

Assessment of causes of Non-performing Loans in Commercial Bank

(The case of Lion International Bank S.C)



Thesis research report submitted for the partial Fulfillment of Master of Business Administration

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CERTIFICATE

This is to certify that the thesis titled “Assessment of the causes of Non-Performing Loans: The Case of Lion International bank SC”, submitted to Mekelle University, College of Business and Economics, School of Management, Department of Management, for the award of Masters of Business Administration and is a record of genuine research work carried out by Ataklti Mekonen , under my guidance and supervision. Therefore, I hereby declare that no part of this thesis has been submitted to any other university or institution for the award of any degree or diploma.

Advisor’s Name Mr.Adonay Habtu (Assistant Professor)

Signature _____ Date August 13, 2024

DECLARATION

I hereby declare that this thesis titled “Assessment of the causes of Non-Performing Loans: The Case of Lion International bank” has been carried out by me under the guidance and supervision of my Advisor Mr. Adonay Habtu (Assistant Professor). All sources of materials used for the thesis have been duly acknowledged. The thesis is original and has not been submitted for the award of any degree or diploma to any university or institutions.

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ABSTRACT

This study intends to assessment of nonperforming loans. The mixed research approach was adopted for the study. The survey was conducted with professionals engaged in Lion International Bank holding different positions and its borrowers using a self administered questionnaire. Accordingly the study explores the problem in an interpretative view using a descriptive approach adopted the survey study type of research in which a sample from the target population used for the study. In addition, based on non-probability sampling method, 120 respondents from the 20 branches sampling group/units who have direct relationship with credit in Lion International Bank S.C in Mekelle city. The study found that weak risk assessment and unsound lending practices, lack of focused loan monitoring and follow-up, and fund diversion as the major factors that contribute to loan default. The study suggest that Bank should put that proactive follow-up and monitoring system to monitor loan performance and check continued viability of operations, clear policy framework and working procedures that effectively address the issues of KYC, Develop and put in place framework for the entire credit management process and set objectives, standards and parameters to guide credit personnel in the overall credit processing, Provide training and development to employees involved in credit operations to enhance the aptitudes and abilities of every staff.

Key words:- *None-performing loans(NPL), know your customer(KYC),Lion International Bank(LIB)*

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ABBREVIATIONS

KYC- Know Your Customer

NBE- National Bank of Ethiopia

NPLs- Non-performing Loans

SBB- Supervision of Banking Business

S.C- Share Company

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CHAPTER I

1. INTRODUCTION

1.1 Background of the Study

Many financial institutions in developing countries provide financial services such as saving and credit to aid several smallholder enterprises as well as big industries. However, the sustainability and continuity of the financial institutions to increase the volume of credit to stimulate the poverty reduction goal depends on the repayment rates. High repayment rates help the institutions to process loans without fear and consequently increase volume of loans. Repayment performance thus serves as a positive signal for increasing the volume of credit availability to various sectors of the economy. Most of the loans default could arise from poor management procedures, loans diversion and unwillingness to repay the loans. According to Kithinji and Waweru(2007), banking problem is back-dated as early as 1986 culminating in major bank failure (37 failed banks as at 1998) they attribute these crises to non-performing loans which is due to the interest rate spread.

There are as many types of loans as there are business borrowers. However, many of the financial institutions like banks who are engaged in loan provision are failed due to the unexpected default or improper risk management. It is obvious when a bank grants a loan to its customers it must face the risk of non-repayment the granted loan from the customers, and this is due to various reasons, some borrowers may be incapable or unwilling to pay the loan at maturity. Commercial banks extend credit to different types of borrowers for many diverse purposes, either for personal, business or corporate clients (Saunders & Cornett, 2003)

According to (McNulty 2001), controlling non-performing loans (NPLs) is very important for both the performance of a particular bank and the economy's financial environment. Due to the nature of their business, commercial banks expose themselves to the risks of default from borrowers. Prudent credit risk assessment and creation of adequate provisions for bad and doubtful debts can cushion the banks risk. However, when the level of nonperforming loans is very high, the provisions are not adequate protected (Waweru and Kalani, 2009).

Therefore, non-performing loans are those in which borrowers are expressing some repayment problems. Historically, the occurrence of banking crises has often been associated with a massive accumulation of nonperforming loans which can account for a sizable share of total assets of insolvent banks and financial institutions. More recently, the apparent association between nonperforming loans and banking crises was further confirmed by the 1997 East Asian financial and banking crisis which left the four countries severely affected, with a more than threefold increase in their volume of nonperforming loans in the period leading up to the crisis. For instance, in Indonesia where over 60 banks collapsed during the crisis, nonperforming loans represented about 75% of total loan portfolios (Caprio and Klingebiel , 2002). The banking crisis which affected a large number of Sub-Saharan African countries in the 1990s was also accompanied by a rapid accumulation of nonperforming loans (Fofack, 2005).

1.2 Statement of the Problem

Commercial banks are part of financial institutions and they are very important in the economy to mobilize savings for productive investments and facilitating capital flows to various sectors in the economy (NCA, 2006), Commercial banks are the principal source of credit for millions of households as well as business firms (Rose,1997).The main source of income for banks is the interest gained from loans.

In Ethiopian context, commercial banks found in the country are required to maintain ratio of their non-Performing loans not more than 5% (NBE, 2008). Although banks loan collection ability in Ethiopia increase from time to time it is not satisfactory as required by national bank of Ethiopia. In similar context, (Wondimagegnehu, 2012) conducted a study on NPL of Ethiopian commercial banks. The findings of the study shows that poor credit assessment, weak loan monitoring, undeveloped credit culture, lenient credit terms and conditions, aggressive lending, compromised integrity, weak institutional capacity, unfair competition among banks, willful default by borrowers and their knowledge limitation, loan diversion for unintended purpose, over/under financing by banks ascribe to the causes of loan default.

Similar study indicated that poor credit analysis and unsound lending practices, lack of focused loan monitoring and follow up, lenient credit terms and conditions, compromised integrity, and fund diversion as the major factors that contribute to loan default (Gebru, 2015).

As far as NPLs problems left unsolved, it can greatly jeopardized the smooth functioning of banks through erosion of banks asset and reduction of income through accumulation of losses and increased provisions to compensate for these losses(Kunt and Detragiache,1998). In the worst scenario, a high level of NPLs in a banking system poses a systemic risk, inviting a panic run on deposits and sharply limiting financial intermediation, and subsequently investment and economic growth (Ahme, 2006).

Studies that conducted in connection with NPLs in private commercial banks in Ethiopia are very few. Especially, in Lion International Bank context specific empirical evidences are not yet available. Hence, this study addresses two issues that were not covered widely in the literature. The first issue is lack of literature about NPLs within the Lion International Bank context, up to the knowledge of the researcher this has not yet been well studied, so it is important to asses it at the same context as far as the researcher is concerned to asses NPLs at Lion International Bank S/C . The second issue is identification of causes for NPLs and also to propose ways through which NPLs in Lion International Bank can be minimized within specific context.

