



WOLKITE UNIVERSITY

ASSESSMENT OF NON-PERFORMING LOAN EVIDENCE FROM COMMERCIAL BANK OF ETHIOPIA NEFAS SILK DISTRICT

**A SENIOR EASSY SUBMITTED FOR THE PARTIAL FULFILLMENT OF
AWARD OF BACHEOR OF ARTS DEGREE IN ACCOUNTING AND
FINANCE**

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DECLARATION

I hereby declare that the research entitled “Assessment of non-performing loan evidence from commercial bank of Ethiopia nefas silk district” submitted for Award of Bachelor of Art Degree in Accounting and Finance Wolkite University is my original work and it hasn’t been presented for the award of any other Degree, fellowship or other similar titles of any other university or institution.

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ABSTRACT

Loan becomes nonperforming when it cannot be recovered within certain stipulated time that is governed by some respective principle of loan. The objective of this study is to assess the non-performing loans of commercial bank of Ethiopia, Nifasilk district. The researcher used mixed approach which means, both qualitative and quantitative research approach to gather relevant data from the concerned body and also the researcher applied descriptive method of the research design because the method used to describe the state of the nature of NPLs in detail. A primary method of data collection is applied. The primary data is collected through questionnaire from the customers and employees of the bank and interview to the loan manager of the bank. The researcher used both convenience sampling technique and calculations used in statics to accumulate a desire data about the non-performing loans of the bank. The collected data were systematically organized and analyzed using tabular representations and descriptive analysis methods to provide a detailed examination of key issues. The study's findings revealed several critical challenges: ineffective asset management, uncontrolled business expansion and diversification, and excessive financing to borrowers. Based on these results, the study recommends that the bank establish clear credit assessment policies and procedures while providing comprehensive guidance to new applicants on asset management practices and overall banking regulations.

Key Words: Non performing loan, commercial bank

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ACRONYMS

NPLs: - non-performing loans

MFG: - Manufacturing Product Loans

DTS: - Domestic Trade and Service Loans

CBE: - Commercial Bank of Ethiopia

BC: - Building and Construction Loan

TR/TL: - Transport Sector Loan

LUR: - Loan Under Reactivation

LIL: - Loans in Litigation

CHAPTER ONE

1. Introduction

1.1. Background of the study

Non-performing loan has a great impact on the country's economic growth which results from the failure customer to meet the initial contract. Many loans became non-performing after being in default for 90 days. But this can depend on the contract terms. Non-performing loan is a loan that is in default or close to being in default. In banking terminology, loans and advances signify bank funds deployed to borrowers at specified rates of interest for specified length of time for which the funds are deployed may not be specified in the main contract. The contract entered in to between the lender and the borrower is called an open credit contract and does not specify time limit (Roman & Holger, 2006).

A bank loan is a form of credit that is often extended for a specified period of time, usually on fixed-interest terms related to the base interest rate, with the principal being repaid either on a regular installment basis or in full on the appointed recovery date. The primary function of a bank is mobilizing deposits from surplus units to deficit units in the form of loan and advances to various sectors such as agricultural, industry, personal and governments. However, in recent times, the banks have become very cautious in extending loans due to non-performing assets (Sontakke & Tiwari, 2013).

Bank problems, mostly failures and financial distress affect numerous banks, which results closed down by the regulatory authorities (Brown, 1998). This in turn led to contraction of activities, decline in output and the imposition of substantial costs on the economy (Chijoriga, et.al 1997). Studies in other countries show that most of the bank failures have been caused by non-performing loans (NPLs) (Brown, 1998). National economic downturn, insider lending, political connection of bank owners, customer's failure to disclose vital information during the loan application process, lack of proper skills amongst loan officials were among major factors identified in other countries to cause non-performing loans (Waweru & Kalani, 2009).

“Non-Performing Loans (NPLs)” shall mean bad debts as defined by NBE for development financial institutions as per in the Directives No SBB/52/2012 of January 19, 2012.

