33%	35.42%	20.83%	8.34%	2.08%	100%
3.	Management/owner intervention in loan processing and approval	0	43.75%	39.58%	14.59%	2.08%	100%
4.	Unreliable and overstated estimation of collateral	8.33%	31.25%	12.50%	39.58%	8.34%	100%
5.	Competition among banks to attract borrowers	6.25%	52.08%	31.25%	8.34%	2.08%	100%
6.	Lending to affiliated parties of the bank such as share holders, board members, managers etc...	2.08%	14.58%	41.67%	41.67%	0	100%
7.	Violations of the existing credit policies of the bank by employees	0	4.17%	41.67%	52.08%	2.08%	100%
8.	Poor credit/risk assessment of the bank	8.33%	12.5%	50.00%	20.83%	8.34%	100%

Lack of strict follow- up and loan workout procedure

Lack of strict follow- up and loan workout procedure regarded by most of the respondents as neutral or average (45.83%) and a total of 37.5% of them consider this factor as relevant(20.83%) and very relevant(16.67%). This result implies that employees of the bank do not feel that there is lack of strict follow-up and loan workout procedure in the bank that makes borrowers relax to settle their debt on the agreeable time. Dashen bank has strict follow-up and loan workout procedure that enable to control its borrowers after disbursed the loan. However, these procedures sometimes might not be respected depending up on the customers' situation.

In connection to this, the student researcher interviewed few loan officers concerning their follow- up effort when customers delay in paying the loan. According to their response, the bank has been using its full effort to follow-up and collects the granted loans on time. The follow -up is done by reminding customers through telephone and written letters repeatedly and physical observation.

Not taking timely action by the bank when borrowers start to default

Not taking timely action by the bank when borrowers start to default is also the major factor to increase the size of NPLs in the bank. As it can be shown in Table 3.4 , majority (69%) of the respondents considered this factor as very relevant (33.33%) and relevant (35.42%).The implication of this result to the management of the bank that when borrowers start to default ,the bank should take timely action in order to get its money as early as possible.

In connection to this, during the interviews made with few loan officers, they revealed that the bank has done actions step by step. Firstly, when borrowers start to default, repeated calls and written warnings has been made for a short period of time (up to three months). If the customers do not start payment during this period, the loan officers transfer the case to the legal department of the bank for further actions. According to their opinion they said that after the case is transferred to legal department, it is difficult to guess when the loan will be settled.

Management/owner intervention in loan processing and approval

Management or owner interventions in loan processing and approval of desiring to acquire fast profit may also result in lending to poor quality borrower. According to the result, 43.75% of the respondents consider it as relevant factor, 39.58% of them take it as average and only 14.59% of them take it as irrelevant. As per the interviews conducted with some selected staff members, there is no that much intervention of management in loan processing and approving in this bank and therefore this factor may not contributed much for NPL.

Unreliable and overstated estimation of collateral

A total of 47.92% of the respondents feels that unreliable and overstated estimation of collateral in the bank is irrelevant fator, i.e, 39.58% said irrelevant and 8.34% said very irrelevant. Cumulative of 39.58% of the respondents regarded this factor as relevant.

To fill the gap of answers in the questionnaire, the student researcher also conducted interviews .As a result, the bank has skilled and experienced proffesionals that can estimate the collateral values with in the reasonable accuracy. If the borrower being in default, the bank can get its money by selling the assets secured as collateral.

The implication of the result might be overestimation of the collateral or the falls in its value upon its sale would result in loss of some income to be covered by the collateral in the event of default. This in turn leads to increase the balance of NPL. A more serious problem is lack of well developed second hand market or saturation of the market for properties pledged as collateral.

Competition among banks to attract borrowers

Competition among banks to attract borrowers also might have adverse effect of lending to non-promising borrowers. Table3.4 shows that 58.33% of the respondents consider this factor as very relevant and relevant, only a total of 10.42% of them regard it as irrelevant. While conducting interviews with employees, some of them said that even though there is swift competition among banks, Dashen bank has been disbursed loans to customers who fulfill the necessary requirements.