1.3 General Objective

The general objective of this paper is to assess the causes of non-performing loans in Lion International Bank S.C

1.4 Specific Objectives

- (i) To examine the non-performing loans in Lion International Bank S.C
- (ii) To identify factors that cause non-performing loans in Lion International Bank S.C
- (iii) To identify the ways through which non-performing loans in Lion International Bank can be minimized within specific context

1.5 Research Questions

- (i) What are the bank specific contributing factors for non-performing loans?
- (ii) What are the factors that can be causes for non-performing loans?
- (iii) What are the ways through which non-performing loans can be minimized?

1.6 The Scope and Limitation of the study

1.6.1 Scope of the study

The study covered Lion International Bank S.C which is one of the private commercial banks located in Mekelle city. This study helped in assessing the causes of NPLs for Lion International Bank in Mekelle city. This bank provides loans to almost economic sectors engaged in various business activities domestically as well as internationally. This bank has been working for long years and helped in providing academic insight for the study that conducted. This makes the NPL management of the bank in question, for this reason the researcher initiated to assess solutions for such questions like the inefficient lending performance, lending policy, lending procedure, screening criteria, determining the appropriate loan size, repayment capacity of the borrower. It is also necessitated the need for making an empirical investigation on the points behind the NPLs so that the bank can make an appropriate precaution in its lending decision as well as to revise its screening criteria to identify the credit worthy borrowers. Furthermore, to see the methodological scope the basic data was gathered by cross sectional method. In addition the study was mainly use data from 2016 up to 2020. Moreover, access to loan, income enhancement, willingness to repay the loan, banks credit procedure & practice manual were conceptual scope of the study. The study also was use qualitative and quantitative data type using primary and secondary sources of data.

1.6.2 Limitation of the study

The researcher conducted a study on Lion International Bank S.C, this research focused only on the branches located in Mekelle city, because of short period of time with in which the study to completed, distance and cost. Additionally, confidentiality of the information required by the study was another factor. Moreover, this research focused only on the 20 branches located in Mekelle city, so, the study may not be representative of the whole branches located in Mekelle city.

1.7 Significance of the Study

The study provided assistance as follows:

It provides empirical data for policy makers that help towards formulating appropriate policy

environment for the operations of private commercial banks. It provides recommendations on how to assess and recover the loans given to bank borrowers and the study helps to future researchers as literature review in the area of lending activities. Implementing the study effectively may be used to different bodies like: National, regional and other local government bodies can use to develop policy and programs to minimize the effect that comes related with NPLs. Similarly it can also use to governmental and nongovernmental organizations to design yearly and annual plan to minimize the problem. Similarly this research study also can use as initially to conduct similar different academic, social and economic researches of NPLs.

1.8 Organization of the Paper

This research paper is organized in to five chapters. The first Chapter made up of introduction part; background of the study, statement of the problem, objective of the study, scope, limitation and significance of the study. Chapter two dealt with review of related literatures. The third chapter focuses on methodology of the research. The fourth chapter deals with data presentation, analysis and interpretation. The last chapter of this research paper contains conclusions, and recommendations of the study. At the end the main references of the study and appendices are attached.

CHAPTER II

2. Literature Review

2.1 .The Role of Financial Institutions

Financial Institutions play very important role for an economic development of a country. As human being cannot live without blood, business organizations cannot perform their production without the active participation of financial intermediaries, who connect the one with excess money and the one who is in a need of money to perform its duties (Heffernan, 1996).

The banking sector makes a meaningful contribution to the economic growth of every country. Banks contribution to the growth lies in the role they play in mobilizing deposits and allocating the resources efficiently to the most productive uses investment in the real sector. So making credit available to borrowers is one means by which banks contribute to the growth of economies. Banks pool resources together for projects that are too large for individual shareholders to undertake (Bagehot, 1873). They are also considered the most important enabler of financial transactions in any country's economy and are the principal source of credit (Rose, 1997). Bank finance is the primary source of debt funding. Commercial banks extend credit to different types of borrowers for many diverse purposes, either for personal, business or corporate clients (Saunders & Cornett, 2003).

2.2. Principles of Bank management

In order to earn the highest possible profit, a bank has to manage its assets and liabilities. According to (Mishkin, 1998), the bank manager is expected to possess the following four primary concerns.

The first is to make sure that the bank has enough ready cash to pay its depositors when there are deposit outflows, that is, when deposits are lost because depositors make withdrawals and demand payment. To keep enough cash on hand the bank must engage in liquidity management, the acquisition of sufficient liquid asset to meet the bank's obligation to deposit.

Second, the bank manager must pursue an acceptable low level of risk by acquiring assets that

have a low rate of default and by diversifying asset holdings (asset management).

The third concern is to acquire funds at low cost (Liability management).

Finally, the manager must decide the amount of capital (Capital adequacy management). Likewise, (Mishkin,1998), explained that, too much leverage ratio indicates excessive indebtedness, (signaling the possibility that the firm will be unable to earn enough cash to satisfy the obligation on its bonds or loans.

To understand bank and other financial institution management fully, we must go beyond the general principles of bank asset and liability management. The two sections that has to be considered are how a financial institution manages credit risk, the risk arising because borrowers may default, and how it manages interest rate risk, the riskiness of earnings and return on bank assets that result from interest rate changes.(Mishkin, 1998)

2.3. Fundamental Credit Issues

Businesses usually take loan for different purposes. They may take for additional working capital. Regardless of the type of the loan, all credit requests mandate systematic analysis of the borrower's ability to repay. When evaluating loan request, bankers can make two types of errors in judgment. The first is extending credit to a customer who ultimately defaults. The second is denying a loan request to a customer who ultimately would repay the debt. In both cases the bank loses a customer and its profits are less. Many bankers focus on eliminating the first type of error, applying rigid credit evaluation criteria and rejecting applicants who do not fit the mold of the ideal borrower. A well-known axiom in banking is that the only time borrowers can get financing is when they really do not need the funds. The purpose of credit analysis is to identify the meaningful, probable circumstances under which the bank might lose. Lenders also use credit analysis to restructure a weak loan application in to a good loan when the borrower is strong but does not fully understand its true borrowing needs. According to (Timothy, 1994), the five fundamental credit issues that have to be assessed are presented below:

a. Character

The foremost issue in assessing credit risk is determining a borrower's commitment and ability to repay debts in accordance with the terms of a loan agreement. Commitment is typically evidenced by an individual's honesty, integrity, and work ethic. For a business, commitment is evidenced by the owners and senior management. Lenders often look for signals of a borrower's condition beyond basic balance sheet and income statement data (Timothy, 1994). On the other hand, Character refers to the borrower's reputation and the borrower's willingness to settle debt obligations. In evaluating character, the borrower's honesty, integrity and trustworthiness are assessed. The borrower's credit history and the commitment of the owners are also evaluated (Rose, 2000). A company's reputation, referring specifically to credit, is based on past performance. A borrower has built up a good reputation or credit record if past commitments were promptly met (observed behavior) and repaid timely (Rose, 2002; Koch & McDonald, 2003). Character is considered the most important and yet the most difficult to assess (Koch & MacDonald, 2003).