Banks need to manage the level of non-performing loans in their loan portfolios to maintain the quality of their assets and improve their efficiency. Good management of non-performing loans is essential for ensuring sustainable and responsible lending practices.

Because of controllable or bank specific factors which are controlled by firm level and uncontrollable factors are external factors or macroeconomic factors which are difficult to control at firm level, it is unlikely to have 100% of collection of loan. (Tirsit, 2017)

Despite the insights gained from previous studies and experiences, the Development Bank of Ethiopia continues to struggle with an increasing rate of non-performing loans. The proportion of non-performing loans relative to the total outstanding loans has been steadily rising. Consequently, it is both important and necessary to investigate the underlying causes of these non-performing loans within the Development Bank of Ethiopia.

1.2 Statement of the Problem

Ethiopia needs a well-functioning and dynamic financial sector to attain sustainable development and growth. The country must also establish an effective institutional and environmental framework to promote and facilitate the inflow of resources

One of the principal economic functions of banks is to provide loans that fund consumption and investment spending by businesses, individuals, and government units. However, many banks struggle with issues in their loan portfolios, which hinders their ability to fulfill this function effectively. (K. C. Chan & J. H. C. M, 2006)

As non-performing loans increase significantly, banks experience a decline in revenue and face higher loan loss expenses. Struggling banks often lack effective systems for identifying and managing problematic loans during the approval and disbursement processes.

The ultimate objective bank while classify, fixing standard, and specific criteria for each loan is to make customers aware not to shift of fund give for one type loan categories without ratify and modify of contractual agreement with banks providing loans. But there is occasion's customers fail to adhere contractual agreements by diverting money un planned purpose which leads to non-performing loan (NPL). (Timothy W. Koch & S. Scott MacDonald, 2003)

Elias Firdawek (2013) assessed non-performing loans in development bank of Ethiopia in Yirgalem branch. The result of the study shows that, the problem that the bank faced due to NPLs like the revenue of the bank will fall off and loan expense loss increase. In addition, Haile Selassie G/Mariam (2014) assessed nonperforming loans in CBE Adigrat branch, the finding of the study shows that the problem of NPL such as decreasing the banks process of growing and profitability, means that loan and advance are granted and become doubtful, the bank will incur much to manage NPL, because it devotes much time, money and man power. The Commercial Bank of Ethiopia provides loans to customers to help them achieve their planned goals. To earn a fair profit from interest, the bank lends money according to government regulations. Customers are expected to use the money they receive from the bank responsibly.

In a nutshell, the problem leading to this research is the significant rise in non-performing loans (NPLs) within the Commercial Bank of Ethiopia (CBE), particularly at the Nifas silk district are. As NPLs increase, the bank's revenue declines, undermining its financial stability and operational capacity. Additionally, the bank incurs higher loan loss expenses, resulting in increased costs associated with managing and recovering these non-performing loans, which further strains its resources. Many banks, including CBE, often lack effective systems for identifying and managing problematic loans, contributing to poor loan performance. Furthermore, customer compliance issues arise when clients divert funds from their intended purposes, violating contractual agreements and exacerbating the problem of NPLs. Ultimately, the presence of NPLs limits the bank's ability to grow and achieve profitability, significantly affecting its role in supporting economic development in Ethiopia.

The study sought on the assessment of non-performing loan on the Commercial Bank of Ethiopia (CBE) Nifas silk district.

Research Question

1. Does the borrower use the loan for the intended purpose?
2. Does commercial bank of Ethiopia follow the customers or borrowers?
3. How to investigate & examine the performance of commercial bank of Ethiopia?

1.4 Objective of the Study

1.4.1 General Objective

The general objective of this study is to assess the non-performing loans (NPLs) Evidence from CBE, Nifas silk district

1.4.2 Specific Objective

The specific objectives of the study are:

- To assess whether the borrowers use the loan for the intended purpose.
- To examine how CBE follow the customers or borrowers.
- To investigate & examine the performance of CBE.