Lending to affiliated parties of the bank such as share holders, board members, managers etc...

Lending to affiliated parties of the bank such as share holders, board members, and managers is not considered by the respondents as a significant factor to increase the balance of NPLs in Dashen bank. Only one person (2.08%) regarded this factor as very relevant and 14.58% of them as relevant. Rather majority of them take this factor as irrelevant (41.67%) and the same percentage of employees said average. This result has an implication that lending money to these parties did not have a negative effect on the profitability of the bank until now in this bank. Because the bank provide loan service to shareholders and board members based on their limited amount.

Violations of the existing credit policies of the bank by employees

About 4% of respondents believe that violation of the existing credit policies of the bank by employees is the relevant factor to create poor quality borrower. On the other hand a total of 54% of the respondents consider it irrelevant (52.08%) and very irrelevant (2.08%) factor. From this result one can infer that few employees might violate the tight credit policy of the bank while processing and approving loan requests from customers. In contrast, as majority of employees' perception, employees who are engaged in loan handling activities respect the existing credit policies of the bank. Consequently, if employees strictly follow the bank's policies and procedures while granting loans, this situation enables the bank to reduce the size of NPLs to the large extent.

Poor credit/risk assessment of the bank

According to the respondents' perception in table 3.4, only 20.83% of them considered this factor as relevant and about 29 % of them regard it as irrelevant. The rest 50 % said average impact. To fill the gap of answer given in this factor, interviews also made to few selected employees. As a result, the bank has been strictly assessing the customer's loan requests and has strong loan procedure manual that every employee should abide by.

As can be seen from the detailed presentation of responses about the causes of NPLs at bank's level, most of the respondents regarded the factors as neutral or said average. But, the student researcher tried to analyze the factors with the answers given during interview to rank them. Accordingly, not taking timely action by the bank when borrowers start to default, competition among banks to attract borrowers and lack of strict follow- up and loan workout procedure are ranked first to third respectively. On the other hand, lending to affiliated parties of the bank such as share holders, board members, managers, violations of the existing credit policies of the bank by some employees and poor credit/risk assessment of the bank are regarded as irrelevant factors in Dashen bank to increase the size of loans.

3.2.8. Staff members' and borrowers' opinion about other factors that might increase the size of NPLs in the bank

There are few other factors that are not specified in the questionnaire either from borrowers' side or creditors' .According to the answers given in the questionnaires and from the conducted interviews; the following are some of the factors that might increase the balance of NPLs in the bank.

Unfavorable macro economic conditions that lead to large scale failures of enterprises of a country may create problem to banks. Since most enterprises are interconnected with banks as a borrower-lender relationship, failure of these enterprises in large scale would make them unable to repay their loans. Similarly, sudden changes in market conditions, interest rate, exchange rates etc would make firms unable to service their loans and resulting in large NPLs.

Unstable prices and substantial variations in prices may cause problems of loan losses because; firms for whom the change in price is unfavorable will get difficulties to pay their debts.

The overall economic performance of the country will affect banks in their loan provision and collection activities. The weak performance of the economy due to prolonged recession and occurrence of recurrent draught decreases profit of business firms and incomes of households, consequently loan repayment would might be difficult.

Absence of market study by debtors before they invest is also one of the significant factors that retard customers to pay their debt as they cannot cope with the current situation in the market. While conducting interview with few branch managers of the bank, majority of the borrowers are not willing to hire professionals that can study the market in a better way before they invest large sum of money. They simply start a business around them, which they seem profitable without analyzing the current and future situations thoroughly. After they enter in to the business, they cannot compete with their rivals competently. Due to this reason, they may face business failure and cannot pay the borrowed fund on time.

Lack of enough market to sell their goods and services as they want in order to generate sufficient amount of money for running their business together with covering the loan. Moreover, the respondents believe that unrealistic forecast of borrowers' revenue and profit generation affects their repayment condition by inflating the loan size or borrowed fund.

Damages to the project

Delay of payment for the work executed

Lack of constructive training with regard to credit and loan processing to employees of the bank.