b. Use of Loan process

The range of business loan needs is unlimited. Firms may need cash for operating purposes to pay overdue suppliers, make tax payments, or pay employee salaries. Similarly, they may need funds to pay off maturing 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. Loan proceeds should be used for legitimate business operating purpose, including seasonal and permanent working capital need, the purchase of depreciable asset, physical plant expansion, acquisition of other firms and extraordinary operating expenses. Speculative asset purchases and debt substitution should be avoided. The true need and use determine the loan maturity, the anticipated source and timing of repayment, and the appropriate collateral (Timothy, 1994),

c. Loan Amount

In many cases, borrowers request a loan before they clearly understand how much external financing is actually needed and how much is available internally. The amount of credit required

depends on the use of the proceeds and the availability of internal source of funds. For example if a firm wants to finance new equipment, a loan request is typically for the purchase price less the resale value of any replaced asset. With term loans the amount can be determined via pro forma analysis. Borrowers often ask for too little when requesting a loan. The lender's job is to help determine the correct amount such that a borrower has enough cash to operate effectively but not too much to spend wastefully. The required loan amount is a function of the initial cash deficiency and the pattern of future cash flows (Timothy, 1994),

d. The Primary source and Timing of repayments

Loans are repaid from cash flows. The four basic source of cash flow are the liquidation of assets, cash flow from normal operations, new debt issues and new equity issues. Credit analysis evaluates the risk that a borrower's future cash flows will be sufficient to meet mandatory expenditures for continued operations and interest and principal payments on the loan. A comparison of projected cash flows with interest and principal payments on prospective loan indicates how much debt can be serviced and the appropriate maturity. Unless specifically identified in the loan agreement, it is inappropriate to rely on new equity from investors or new debt from other creditors for repayment. Too often these external sources of cash disappear if the firm's profitability declines or economic conditions deteriorate (Timothy, 1994),

e. Collateral

Banks can lower the risk of loss on a loan by requiring backup support beyond normal cash flow. This can take the form of assets held by the borrower or an explicit guarantee by a related firm or key individual. Collateral is the security a bank has in assets owned and pledged by the borrower against a debt in the event of default. Banks look to collateral as a secondary source of repayment when primary cash flows are insufficient to meet debt service requirements. Virtually, any asset or the general capacity to generate cash flow can be used as collateral (Timothy, 1994), Collateral (also called security) is the assets that the borrower pledges to the bank to mitigate the bank's risk in event of default (Sinkey, 2002). It is something valuable which is pledged to the bank by the borrower to support the borrower's intention to repay the money advanced. Security is taken to mitigate the bank's risk in the event of default and is considered a secondary source of repayment (Koch & MacDonald, 2003).

2.4. Purpose and Repayment Period of a Loan

The purpose of the loan, needless to say, is the factor that first and foremost defines the loan, and as a result, determines the way the bank analyze the application and underwrite the loan. Obviously, a loan to provide working capital will be looked at and structured differently from a loan to purchase a private vehicle, or a loan to build a factory, simply because the purposes are different and the source of repayment are different too.

For instance, in reference to the terms of repayment, a working capital loan should not be extended for more than the business cycle of the project as we expect the business to be able to generate sufficient money to repay the working capital with in a business cycle, or a business season. On the other hand, a loan to finance a long term project should be extended over a long period as we do not expect the project to be able to generate sufficient cash to repay the loan any time soon within the one business cycle. The main goal why we have different terms of repayment for different purposes is to ensure that the purpose, the source of repayment and the frequency of repayment perfectly match each other so that it is possible to end up with a good loan, being repaid in a timely manner, in compliance with the terms agreed up on. (HUNG, 2009). Failing to consider the purpose of the loan may lead the banker to end up with a loan inappropriately structured which could easily become a non performing loan. To avoid a non performing loan, it is vital that a lender attempts to structure the repayment terms to be around the business cash flow cycle.

2.5. Non-performing loan

According to (Tyler, 2010), Non performing loans are loans, especially mortgages that organizations lend to borrowers but do not capitalize on. In other words the borrower cannot pay the loan back in full, or even enough for the bank to make a profit. When this happens, the bank can either workout a new payment option, or foreclose on what collateral the borrower has provided. Either option costs the bank money, so lenders try to avoid nonperforming loans whenever possible.

For (Timothy, 1994), Loans are designed as nonperforming when they are placed on nonaccrual

status or when the terms are substantially altered in a restructuring. Nonaccrual means that banks deduct all interest on the loans that was recorded but not actually collected. Banks have traditionally stopped accruing interest when debt payments were more than 90 days past due. However, the interpretation of when loans qualified as past due varied widely. Many banks did not place loans on nonaccrual if they were brought under 90 days past due by the end of the reporting period. In response to foreign loan problems at large banks in 1993 and 1994, federal regulators formally tightened the accounting rules for nonperforming loans. July 1, 1984, loans were put on nonaccrual as soon as any repayment went beyond 90 days past due. Interest could not be recorded until the bank received an actual payment or the loan was made current.

2.6. Managing credit risk

(Mishkin, 1998) stated that Banks must make successful loans that are paid back in full in order to earn profits. The economic concept of adverse selection and Moral hazard provide a framework for understanding the principles that financial institutions have to follow to reduce credit risk and make successful loans.

It is essentially default risk analysis, in which the loan officer attempts to evaluate a borrower's ability and willingness to repay. There are three distinct areas of commercial risk analysis related to the following question

- * What risks are inherent in the operation of the business?
- * What have managers done or failed to do in mitigating these risks?
- * How can a lender structure and control its own risks in supplying funds?

Traditionally, key risk factors have been classified according to the five Cs of credit: character, capital, capacity, conditions, and collateral. Character refers to the borrower's honesty and trustworthiness. Capital refers to the borrower's wealth position, measured by financial soundness and market standing. Capacity involves both the borrower's legal standing and management's expertise in maintaining operations so the firm or individual can repay its debt obligations. Condition refers to the economic environment or industry specific supply, production, and distribution factors influencing a firm's operation. Repayment sources of cash

often vary with the business cycle or consumer demand. Finally, collateral is the lender's secondary source of repayment or security in the case of default. (Timothy, 1994)

On the other hand, Golden and Walter identify the five Cs of bad credit, representing things to guard against in order to help prevent problem. These include complacency, carelessness, communication breakdown, contingencies and competition. Complacency refers to the tendency to assume that because things were good in the past they will be good in the future. Carelessness involves poor underwriting, typically evidenced by inadequate loan documentation, a lack of current financial information or other pertinent information in the credit files, and a lack of protective covenants in the loan agreement. Each of these makes it difficult to monitor a borrower's progress and identify problem before they are unmanageable. Loan problems often arise when a bank's credit objectives and policies are not clearly communicated. Management should articulate and enforce loan policies, and loan officers should make management aware of specific problems with existing loans as soon as they appear. Contingency refers to lender's tendency to play down or ignore circumstances in which a loan might default. Finally competition involves following competitors' behavior rather than maintaining the bank's own credit standards. Just because the bank down the street is doing something does not mean it is good. As explained by (Lawrence et al 1996), Banks face many kinds of risk like any company with debt on its balance sheet; banks are riskier because of their leverage. As do other financial intermediaries, banks face credit risk and interest rate risk. But unlike other financial intermediaries, banks and other depository institutions face a unique risk associated with acting as dealer in foreign currencies and securities, we refer to this as trading risk.

Leverage risk means that debt is combined with equity to purchase asset. Credit risk arises because some bank borrowers may not be able to pay back their loans. Interest rate risk stems from a mismatch in the maturity of a bank's Asset and liabilities.