1.5 Significance of the Study

The significance of this study lies in its potential contributions to various stakeholders. For the Commercial Bank of Ethiopia, Nifas Silk District, the study will provide a comprehensive assessment of non-performing loans (NPLs), helping the bank better understand the current state of NPLs and potentially improve its loan management practices. For the government, the study offers valuable insights into the performance of the banking sector, which can guide regulatory decisions to ensure financial stability and promote economic growth. For students and researchers, this study serves as a practical case for understanding NPLs in the context of the Ethiopian banking sector, enriching their academic knowledge and providing a basis for further research in finance and banking.

1.6 Scope of the Study

The scope of this study is centered on assessing non-performing loans (NPLs) at the Commercial Bank of Ethiopia, specifically within the Nifas silk district. This research will focus on various aspects of loan management and its relationship with economic growth, examining how effective management practices can mitigate the impact of NPLs. Additionally, the study will explore the types of loans offered by the CBE Nifas silk district, analyzing their characteristics and relevance to the incidence of non-performing loans. By addressing these elements, the research aims to provide a comprehensive understanding of the dynamics surrounding loan performance and its

implications for both the bank's operational efficiency and the broader economic context in which it operates.

1.7 Organization of the study

The study is organized in to five chapters. The first chapter dealt with introduction part mainly back ground of the study, statement of the problem, research question, objective of the study, significant of the study scope and limitation of the study.

The second chapter presented the review of related literature. It describes the theoretical and empirical literature review. The third chapter would be present the interpretation and presentation of the data collected. The fourth chapter dealt with the analysis and interpretation of data. Finally, the fifth chapter would bring to end this study with summary, conclusions, and recommendations.

CHAPTER TWO

REVIEW RELATED LITERATURE

2.1 Introduction

This chapter starts with presenting the definition of terms related to the study.

Additionally, concepts relating to nonperforming loans are discussed. Following this, empirical studies are reviewed by focusing on the major causes of NPLs of these bank related causes.

Various journal articles have increasingly highlighted the risks associated with borrowing, examining them through the lens of different variables. Bank perform the important role of limiting adverse selection problem in the economy by screen and analyzed borrower's credit history makes riskier portfolios and weaker balance sheets, with potentially negative consequence for the stability of credit marker (Janericson, 2006).

According to Boo:(2000) banking relationships entail the supply of financial service to a firm by a bank that invests I obtaining specific information about the firm and evaluates the chance of success of its investment through multiple interactions with the same. client over a period of time in the case of several products. The advantage and disadvantages of banking relationships have been widely studied. Assuming asymmetric information, one advantage of establishing link between a borrower and bank reduced inefficiencies, firms whose loans are renewed will be seen as of good reputation (Diamod, 2007).

Finally, Yosha (2003) predicted that borrower with more valuable information will concentrate their relationship through bilateral negation with a bank in order to limit the information that must be conveyed to the market. (Janerison and Renault-2006)

Most of journal articles risk of default with symmetric information. Lending volume and lending standards. But the researcher wants to analyze the main causes of non-performing loans (NPL)

2.2 Theoretical Review

2.2.1 Term Loan

Term loans are credit facilities obtained under an agreement to repay the principal along with interest within a specified timeframe, with the due date for final settlement predetermined. Loan repayment is structured through periodic installments, which can be scheduled monthly, bi-monthly, semi-annually, or as a lump sum, depending on cash flow. Term loans are categorized as short-term, medium-term, or long-term.