CHAPTER FOUR

SUMMARY OF THE FINDINGS, CONCLUSION AND RECOMMENDATION

4.1 Summary of Findings

According to the information posted on the bank's website, Dashen bank provides many credit facilities to its customers, the major loan categories are: Agriculture, Manufacturing, Import/Export Loans, Trade and Services, Building & Construction ant Transport loans.

According to the responses given by the employees, the bank strongly assesses requests of borrowers to check whether the customers fulfill the necessary requirements or not before issuing the loan amount. This is done by analyzing the documents provided and physically observing the borrowers' business premises. In addition, the customer loan request should pass through five stages namely, initiation, screening, processing, approval and disbursement.

As the staff member's opinion, the bank also has its own procedures that enable itself to follow up its borrowers after providing the loan. This has been accomplished through reminding customers in telephone, letters and physical observation and the like since installment payments overdue by one month.

As per the responses given on the questionnaire, when customers starts not to pay regularly, the bank has been using different methods depending on the condition of the borrower, structure of the loan and the nature of the problem. This is usually done through discussion with the customer, but extending the life of the loan, rearrangement/rescheduling of loan repayment structures and foreclosure are the most common methods to re-collection.

According to the perception of majority of staff members and borrowers, among various causes of NPLs from borrowers' side**,** diversion of the borrowed fund to other purpose, un-planned and ambitious business expansion, lack of adequate knowledge and experience on how to use the granted loan and unwillingness of borrowers to disclose truthful information by the borrowers are regarded by most of the respondents as relevant factors. On the other hand, interest rate on loans and contingencies on the part of borrowers like death, disability or insanity are considered as irrelevant factor to increase the size of NPLs in the bank.

As per the opinions of employees of the bank, among various causes of NPLs at the bank’s level, not taking timely action by the bank when borrowers start to default, competition among banks to attract borrowers and lack of strict follow- up and loan workout procedure are ranked first to third respectively. On the other hand, lending to affiliated parties of the bank such as share holders, board members, managers etc, violations of the existing credit policies of the bank by some employees and poor credit/risk assessment of the bank are regarded as irrelevant factors in Dashen bank to increase the size of loans.

According to the opinions of both employees and borrowers regarding other factors, unfavorable macro economic conditions, the overall economic performance of the country, absence of market study by debtors before they invest are some of the significant factors that retard customers to pay their debt as they cannot cope with the current situation in the market.

4.2 Conclusions

The main purpose of this study is to identify factors that might increase the size of non-performing loans (NPLs) in banks .After analyzing opinions of staff members of Dashen bank and its borrowers including the bank's annual reports, loan procedure manuals and various literatures , the student researcher forwards the following concluding remarks.

- Dashen bank S.C offers various credit facilities to its customers the major loan categories are: Agriculture, Manufacturing, Import/Export Loans, Trade and Services, Building & Construction ant Transport loans. Each loan category has its own requirements that customers should fulfill to be granted. Therefore the bank should strengthen its controlling mechanism in order to collect its money form varies loan categories on time

- The bank has its own procedures that enable itself to follow up its borrowers after providing the loan. Reminding of customers starts when installment payment overdue by one month, this should be appreciated, however, some borrowers failed to pay by their own reason. Thus, if the bank staffs strictly follow the bank's procedures after granting the loan, they can minimize the chance of loan loss or the size of NPLs in the bank.
- The bank has clear loan processing steps that every borrower should follow and abide by, from initiation to disbursement. If the employees disburse loans based on these procedures without distortion, there is no such big gap that makes borrowers failed to pay their debt and increase the size of loan.
- Among various factors that contribute to increase the size of NPLs in Dashen bank S.C, majority of the reasons comes from the borrower's problem, weakness and behavior.

- Diversion of the loaned fund to other purpose by borrowers is the first and major determinant factors that contribute to increase the size of NPLs in the bank. Most of the time, customers invest the borrowed fund in to another project by diverting the original purpose of the loan, for instance, they invest the business purpose loan to purchase automobile, house or any luxury goods. This condition shrinks their capacity to pay their debt including the interest of the loan with in agreeable time.