Banks are exposed to trading risk because they act as dealers in financial instruments such as bond foreign currency and derivatives. Banks and other depository institutions share Liquidity risk because transactions deposit and savings accounts can be withdrawn at any time.

A bank is essentially a dealer in money. It is a financial institution which accepts the demand and

time deposits from businesses, institutions and individuals and engages in both business and consumer lending. A Bank lending, however, differs from a money lender who also deals in money because, unlike the money lender who also deals in money which belongs to him, the money dealings of the bank are largely based on the money which it receives from others- its depositors and/ or creditors. The funds derived from different sources constitute the liability of the bank since the act of receiving of all these funds, except the paid up capital, the stock-in-trade of a bank consists of its paid up capital and reserves, creates a corresponding liability on the bank to repay the same on demand to those who own these funds (Vanish, 1989).

A credit market differs from standard market (for goods and services) in two important aspects. First standard markets, which are the focus of classical competitive theory, involve a number of agents who are buying and selling a homogeneous commodity. Second, in standard market, the delivery of commodity by a buyer occurs simultaneously. In contrast, credit received today by an individual or a firm in exchange for a promise of repayment in the future. But one person's promise is not as good as another. Promises are frequently broken and there may be no objective way to determine the likelihood that promise will be kept. (Jaffe and Stiglitz, 1990)

Some banks quantify individual's credit worthiness using a **credit scoring** system based on the economic and demographic characteristic and default frequencies of past borrowers. Single people default more often than married couples, so those who are married get points. (Gary - 1991)

2.7. Means of screening Credit worthy borrowers

Financial managers usually use different kinds of screening methods before granting loan to applicants. The commonly applied means of screening credit worthy borrowers is the 5 C's approach (the Character, Capacity, Capital, Collateral and Condition). According to (Lawrence, 1997), the 5 C's are explained as follows. Whether we are dealing with commercial loans or project loans, the basic credit analysis exercise still starts with a review in details of what we call the 5 C's, which are the most fundamental factors affecting a loan decision.

It is very clear that project lending is so much more risky than normal commercial lending. As a result, the assessment of the 5 C's is all the more critical.

- * **Character:** As Development Bank is dealing with a future project, uncertain performance, and no track records, it must pay much closer attention to the owner or promoter and make sure they have not only the qualification and experience needed to start the project, but also the ability to run it in a profitable manner in the long run. The bank also has to ascertain his /her creditworthiness to ensure that he/she will repay the loan as agreed.
- * **Capacity:** Since the bank do not have past financial statements to analyze in most cases; it has to rely even more on the projection. Thus there is a need to scrutinize the cash flow projection, along with the pro-forma income statement and the pro-forma balance sheet (Lawrence, 1997. Capacity refers to the business's ability to generate sufficient cash to repay the debt. An analysis of the applicant's businesses plan, management accounts and cash flow forecasts (demonstrating the need and ability to repay the commitments) will give a good indication of the capacity to repay (Sinkey, 2002; Koch & MacDonald, 2003).
- * **Capital:** Capital represents the amount of equity a company has that can be liquidated to repay the loan when all other means of recovery have been exhausted. Due to highly uncertain nature of project loan, capital contribution is an even more important consideration. The amount of the approved loan must be directly tied to the total cost of the project and the bank will make sure it finances only part of it, with the rest being the contribution from the promoter (Lawrence, 1997). Capital refers to the owner's level of investment in the business (Sinkey, 2002).
- * **Collateral-** In the real business world, things rarely happen as projected. More often than not, there will be fluctuations, deviation that are within expectation, with in margin of error, and somehow the borrower will manage to perform more or less as expected. There will also be a time when things get worse, and the borrower will not be able to perform as agreed. There will be non performing loans that need to be rehabilitated (through rescheduling, restructuring etc). Unfortunately, there will be situation when no rescheduling or restructuring would be enough to save the deal. That is when the bank would need to look at another means to save the banks interest: the collateral that the

bank has taken to secure the loan. Regardless of the probability of success of the venture, no bank should lend money without taking some kind of collateral for protection. In order the security to be acceptable by the bank, it should possess certain qualities, so that it can serve the purpose for which it is intended.

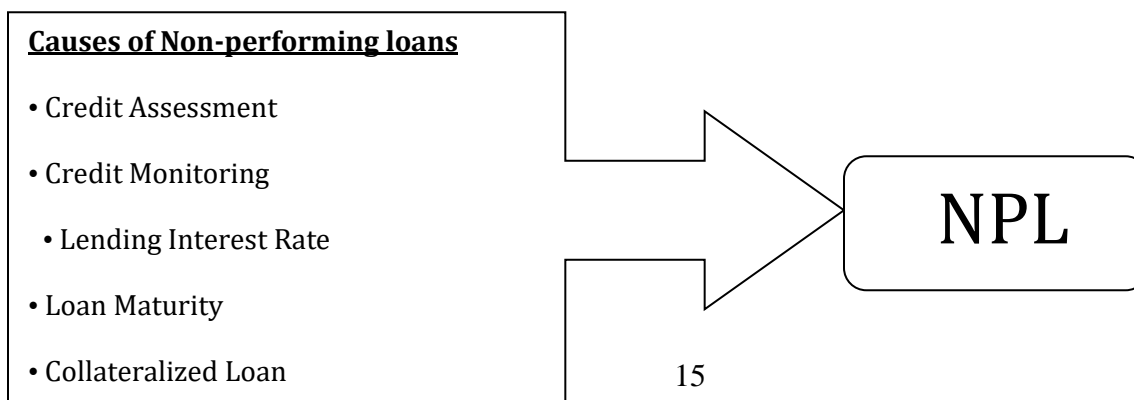
- * **Condition-** Conditions can be understood in the largest meaning, to cover all external factors that beyond the customer's control, but that may affect his ability to perform and repay the debt (Lawrence, 1997). Conditions are external circumstances that could affect the borrower's ability to repay the amount financed. Lenders consider the overall economic and industry trends, regulatory, legal and liability issues before a decision is made (Sinkey, 2002).

2.8. Causes of problem loans

As to (Timothy, 1994), Problem loans and loan losses are caused by a variety of factors, some controllable and some uncontrollable. Controllable factors are those that reflect over all bank credit policy as well as inadequate credit analysis, loan restructuring, loan documentation. Uncontrollable factors typically reflect adverse economic conditions, adverse change in regulations, environmental changes surrounding the borrower's operations, and catastrophic events. While there is little that can be done to prevent uncontrollable problems, effective credit granting procedures can be significantly reduce other sources of losses.

2.9. Conceptual Framework

The main objective of the study is to assess the causes of NPLs in Lion International Bank. Based on the objective of the study the following conceptual frame work is framed and the conceptual framework indicates the causes of non-performing loans.



CHAPTER III

3. RESEARCH METHODOLOGY

3.1. Research Methodology

3.1.1. Methodology

This section presents an overview of the methods that used in the study. The areas covered include research design, population, sample and sampling techniques, data collection and analysis.

3.1.2. Research Design and Strategy

The study assessed the causes of non-performing loans in Lion International Bank S.C which is a private commercial bank in Mekele city. Accordingly, the study explored the problem in an interpretative view using a descriptive approach adopted the survey study type of research in which a sample from the target population used for the study.