Category of loans and advances

The categorization of loans reflects the intended purpose or end-use of the funds by borrowers. Bank managers and loan officers are responsible for ensuring that the funds are utilized as intended. However, borrowers may plan to use the funds for various economic activities, complicating straightforward categorization. For example, a borrower could be involved in importing, exporting, and local trade, making it possible that the loan could be used for any one of these activities or all of them. When clear distinctions are challenging, the primary activities for which the financing is sought should be identified

2.2.2 Agricultural loans

Loan for the purpose connected with agricultural sector falls in to this category. These include loans granted for the purchase of agricultural inputs like selected seeds. Fertilizers and agrochemicals, along with the rental or purchase of agricultural machinery and equipment for crop collection, processing, and marketing of agricultural products, are essential. Additionally, projects focused on producing exportable products such as flowers, fruits, and vegetables, as well as the development of agro-industries like dairy farming, are also significant. Cattle fattening etc... Though the descriptions give encompass wider range of agriculture activities, the focus at present is limited to assisting customers engaged in modern style of farming which presupposes application of mechanization and installation of irrigation system for the production of exportable produces or selected seeds. Loans granted for the purpose explained above are normally short lived unless the financing extended has investment nature like constricting, blinding, purchasing of equipment and machinery etc.

2.2.3 Manufacturing production loans (MFG)

Manufacturing production loans should be used for purchased of basic and auxiliary raw materials, intermediate goods, or semi processed goods. These loans are granted to manufacturing enterprises that utilize agricultural products, large-scale capital goods, or products aimed at import substitution, among others. Loans availed for purchase of industrial machinery and equipment's are also classified under this category. Life of the loans rage from short term to medium term and are extended against acceptable after proper study and analysis of the viability.

2.2.4 Domestic trade and services loans (DTS)

Domestic trade refers to wholesale and retail activities, primarily focused on distributing locally produced, manufactured, and imported goods. This sector also includes various types of services. Financing domestic trade and services facilitates the smooth flow of goods between manufacturers and consumers. Therefore, it is essential to encourage domestic trade—whether through imported or locally produced goods—via bank financing, as distribution serves as a crucial link between production, manufacturing, and consumption. Credit assistance, typically in the form of short-term working capital, is necessary to prevent potential bottlenecks in operations.

Funding in this category should be allocated for legitimate and recognized commercial purposes, rather than speculative ventures that could create artificial shortages. Products within domestic trade and services can be broadly classified into five main categories: agricultural products, manufactured goods, cottage and handicraft industry products, mining products, and various services excluding transportation.

2.2.5International trade

Foreign placed a key role in the development of the economy .in view of the great importance and the bank's role to promote the growth of the Ethiopian economy international trade financing is to be given priority. International trade is classified in to two categories as under

Export loan

Key agricultural products, including livestock hides and skins, cereals, pulses, oilseeds, and coffee, are vital for generating foreign exchange. Furthermore, a modest selection of industrially processed or semi-finished goods is also exported. Consequently, it is crucial that these exports obtain financial

backing from the bank.

Import loan In today's global economy, characterized by interdependence and globalization, importing goods and services is essential. Importation becomes crucial in economies that are not self-sufficient. As a result, importers of necessary raw materials, industrial inputs, and final products such as medicines and spare parts require support from banks. These importers must secure the appropriate import licenses and foreign exchange permits to fulfill their foreign currency commitments in birr. They may need to maintain birr in their accounts with the bank. Loans are processed in the standard way, with advances made against acceptable collateral. Repayment can occur either from the proceeds of selling the imported goods or from other revenue sources.

2.2.6 Building and construction loan (BC)

This category of loan involves two types of financing.

Mobilization fund to building contractors (working capital loan).

Bank loan can be provided to license building contractors to cover working capital shortages i.e. to mobilize materials required to construct buildings, roads Domestic. .Based on contracts concluded with employers.