- Lack of adequate knowledge and experience on how to use the granted loan by the borrower is another significant factor that might increase the balance of NPLs in the bank. Most of the borrowers are uneducated and unwilling to higher professionals in running their business. Due to this problem, they lack the necessary skill on how to manage the borrowed funds and this might lead them in default.

- Lack of proper business plan and ambitious business expansion of borrowers is regarded as the third significant factor that affects the borrowers' capacity to settle its arrears. Due to this factor, the borrowers might miss opportunities of getting benefit in business that can build up its capacity to run their business competently. From this result one can infer that if borrowers expand their business without plan or ambitiously, they would face bankruptcy problem and cannot pay their debt at the time specified by the bank, this in turn make the balance of NPLs to grow up.

- In order to get maximum amount of loan, customers might provide falsified financial statements and other documents to the bank. This leads the bank to release large amount of money that might not be collected within agreeable time. In connection to this, most of the borrowers maintain two types of financial statements one is for tax purpose the other one is for bank credit; therefore it might not be a reliable document. Further, the financial statements provided by majority of borrowers are un-audited, because the law forces only financial statements of share companies to be audited. All these reasons force the bank to rely on the provisional financial statements provided by borrowers whether it is truthful or not. Consequently, unwillingness of the debtor to disclose truthful information might be one of the reasons to increase the size of non-performing loans in the bank.

- From various causes of NPLs at the bank's level, not taking timely action by the bank when borrowers start to default, competition among banks to attract borrowers and to some extent lack of strict follow- up and loan workout procedure are considered to be the relevant factors.

- Some factors are beyond the control of the borrowers as well as the bank. Unfavorable macro economic conditions that lead to large scale failures of enterprises of a country may create problem to banks. Since most enterprises are interconnected with banks as a borrower-lender relationship, failure of these enterprises in large scale would make them unable to repay their loans. Similarly, sudden changes in market conditions, interest rate, exchange rates and substantial variations in prices may cause problems of loan losses because; firms for whom the change in price is unfavorable will get difficulties to pay their debts resulting in large NPLs in the bank.

4.3 Recommendation

Based on the findings, the present study recommends the following points to minimize the balance of non-performing loans in the bank.

- In order to reduce the diversion of loan funds by borrowers, the bank should make its maximum effort to control the end use of the loan or pay loan proceed directly to the intended purpose. For amounts granted to working capital loans, the bank should assign its staffs to make regular business visit and follow-up the performance of the borrower continuously.
- Since most of the borrowers lack experience and knowledge regarding how to use the loan granted, the bank should provide sufficient credit awareness to the borrower and support them to some extent by giving advices.
- Even though there is lack of organized information about each sector of the economy in our country, the chance of loan loss would have been reduced if the bank has made market study about the viability of the investment project through hiring professionals before it releases huge amount of money. Alternatively, if the bank cannot do this, it should teach borrowers to do so before they invest large sum of money on different projects.
- Even if the bank cannot urge borrowers to provide audited financial statements, it should inform governments about its bad consequence and hence to enforce all formally established businesses to maintain accounting records like that of share companies.
- The bank should strengthen its existing loan follow- up and disbursement procedure in order to increase its credit-processing quality.

- In general, the bank should update its credit policies continuously according to the borrowers need and in line with market, political and economic conditions. In doing this, the bank should have competent and trained staffs to assess the possible credit risks. Therefore, the bank staffs working in loan section should get adequate and up to date training as a continuous basis.

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Dashen Bank Audit Financial Result from year 2004-2008

ANNEXES

Annex I: Questionnaire

St, Mary's University College
Faculty of Business Management Department

Dear respondents, I am a prospective graduate student in the department of management **s**t, Mary's university college degree program this year. I am conducting a research project in titled "**Factors that affect the size of non-performing loans (NPLs) in Dashen banks"** in partial fulfillment of BA degree in Management. The purpose of this paper is to identify various factors that increase the size of non-performing loans (NPLs) in banks. Therefore, your willingness and cooperation in giving reliable information is extremely important. The information you provide is strictly used for academic purpose and will be kept confidential .I would like to thank you in advance for sacrificing your valuable time. This questionnaire is to be completed by the employees of the bank who are currently engaged in loan processing activities, such as loan officers, loan clerks, branch managers, loan section heads, credit follow-up personnel etc.