3.1.3. Target Group and sampling method

The target groups of this study were (861) the clients of Lion International Bank S.C and employees of this bank who directly involves in credit process. In addition, based on non-probability sampling method, 120 respondents from the 20 branches sampling group/units who have direct relationship with credit in Lion International Bank in Mekelle city by way of questionnaire and interview also included.

3.1.4. Data Type and Source

The aim of this study is to determine the major causes of nonperforming loans and to provide

guideline for solutions. The information for this study generated from primary and secondary sources. Primary data collected to strengthen the study. Additionally, the researcher uses the banks the past five years reports, clients' files, directives, previous research reports, annual reports of National Bank of Ethiopia used as a data source for the study.

3.1.5. Data Collection Instrument

3.1.5.1. Primary data

The primary data is sets of questionnaires and interviews. The first set of questionnaires distributed to clients and the second set of questionnaires and interviews distributed to employees of the Lion International Bank S.C in Mekelle city who involves in credit processing activities. The structured questions were both close-ended and open ended type and respondents are asked to mark the appropriate box matching the correct answer.

3.1.5.2. Secondary data

The methodologies used in collecting and organizing the secondary data(Lion International Bank annual reports, credit manuals and memos, national bank of Ethiopia credit directives and guidelines, books, journals, empirical studies, and websites). In addition to this, such data are published as well as done by national bank of Ethiopia authorized auditor; is used to check the validity and reliability of information gathered from secondary data.

3.2. Data Process and Analysis

3.2.1. Data Process

The information that was collected from data sources is organized and statistical computations

made to explore the inherent relationships among the different variables. First minor questionnaire error was edited at office as sample and the rest was finished at home. After effective data cleaning is processed by adding another supporter which is data encoder carefully data coding (preparing to enter the data to computer) using scales was finished. Following to this data entering was taken and by processing the result in the software was precede to data analyzing. The collected data was processed by computer software which is SPSS version 16.0.

3.2.2. Data Analysis

After the relevant data process in the software done, descriptive analysis was carried out which is preferable for assessment purpose. Hence for all collected data interpretations was taken place. In addition to qualitative description data's was analyze through different tables and others is used to understand easily for reads, problem solvers and other researchers behind. Simple descriptive statistical measures of frequencies and percentages are used to analyze the data.

3.3 Data Reliability and Validity

The researcher was created and keeps documentation with a description of the methods and procedures used in this case study research to ensure reliability and validity. The documentation, including for example questionnaire, personal notes, and interview transcripts were stored, saved electronically, and archived for a time period of at least three years. In addition, a back-up file of the whole documentation were created and stored in locked safe. Finally, the researcher was acknowledging with sincere thanks to all those people, who helped me and contributed to the successful completion of this case study research with their valuable time, opinion, and consideration.

3.4 Ethical Consideration

Ethical questions arise in all research involving human 'subjects' (Yin, 2014). In this case study research, the unit of analysis is the clients and employees in Lion International Bank. These

human subjects are interviewed and participated in a questionnaire. All participants are informed about the nature of the research and purpose of the case study and must formally agree to participate (Yin, 2014). Additionally, the interviewer informs the participants about both their roles and responsibilities. This includes for example all ethical assurances, the confidentiality of data and data protection, the storage and analysis of the collected data, the individual rights and risks, and finally the access of the participants to the transcripts, research data, and results (Hatch, 2002).

None of the participants discriminated against because of social class, gender, religion, race, or age. Individuals who participated in this case study research, was receive enough information to guarantee understanding as well as transparency during the research process (Hatch, 2002; Patton, 2002). The participants were encouraged to answer the open-ended questions freely and without bias, to express their opinions, beliefs, thoughts, and attitudes regarding the opportunities and challenges in the issue at hand. This also includes criticism or assumed contradictions (Hatch, 2002).

CHAPTER IV

4. SURVEY RESULTS AND DISCUSSIONS

In this chapter data results and discussions are presented.

4.1. General Information

A structured questionnaire (Appendix I) was distributed to one hundred twenty employees,(loan officers, managers) and borrowers of Lion International Bank.

The questionnaire was distributed in person to hundred twenty respondents. Out of 120 questionnaires 120 were completed and collected (see Table 1 below). As a result, the analysis is made on the valid number of responses. In some incidents analysis and explanation for amounts in the table are given only for most frequented and extreme figures.

Table4.1. Survey Response rate

Respondents	Size
Sample size	120
completed and returned questionnaire	120
Response rate	100%

Source: Survey outcome

4.2. Gender Distribution of Respondents

Out of the 120 respondents found to have male respondents, 84, representing 70% were male's whiles 36, representing 30% were females. The analysis of the questionnaire showed that male respondents of the bank are greater in number than the female members.

Table 4.2: Gender Distribution among Respondents

Gender	Frequency	Percent
Male	84	70

Female	36	30
Total	120	100

4.3. Educational status of Respondents

Out of the 80 questionnaires received from borrowers, only 4 persons representing 5% had attained high school education. Majority of the borrowers were elementary school, having as high as 95%. It was realized from the study that most of the borrowers have not attained high levels of education.

The tables below show the educational status of borrowers respectively.

Table 4.3: Level of Education of Respondents

Level	Frequency	Percent
Illiterate	0	0
Elementary	76	95
Junior	0	0
High School	4	5
Higher Education	0	0
Total	80	100

4.4. Experiences in Business

In terms of business experience, the absolute majority (about 45 percent) of the respondents reported to have served the business for around 10 years, of which close to 30 percent were

long-serving borrowers, having over 10 years of work experience in the business. On the other hand, about 25 percent of the respondents had five to seven years of business. This implies that most of the respondents have well experience in business.

Table 4.4 Respondents Experience in Business

Experiences in Business (in years)	Frequency	Percent
1-4	0	0
5-7	20	25
8-10	36	45
Above 11	24	30
Total	80	100

4.5. Access to loan and its practice in providing loans

The following table and discussion is about getting access to loan from the bank and the practice of the bank in providing loan to its customers.

According to table 4.5, most of the respondents (59 or 74%) agreed that getting loan service from the bank is easy for every business. Some of the respondents (21 or 26%) are neutral in getting loan service from banks is easy for every business. The result indicted that most of the respondents have not difficulty in getting loan from the bank.

As per table 4.5, all of the respondents are agreed that visiting business sites is undertaken during loan requests and before loan approval. Interview result indicated that the bank has visiting

business sites program during loan requests and before loan approval.

The same table indicated that, most of the respondents (53 or 66%) agreed on the application requirements and procedures are convenient and simple. On the other hand, some respondent (27 or 34%) are not agreed on the application requirements and procedures are convenient and simple. From the result of the study, it is safe to say that most of the respondents are considered the application requirements and procedures are convenient and simple.

As per table 4.5, most of the respondents (47 or 59%) agreed on the loan processing time duration is very short. On the other hand, some of the respondents (33 or 41%) disagreed on the loan processing time duration is very short. The result of the study showed that most of the respondents should not have problem of time on the loan processing duration period.

According to the same table, most of the respondents (42 or 52%) agreed that being long time customer of a bank have advantage to get a loan. Some of the respondents (30 or 36%) neutral about being long time customer of a bank have advantage to get a loan. This implies that most of the respondents indicated that being prominent customers of the bank have advantages to get a loan.