Working capital loan to building contractors are normally made giving consideration to the following in addition to the normal prerequisite to the loan: Proof of ownership of equipment and machinery reported in the balance sheet, Evidences explaining good performance of projects completed from previous employees, Copy of the contract to be executed, Payment certificates as evidences for retention money if reported as receivable and Letter of agreement from the current employer to channel all payments through deposit account of the customer maintained with the lending area bank. Term of the loan will normally be linked with the project life, unless several projects are undertaken simultaneously this type of credit is availed in the form of term loan, unless the number of projects executed at any one time the classification of the construction firm to be financed encouraged considering overdraft facilities based on the going on concerned creation. Loans to partially cover construction costs of building (investment loan). Commercial bank will avail loans to individuals or enterprise engaged in the construction of commercial or residential buildings these loans are usually of medium- or long-term duration; hence their treatment will be entirely based

on propriety orders to prevail at time of financing. Loan to be advanced partially covered construction cost of commercial buildings will not exceed 50% of the total value of the construction. As periodic installment towards the loan is expected to be from rent revenue, loans for such purposes should entirely be based on viability. Market factors such as demand and supply and location have to be given due consideration while threatening the loan.

2.2.7. Transport Sector Loans (Tr/TI)

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, loan availed to facilitate smooth operation trucking companies or loans to cover custom duty charges or modification costs are to be included under this category.

However, loans granted for other purposes such as loans for purchase of truck granted to construction companies to transport own materials to construction site are to be included under Building & construction and not transport loan. So, to say, loans for transport of own goods are reported under the specific sector of that business.

Due to the delicate nature of the transport business, it is necessary to regularly review changes in the business environment and develop suitable procedures that govern the administration of this type of loans. Hence, revised procedures will be issued by way of credit circulars wherever it is found essential.

2.2.8. Personal Loans

Personal loans are normally the least preferred categories of loans. Funds are allocated to them after the other categories are satisfied.

They are the least preferred because they are not easy to administer due to mobility of borrowers and guarantors from one employer to the other.

They are usually of small size when taken individually and involve work when viewed against the benefits derived. Personal loans are usually consumer oriented and narrow based.

The hierarchy is determined by banks usually on the basis of needs, societal goods and ability to pay. They are charged higher rate of interest than other categories of loans and are disbursed

generally directed to the supplier of goods or services rather than to the borrower himself after obtaining consent of the borrower himself after obtaining consent of the borrower.

2.2.9. Loans under Reactivation (L u r)

In most cases it is important to suspend immediate transfer of loans overdue to litigation, so that chances available for amicable settlement will be properly exploited.

On the other hand, it is prudent to freeze interest realization on overdue loans, hence such loans known as loans under reactivation. This account is a transitory account where overdue loans will be kept for a maximum period of six months during which time the loan will be fully settled, rescheduled or transferred to legal.

The purpose of categorizing overdue loans under this account is to alter Area Banks to make persistent follow-up. Therefore, Area Bank Managers are required to give special attention to loans classified under this account in order to expedite the debt recovery process.

2.2.10. Loans In Litigation

All loans and advances that are deemed uncollectible for one reason or the other are passed to this account mostly from 'loans under Reactivation' account. This is where all overdue loans are to be segregated and kept for a maximum period of six months, during which time extra effort should be exerted and the loan has to be fully settled, rescheduled or transferred to the account in caption if effort for reactivation turns futile. The procedure to be followed in handling loans in litigation is indicated under the chapter entitled credit follow up.

2.3. Nonperforming Loans (NPL)

Non-performing loans are loans and advances whose credit quality has deteriorated such that full collection of principals and /or interest in accordance with the contractual repayment terms of the loan or advance is in question.

Loans or advances with pre-established repayments programs are non-performing when principal and/or interest is due and uncollected for 90 days or more beyond the scheduled payment date or maturity.

Overdrafts and other loans that do not have a pre-established repayment program shall be considered as non-performing when:-The debt remains outstanding for 90 consecutive days or more beyond the scheduled payment date or maturity, the exceeds the approved limit for 90 consecutive days or more, interest is due and uncollected for 90 days or more for overdrafts the account has been inactive for 90 consecutive days and/or deposit is insufficient to cover the interest capitalized during the period, the entire principal balance of loans or advances outstanding exhibiting the characteristics described under and here above shall be considered as non-performing.