Part I: **Personal Information**

The following questions are about your self; put a tick mark **(√)** on the box given.

1) Sex

   Male☐ Female ☐

2) In which age category are you?

   Below 25 ☐ 26 to 35 years ☐

   36 to 45 years☐ 46 and above ☐

3) Service year in the banking industry

   Less than 2 years☐ 3 to 5 years☐

   6 to 10 years☐ 10 years or more☐

4) Educational background

   Diploma☐ Degree☐ Masters and above ☐

5) Job position or title………………………………………………………….

Part II: Assessment of the Bank's Loan Procedures

1) Does the bank assess borrower's past financial history , credit worthiness and perform detail financial analysis before extending the loan?

- ☐ Yes, definitely
- ☐ Yes to some extent
- ☐ Not at all
- ☐ I am not quite aware of it

2) Is there any follow-up mechanism of your customer after granting a loan?

☐Yes ☐ No

3) If your answer for Q.No.2 is yes, please specify how often?

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4) When the borrower faces a certain problem and unable to pay the loan, what mechanism do you apply in order the loan to be collected?

- ☐ Extension of the life of the loan
- ☐ Injection of additional loans
- ☐ Rearrangement of loan repayment structure
- ☐ Any other--

5) What steps customers should follow in order to borrow money from the bank?

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6) To what extent the bank's loan processing steps contribute towards the customers' failure to pay?---

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Part III: Causes from Borrowers' side

The following items are considered to be factors that might increase the size of non-performing loans (NPLs) in Dashen banks from borrowers' side. Please put a tick **(√)** on the appropriate space about the relevancy of each factor contributes to make borrowers failed to pay their debt.

No.	Description of items	**Very Relevant**	**Relevant**	**Average**	**irrelevant**	**Very irrelevant**
1.	Lack of adequate knowledge and experience on how to use the loan amount					
2.	Diversion of the borrowed fund to other purpose					
3.	Failure of the investment project to generate enough cash to settle their debt					
4.	Un-planned and ambitious business expansion					
5.	Death, disability or insanity of borrowers					
6.	Unwillingness and carelessness of borrowers to pay their debt					
7.	Unwillingness of the debtor to disclose truthful information					
8.	High interest rate on loans					

Part IV: Causes from Creditor's (Bank) side

The following items are considered to be factors that might increase the size of non-performing loans (NPLs) in Dashen banks from creditor's (bank) side. Please put a tick **(√)** on the appropriate space about the relevancy of each factor contributes to make borrowers failed to pay their debt.

No.	Description of items	**Very Relevant**	**Relevant**	**Average**	**Irrelevant**	**Very irrelevant**
1.	Lack of strict follow- up and loan workout procedure					
2.	Not taking timely action by the bank when borrowers start to default					
3.	Management/owner intervention in loan processing and approval					
4.	Unreliable and overstated estimation of collateral					
5.	Competition among banks to attract borrowers					
.						
6.	Lending to affiliated parties of the bank such as share holders, board members, managers etc...					
7.	Violations of the existing credit policies of the bank by employees					
8.	Poor credit/risk assessment of the bank					

Part V: Other Factors

Please specify other factors that you think relevant, which are not listed on the above tables
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Thank you for taking your time to complete this questionnaire!

Annex II: Interview questions

1. What are the major causes that make borrowers being in default?
2. Do employees stick on the bank's credit policy while permitting loans to customers?
3. Are the employees, who engaged in loan processing and approving, competent enough to handle the work?
4. Does the bank have strict loan follow-up and workout procedure?
5. How much follow-up effort the bank has put to collect its money on the agreeable date?
6. What actions the bank has done when the borrower starts to being in default?
7. What do you think as a solution to reduce the balance of non-performing loans (NPLs) in the bank?