As per the same table, most of the respondents (69 or 86%) disagreed that collateral or security is not mandatory to grant a loan. The result indicted that most of the respondents said that collateral or security is mandatory to grant a loan.

In addition, most of the respondents (68 or 85%) disagreed that the type of business that you engage does not matter to get a loan from the bank. This implies that most of the respondents believe that the type of business that you engage have advantages to get a loan from the bank.

By the same token, most of the respondents (78 or 96%) disagreed that duration time of the loan does not affect the repayment of the granted loan. This means that most of the respondents considered that the duration time of the loan granted does affect the repayment of the loan.

Moreover, most of the respondents (74 or 93%) disagreed that the interest rate charged by the bank does not affect the loan repayment. This indicated that most of the respondents considered that the interest rate charged by the bank have not affect the loan repayment.

Table 4.5 Access to loan and its practice in providing loans

Statements	Strongly disagree(1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly agree(5)
4.1 Getting loan service from banks is easy for every business	0	0	21	36	23
4.2 Visiting business sites is undertaken during loan requests and before loan approval	0	0	0	60	20
4.3 The application requirements and procedures are convenient and simple	0	27	0	43	10
4.4 The loan processing time duration is very short	0	33	0	39	8
4.5 Being long time customer of a bank have advantage to get a loan	0	8	30	35	7

4.6	Collateral or security is not mandatory to grant a loan	48	21	11	0	0
4.7	The type of business that you engage does not matter to get a loan from a bank	23	45	12	0	0
4.8	Duration time of the loan does not affect the repayment of the granted loan	50	28	2	0	0
4.9	The interest rate charged by the bank does not affect the loan repayment	53	21	6	0	0

5. Income enhancement and willingness to repay the debt

The following table and discussion is about income enhancement and willingness to repay the debt after granted the loan.

From the below table result most respondents (60 or 75%) agree that their monthly income enhanced after granting the loan. Some of the respondents are neutral (20 or 25%) on whether their monthly income enhanced after granting the loan. The result showed that most of the respondent's monthly income increased after granting the loan.

Similar with the result of the study, Lawrence (1995) examines the theoretical literature of life-cycle consumption model and introduces explicitly the probability of default. This model

implies that borrowers with low incomes have higher rates of default due to increased risk of facing unemployment and being unable to settle their obligation. Moreover, Rinaldi and Sanchis-Arellano (2006) extend Lawrence's model by assuming that agents borrow in order to invest in real or financial assets. They argue that the probability of default depends on current income and the unemployment rate, which is linked to the uncertainty regarding future income and the lending rates.

In addition, most respondents (35 or 44%) are agreed that charging high interest rate by the bank affects their loan repayment. On the other hand, some respondents (28 or 35%) are disagreed that charging high interest rate by the bank affects their loan repayment. This implies that most of the respondents indicated that high interest rate by the bank affects their loan repayment. Previous studies indicated about the similar result for example according to Nkusu (2011) investigating the macroeconomic assessment of loan defaults through panel regressions and panel vector autoregressive models. The author suggests that high in interest rates result in deterioration of borrower's repayment capacity and hence, cause of increase in NPLs. In addition, Berge and Boye (2007) find that problem loans are highly sensitive to the real interest rates and unemployment for the Nordic banking system over the period 1993–2005. Furthermore, Rajiv and Dhal (2003) utilized panel regression analysis to report that favorable macroeconomic conditions and financial factors such as maturity, cost and terms of credit, banks size, and credit orientation impact significantly on the NPLs of commercial banks in India.

As (Collins and Wanjua, (2011), observe, high interest rates makes it hard for the borrowers to services their loans, which means that an increase in the levels of NPLs is the result. For instance, the increase of high interest rates in Kenya before the 2007 and 2013 elections have

been suggested to having been the cause of the rise in bad loans at this period as the borrowers became hard-pressed to service the loans (Onsarigo, et al., 2013).

Besides, most respondents (48 or 60%) disagreed that the revenue from the existing business transaction is enough to cover the loan repayment. On the other hand, some respondents (29 or 36%) are agreed that the revenue from the existing business transaction is enough to cover the loan repayment. From the result of the study, we came to understand that most of the respondents replied that the revenue generated from the existing business transaction is not enough to cover the loan repayment. But, significant number of respondents said that the revenue from the existing business transaction is enough to cover the loan repayment.

Furthermore, most the respondents (43 or 54%) disagreed that irregularity of loan repayment on time does not affect the relationship with a bank. On the other hand, some respondents (21 or 26%) agreed that irregularity of loan repayment on time does not affect the relationship with a bank. This indicated that most of the respondents believe that the irregularity of loan repayment on time does affect the relationship with a bank.

According to table 5, most respondent (56 or 70%) disagreed that diversion of the borrowed loan will lead to default loan. On the other hand, some respondent (16 or 20%) agreed that diversion of the borrowed loan will lead to default loan. From the result of the study, it is safe to say that diversion of the borrowed loan will not lead to default loan.

In addition, most respondents (45 or 56%) disagreed that loan granted from the bank with lack of adequate knowledge in the business will lead to default loan. On the other hand, some respondents (18 or 23%) agreed that loan granted from a bank with lack of adequate knowledge

in the business will lead to default loan. This implies that most of the respondents indicated that the loan granted from the bank with lack of adequate knowledge in the business may not lead to default loan.

Moreover, most respondents (36 or 45%) disagreed that being extravagant for consumption expenditure will affect the loan repayment on time. On the other hand, some respondents (22 or 28%) agreed that being extravagant for consumption expenditure will affect the loan repayment on time. Based on the most respondents opinion, being extravagant for consumption expenditure does not affect the loan repayment on time.

Table 5 Income enhancement and willingness to repay the debt

Statements		Strongly disagree(1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly agree(5)
5.1	Your monthly income enhanced after granting the loan	0	0	20	50	10
5.2	Charging high interest rate by the bank affects your loan repayment	0	28	17	30	5
5.3	The revenue from the existing business transaction is enough to cover the loan repayment	17	31	3	29	0
5.4	Irregularity of loan repayment on time does not	35	8	16	21	0

	affect the relationship with a bank					
5.5	Diversion of the borrowed loan will lead to default loan	32	24	8	16	0
5.6	Loan granted from a bank with lack of adequate knowledge in the business will lead to default loan	0	45	17	18	0
5.7	Being extravagant for consumption expenditure will affect the loan repayment on time	0	36	22	22	0

6. Banks credit procedure and practice manual

The following table and discussion is about banks credit procedure and practice manual in connection with non-performing loans.

When we see to the response on banks credit procedure and practice, most of the respondents (32 or 80%) agreed that non-compliance with credit policies and procedures will cause non-performing loans. This implies that most of the respondents’ believe non-compliance with credit policies and procedures will cause non-performing loans. Interview results also support that non-compliance with credit policies and procedures will cause non-performing loans.