2.4. Classification of Non-Performing Loans

Non-performing loans are classified into three groups of substandard Doubtful and loss depending on the number of days that they are past due. Definitions of the three groups are presented here below.

2.4.1. Substandard

Non-performing loans or advance past due 90 days or more but less than 180 days shall be classified as substandard.

2.4.2. Doubtful

Non-performing loans or advances past due 180 days or more but less than 360 days shall be classified as Doubtful.

2.4.3. Loss

Non-performing loans or advances past due 360 days or more shall be classified as loss.

2.5. Diversion of Loan

Commercial bank categorizes loans by their end us irrespective of the type of securities pledged. If the loans disbursed are changed their end use this indicates that the loan is diverted.

2.6. Loans Provision

All commercial activities undertaken by business organization involve different risks with varying chances of occurrence that affect the interest of the promoters. This is a phenomenon that cannot be controlled fully since it is not possible to identify and mitigate the risk involved in

the operation of a business with certainty. In other words, 100% attainable business plan is less likely to be drawn under conditions of uncertainty. Hence is normal to record variances that are attainable within tolerable margins.

Due to the fact explained above, commercial bank lending involves risk and that bankers enter into the lending process after a careful analysis of the factors that have a bearing on the borrowers' willingness and ability to repay their obligation. However, credit analysis is only under progress to the level where it is possible to predict with better accuracy whether or not a loan will be repaid as agreed. As a result, the occurrence of problem loans that eventually entail losses could be expected.

Maintenance of provision on loans is essential for cleaning the balance sheet of the bank from non-collectable items and helps report true and fair values of its assets. To this end, each non-performing loan (NPL) cases is reviewed in tandem with the national bank of Ethiopia (NBE) directive about treatment of the same to determine the prudent amount required to be provided. The ultimate purpose our accumulation of provision by way of deducting from annual profit of the bank each year is to give allowance for possible loan losses that arise due to various causes.

This should not, however, imply that the bank prefers write-off. It is only to protect the bank to withstand forcing circumstance.

2.7. Renegotiated Loans or Advances

Renegotiated loans or advances are loans that have been refinanced, rescheduled, rolled over, or otherwise modified at favorable terms and conditions for the borrower because of weaknesses in the borrower's financial condition and or ability to repay.

Renegotiated loans are non-performing loans and shall be categorized as sub-standards that include: Renegotiated term loans unless equivalent of all past due interest is paid by the borrower in cash at the time of renegotiation and the following payments are made by the borrower on a consistent and timely basis in accordance with the restructured terms of the loan of advance in the case of term loans with Monthly installment repayments, at least 4 consecutive repayments, Quarterly installment repayments, at least 3 consecutive repayments, Semi-annual installments,

at least 2 consecutive repayments and If repayment amount is significant and covers the above at the time of renegotiation, then the balance can be reactivate.(Frederic Mishkin, Year 2007).

2.8. Suspend Interest Account

Interest income calculated and accrued, but not collected on non-performing loans or advances shall be reversed from income account and to be placed in suspended interest account. However, monthly interest calculated on non-performing loans should be accounted under this account; hence no income can be realized from non-performing loans.

Non-accrual status means a loan or advance has been placed on a cash basis for financial reporting purpose. Interest on such loans or advances accrued on the book of the bank or for which a specific reserve (such as a suspended interest account) has been established by the bank to offset the full amount of interest being accrued shall not be taken into income of the bank.