The number of banks that lose their money because they lack an effecting mechanism of monitoring their borrowers is unprecedented (Warue, 2013). Lack of proper monitoring of how the funds acquired through loans has led to situations where such funds are not utilized well or they are invested in high-speculative ventures having little ability for generating funds in good time making borrowers incapable of servicing the loans (Karim, et al., 2013). In these situations, the loans become bad debt, which affect the issuing bank. Emerging from this trend therefore is the need to ensure that the loans are utilized promisingly through a close and effective monitoring of borrowers (Farhan, et al. 2012). In fact, some studies suggest that ineffective monitoring mechanism for borrowers has a positive association with the accumulation of NPLs (Babouček and Jančar, 2005). Banks have implemented the monitoring of loan utilization by borrowers not only to see to it that the funds are put to proper use, but also to ensure that they are ready to deal effectively with any issue arising. In monitoring the loans, the banks have utilized contents of loan files to screen loans (Richard, 2011). Through an effective monitoring mechanism, banks are able to identify delinquent borrowers and effectively determine how to deal with these groups of borrowers (Onyia and Oleka, 2000). Banks have also implemented regular ways of monitoring the quality of loans and implemented early warning systems that enable alert and enable bank managers to avoid potential stress (Babouček and Jančar, 2005). Consequently, banks have realized the need to accord their borrowers proper attention so that loan performance can be ensured. This facilitates repayment, as borrowers are more likely to pay since they consider themselves as obtaining proper attention from the bank (Richard, 2012). The need for continued for monitoring of the borrowers is to accord banks means to assess whether the reasons for advancing the loans still hold and to confirm that the money is being used for the intended purpose (Fatemi and Fooladi, 2006). Furthermore, close monitoring of the borrower

gives the bank an opportunity to assess the borrower's character, to evaluate the borrower's ability to pay the loan, the value of the collateral against the prevailing market conditions (Farhan, et al. 2013).

In addition, most respondents (15 or 38%) agreed that inadequate financing will be the cause to loan diversion. On the other hand, almost similar respondents disagreed that inadequate financing will be the cause to loan diversion. Based on the result of the study, most of the respondents considered inadequate financing will be the cause to loan diversion. But, significant number of respondents still considered inadequate financing will not be the cause to loan diversion.

Moreover, most respondents (29 or 73%) agreed that know your customer policy of the bank will help to minimize the loan defaulters. Some respondents (11 or 28%) also neutral that know your customer policy of the bank will help to minimize the loan defaulters. From the result of the study, we came to understand that most of the respondents believe that KYC policy of the bank helps to minimize the loan defaulters.

Furthermore, most of the respondents (31 or 78%) agreed that good credit monitoring policy of a bank will minimize bad loans. The result showed that most of the respondents considered good credit monitoring policy of the bank minimize bad loans

Table 5, further shows that, (29 or 73%) most respondents agreed that non-performing loans of the bank associated with weak risk assessment. This implies that most of the respondents explained that the non-performing loans of the bank associated with weak risk assessment. Interview result similarly indicated that non-performing loans of the bank associated with

weak risk assessment

In this regard, (Garcia-Marco and Robles-Fernandez, 2007) investigate the relationship between risk taking and ownership structure. They document that commercial banks (mainly private owned) are more exposed to risk than deposit banks (mainly state owned). More recently (Hu et al 2006) analyzed the relationship between NPLs and ownership structure of commercial banks in Taiwan with a panel dataset covering the period 1996-1999. The study shows that banks with higher government ownership recorded lower NPLs.

Loan officials are at the center of determining the credit worthiness of potential borrowers and extend loans to borrowers. Therefore, as part of the risk management strategy, different banks have employed different strategies to ensure that the loan officials have sufficient knowledge of managing the associated risks (Brownbridge, 2007). Several banks are providing their loan officials secondary training to ensure that they are well acquainted with the risks that are associated with loans especially the NPLs (Richard, 2013). Beck, et al., (2013), observe that banks have used such risk assessment criteria as specific limits and ratios to better deal with the risks posed by non-performing loans.

In addition, (20 or 50%) most respondents agreed that non-performing loan occurs due to the borrower's knowledge gap on credit terms of the bank. On the other hand, (13 or 33%) respondents disagreed that non-performing loan occurs due to the borrower's knowledge gap on credit terms of the bank. The result indicated that most respondents believe that non-performing loan occurs due to the borrower's knowledge gap on credit terms of the bank.

Moreover, (29 or 73%) most respondents disagreed that loans granted with insufficient collateral

leads to default loans. From the result of the study, it is safe to say that a loan granted with insufficient collateral does not lead to default loans.

Besides, (30 or 75%) most respondents disagreed that loans with full coverage of collaterals will perform well. This indicated that most of the respondents' believe that a collateralized loan does not perform well.

Similarly, most respondents disagreed that most of the time clean base loans are faced to be defaulted loans. This implies that most of the respondents considered loans collateral free is not faced to be defaulted loans.

In addition, (31 or 78%) most respondents disagreed that loans with big interest rate lead to non-performing loans. From the result of the study, we can say that most of the respondents believe a loan with big interest rate does not lead to non-performing loans. Interview results support that high interest rate does not lead to non-performing loans.

Furthermore, (26 or 65%) most respondents agreed that if the bank gives a loan to various business sectors the risk of default loans will be minimized. The result indicated that most of the respondents considered if the bank gives a loan to various business sectors the risk of default loans will be minimize. The remaining respondents (14 or 35%) neutral that if the bank gives a loan to various business sectors the risk of default loans will be minimize.

On the other hand, Salas and Saurina (2002) find that a negative relation between bank size and NPLs and argue that bigger size allows for more diversification opportunities. Hu et al. (2004) and Rajan and Dhal (2003) reported similar empirical evidence. Another strand of literature has focused on the degree of loan concentration in various sectors, and proposes that vulnerabilities

within sectors of high loan concentration tend to exacerbate the non performing ratio (Herring and Wachter, 1999 as cited in Guy, 2011). However, (Stiroh, 2004) does not find evidence of benefits from diversification in the form of reduced risk, for the US banking system, since non-interest income growth was highly correlated with net interest income during the 1990s.

Table 6 Banks credit procedure and practice manual

Statements		Strongly disagree(1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly agree(5)
6.1	Non-compliance with credit policies and procedures will cause non-performing loans	0	5	3	30	2
6.2	Inadequate financing will be the cause to loan diversion	6	8	11	15	0
6.3	Know your customer policy of the bank will help to minimize the loan defaulters	0	0	11	26	3
6.4	Good credit monitoring policy of a bank will minimize bad loans	0	6	3	29	2
6.5	Non-performing loans of a bank associated with weak risk assessment	0	3	8	27	2
6.6	Non-performing loan occurs	0	13	7	18	2

	due to the borrowers knowledge gap on credit terms of the bank					
6.7	Loans granted with insufficient collateral leads to default loans	5	24	6	5	0
6.8	Loans with full coverage of collaterals will perform well	11	19	7	3	0
6.9	Most of the time clean base loans are faced to be defaulted loans	12	16	9	3	0
6.10	Loans with big interest rate lead to non-performing loans	15	16	4	5	0
6.11	If the bank gives a loan to various business sectors the risk of default loans will be minimize	0	0	14	20	6

CHAPTER V

5. CONCLUSIONS AND RECOMMENDATIONS

Conclusions

When a bank disburses a loan, the loan may not be collected because of many factors and those uncollected loans are said to be NPLs or bad loans. Commercial banks in Ethiopia render different kinds of services; among which provision of credit is the major one as bank lending is the core function. It is commonly said that the successful banker is the successful lender

NPLs are serious problem that need to be accorded careful attention. A loan is identified and segregated as non-performing depending on the number of days a repayment is delayed or discontinued. According to National Bank of Ethiopia's Directive No SBB/43/2008 Asset Classification and Provisioning Directive, Non-performing means loans or advances whose credit quality has deteriorated such that full collection of principal and/or interest in accordance with contractual repayment terms of the loans or advances is due and uncollected for 90 (ninety) consecutive days or more beyond the scheduled payment date or maturity. The basic objective of this research has been to identify the causes of non-performing loans. On the basis of the broad objective one major research questions and three sub research questions were developed and dealt with. For the achievement of the objective the study used survey of employees of Lion International bank SC its borrowers.