A non-performing loan or advance placed on non-accrual status may be restored to accrual status when None of the outstanding principal and/or interest is past due, and for negotiated loans or advances, where all part due interest is paid by the borrower in cash at the time of negotiation and the loan or advances is not classified as substandard. (Frederic Mishkin: Year 2007)

2.9. Credit Management

To its profit, the bank must simultaneously seek the highest return possible on loans and securities, reduce risk, and make adequate provisions for liquidity by holding liquid assets. Banks try to accomplish these three goals in following basic ways (Frederic Mishkin, Year 2007)

Firstly, Banks try to find borrowers who will pay high interest rates and are unlikely to default on their loans they seek out loan business by advertising borrowing rates and by approaching corporations directly to solicit loans. It is up to banks loan officer to decide if the potential borrowers are good credit customers who will make interest principal payment on time. Typically, banks are conservative in their loan polices; the default rate is usually less than 1%. It is important, however, that banks not to be so conservative that they miss out attractive lending opportunities than warn higher interest rates. Banks try to purchase securities with high returns and low risk. Secondly, in managing their assets, banks must attempt to lower risk by

diversifying loan portfolio. They achieve this by purchasing many different types of assets (short term and long term) and approving different type of loans to number of potential customers after careful analysis. Finally, the bank must manage liquidity of its assets so that it will hold liquid securities even if they earn a somewhat lower return than another asset.

Bank and also other financial instruction must overcome the adverse selection and moral hazards problem that makes loan default more likely. The attempt of financial instruction to solve these problems explain number of principles for managing credit risks, screening and monitoring, establishment of long-term customer relationships, loan commitment, Collateral, compensating balance requirements and credit rationing (Frederic Mishkin, Year-2007).

2.10. Screening and Monitoring

Asymmetric information is present in loan markets because lenders have information about the investment opportunities and activities of borrowers that borrowers do. This situation leads to information producing activities by banks and other financial institutions, screening and monitoring. Indeed, Walter Winston, a former head of Citicorp, the largest bank corporation in USA, was often quoted as stating the business of banking that the business of banking is the production of information. (Frederic Mishkin, Year 2007).

2.11. Screening

Adverse selection in loan markets requires that lenders screen out the bad credit risks from the good ones so that loans are profitable to them. To accomplish effective screening, tenders must collect reliable information from prospective borrowers. Effective screening and collection together form an important principle of credit risk management.

When you apply for a consumer loan (such as a car loan or a mortgage to purchase a house), the first thing you are asked to do is fill out forms that elicit a great deal of information about your personal Finances. You are asked about salary, bank accounts, other assets (such as car, insurance policies, and furnishings) and outstanding loans, your record of loan, credit card, and charge account repayments the number of years you have worked and who our employers have been. The lender uses this information to evaluate how good a credit risk you by calculating your credit score, a statistical measure derived from your answers that predicts whether you are likely to have trouble making your loan payments. Deciding on how good a risk you are cannot be

entirely scientific, so the lender must also use judgment. The loan officer whose job is to decide whether you should be given the loan, might call your employer or talk to some of the personal references you supplied. The officer might even make a judgment based on your demeanor or your appearance. (This is why most people dress neatly and conservatively when they go to a bank to apply for a loan).(Frederic Mishkin, Year 2007)

The process of screening and collection information is similar when a financial institution makes a business loan. It collects information about the company's future plans, how the loan will be used, and the competition in the industry. The officer may even visit the company to obtain a firsthand look at its operations. The bottom line is that whether for personal or business loans, bankers and other financial institutions need to be nosy (Fredric Mishkin, Year-2007)

2.12. Credit Policy

Credit policy is often referred as a standing decision made to cover a prescribed set of conditions. It provides guidelines for determining whether to extend to extend credit to clients and how much credit to extend. A bank may adopt either liberal or tight credit policy. Liberal credit policy involves extending credit to one more risky class whose credit worthiness is not known exactly this policy increases profit by increasing the level of loans extended to customers but incurs higher risk of bad debts and face the problem of liquidity. On the other hand, right credit policy involves extending credit to those who have proven credit & result in a low profit but is has minimum cost & chance of bad debt. Thus, managers should develop credit policies which make tradeoff between risks & return (commercial bank credit manual).