The study indicated that poor credit analysis on the part of lending bank unsound lending practices, failure in loan monitoring and follow-up, knowledge gap in business by borrowers, fund diversion, and the like are the major causes behind NPLs.

Recommendations

Lion International bank SC (lending bank) should be aware of the dangers involved in maintaining bad loans in their books of accounts and make advance preparations as to how disbursed loans should be collected timely. Collection plans are not to be initiated after approval or disbursement. It has frequently been said that a good banker collects a loan at the time of its disbursement; meaning a loan properly analyzed and scheduled at the outset is virtually self servicing.

Administration of loans involves the entire process starting from credit application to final resolution. Therefore, lending bank need to develop and put in place prudent credit processing, encompassing appropriate exercise of KYC for proper customer selection and assessment of credit worthiness of borrowers.

Lion International bank SC in order to be quality bank should:

- * Put in place proactive follow-up and monitoring system to monitor loan performance and check continued viability of operations.
- * Put in place a clear policy framework and working procedures that effectively address the issues of KYC.
- * Develop and put in place framework for the entire credit management process and set objectives, standards and parameters to guide credit personnel in the overall credit processing.
- * Provide training and development to employees involved in credit operations to enhance the aptitudes and abilities of every member.

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Appendix 1

Questionnaire Sheet

Mekelle University College of Business & Economics

Department of management

Dear respondents

Thank you very much for your willingness to take time to respond these research questions. This study is being conducted by a postgraduate at Mekelle University College of Business & Economics Department of management Extension MBA Program.

It is all about questions pertaining to assessment of causes of non-performing loans and related practices in Lion International Bank S.C . Eventually, it intends to gather information from borrowers of the bank and employees of the bank who involved in credit and related activities.

The participants are fully on voluntary basis, your openness and your accurate and frank responses are vital for the successful accomplishment of the study.

Please be assured that your responses will be treated in a strictly confidential manner, and the results will be used only for the purpose of this research presented only for Lion International Bank S.C

Finally, I assured you that all personal information obtained from you will be kept confidential.

Thank You In advance;

Respectfully

Instruction

Tick this mark () on the box provided

1. Personal detail of the respondents

Gender Sex: Male Female

2. Educational level: Illiterate: Elementary:

Junior:

High School: Higher Education:

3. How many years do you stay on this particular business?

1-4 years 5-7years 8-10years above 11years

Section 1: Questionnaire for borrowers

4. What is your opinion on the following statements towards getting access to loan from the bank and the practice of the bank in providing loans to its customers?

Statements		Strongly disagree(1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly agree(5)
4.1	Getting loan service from banks is easy for every business					
4.2	Visiting business sites is undertaken during loan requests and before loan approval					
4.3	The application requirements and procedures are convenient and simple					
4.4	The loan processing time duration is very short					
4.5	Being long time customer of a bank have advantage to get a loan					
4.6	Collateral or security is not mandatory to grant a loan					
4.7	The type of business that you engage does not matter to get a loan from a bank					
4.8	Duration time of the loan does not affect the repayment of the granted loan					

4.9	The interest rate charged by the bank does not affect the loan repayment					
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5. What is your opinion on the following statements regarding to your income enhancement and your willingness to repay the debt after granted the loan

Statements	Strongly disagree(1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly agree(5)
5.1 Your monthly income enhanced after granting the loan					
5.2 Charging high interest rate by the bank affects your loan repayment					
5.3 The revenue from the existing business transaction is enough to cover the loan repayment					
5.4 Irregularity of loan repayment on time does not affect the relationship with a bank					
5.5 Diversion of the borrowed loan will lead to default loan					

5.6	Loan granted from a bank with lack of adequate knowledge in the business will lead to default loan					
5.7	Being extravagant for consumption expenditure will affect the loan repayment on time					

Section 2: Questionnaire for employees of the bank

6. What is your opinion on the following statements regarding to your bank credit procedure and practice manual in connection with non-performing loans?

Statements	Strongly disagree(1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly agree(5)
6.1 Non-compliance with credit policies and procedures will cause non-performing loans					
6.2 Inadequate financing will be the cause to loan diversion					
6.3 Know your customer policy of					

	the bank will help to minimize the loan defaulters					
6.4	Good credit monitoring policy of a bank will minimize bad loans					
6.5	Non-performing loans of a bank associated with weak risk assessment					
6.6	Non-performing loan occurs due to the borrowers knowledge gap on credit terms of the bank					
6.7	Loans granted with insufficient collateral leads to default loans					
6.8	Loans with full coverage of collaterals will perform well					
6.9	Most of the time clean base loans are faced to be defaulted loans					
6.10	Loans with big interest rate lead to non-performing loans					
6.11	If the bank gives a loan to					

	various business sectors the risk of default loans will be minimize					
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Interview Questions for Employees of the bank involving in credit activities

- 1. What are the factors that cause high non-performing loans?
- 2. Do you think that customer of the bank repay the loan on time?
- 3. Does the bank have a supervision program?
- 4. Does the supervision of clients support the bank to minimize the risk of default?
- 5. How the incidence of non-performing loans can be minimized?

Appendix 2. Surveyed branches of Lion international bank s.c

S/no.	Branch name	No. of borrowers	Loan outstanding balance as of 10/08/2024
1	Adiha	26	122,914,115.67
2	Adihaki	31	720,364,052.70
3	Adihawsi	34	131,156,114.83
4	Adisalem	18	88,634,866.90
5	Adishumdhun	49	111,229,023.33
6	Alula abanega	81	1,043,508,912.57
7	Ambasera	13	50,027,723.20
8	Ayder	14	31,373,348.35
9	Edagakedam	22	103,330,898.32
10	Elala	41	307,308,395.03
11	Hadnet	27	97,623,586.98

12	Hawelti	12	81,865,956.68
13	Jibruk	106	781,958,678.44
14	Lachi	25	41,821,709.48
15	Mekelle	117	1,980,685,988.78
16	Mekelle Market	142	945,103,529.89
17	Momena	25	111,170,187.13
18	Quiha	36	42,060,120.88
19	Romant	30	147,635,995.19
20	Semaetat	12	513,080,891.61
	Total	861	7,452,854,095.96

Source: monthly report of the branches

NPL status by days and the percentage provision

Pass	less than 30 days	1%
Special mention	less than 90 days	3%
Substandard	G 90 L 180 days	20%
Doubtful	G 180 L 365 days	50%
Loss	G 365 days	100%