2.13. Credit Standard

Credit standard is a minimum criterion for extension of credit to a client. It enables the credit manager or loan officer to accept the desirable client & reject the undesirable ones. Setting credit standard implicitly requires a management of credit quality, which is defined in terms of the probability of borrower default. The probability of a given borrower to pay the loan is by a subjective judgment. However, a system of credit standard enhances the ability of the credit manage to make the correct decision of use fairly & consistently (commercial bank credit manual).

2.14. Credit Terms

Credit term involves both the length of the credit period & the discount given. Credit is a means by extending the credit period. Discount given involves an attempt of increase the payment of receivables (commercial bank manual).

2.14.1 Short Term Loans

Short term loans are facilities availed for a maximum period of 18 months for working capital purposes. End-use of short-term loans should be effectively followed by visits made to business sites and evaluation of the financial standing of the borrower both before and after disbursement of the loan (commercial bank credit manual).

2.14.2 Medium Term Loans

Medium term loans are granted for the purchase of capital good, truck, trailers, public, and transport buses of investments whose payback periods justify. Duration of medium-term loans van extend up to a maximum period of 60 months. Loans approved in package (integrated loans) which include participation in the construction work of projects, purchase of equipment and machinery required for the project, which also incorporate permanent working capital component would be payable in the medium term (commercial bank credit manual).

2.14.3 Long Term Loans

Long term loans are loans granted for the financing of business of investment nature. The financing includes participation in the establishment of viable business ventures and supporting expansion program of successful businesses. Manufacturing, mining, and building and construction sector are among the beneficiaries of the long-term loans. The duration of long-term loans extends up to ten years (Credit policy and procedure manual of commercial Bank).

2.15. Credit Investigation

Credit investigation is a means of developing information not at hand as well as verifying information supplied from different sources. It carried out to aid in making a sound credit decision. After having obtaining the vital information for credit the credit manager will get a knowhow or clue regarding the matter that should be further to be investigated. The investigation seeks pertinent information to the specific credit decision sufficient to assure that the decision

will fail in the probability range for payment set by the operating policies. The extent of credit investigation need is influenced by the degree of certainty necessary for proper by borrowers is important when the question of investigation is raised it is customary to focus on the six characteristics of credit namely character, credit worthiness, capacity, capital & collateral.

Credit worthiness: -of the customer is the intangible personal attribute of the customer. Those include personal habit, attitude & moral past payment history as well as any pending or resolved legal judgments against the applicants is vital to evaluate its character. At the same time good character may be result of never having faced adversely. Capacity is credit quality that results on a widely diverse group of specific conditions. It is their ability to pay a specific sum when it is due in a much wider sense it means the source of ability to pay such an employment income earning power etc.

Financial statement analysis with the particular emphasis on liquidity is used to assess the applicant's capacity. Capital is financial strength the applicant has to reduce risk in case of he/she failed to repay obligation when due. It is the financial strength of the applicant reflected by its owner ship position of asset.

Condition while credit analyst today can obtain a fairly reliable image of an individual applicant through series of specific information. They always face the problem of interpreting this information in the form of the current environment. Analysis of general economic and business condition as well as special circumstances that may affect the applicant or firms is performed to assess conditions. The current economic and business climate have to take account.

Collateral: -describes the amount of assets that the applicant has available to secure the loans collateral has to be evaluated from its current and with possible future marketability and stability of its value. (Commercial bank credit manual 2001).

2.16. Specialization in Lending

One puzzling future of bank lending is that a bank often specializes in lending to local firms or to firm in particular industries, such as energy. In one sense, this behavior seems surprising because it means that the bank is not diversifying its portfolio of loans and thus is exposing itself to more risk. But from another perspective such specialization makes perfect sense. The adverse selection

problem requires that the bank screen out bad credit risks. It is easier for the bank to collect information about local firms and determine their credit worthiness than to collect comparable information on firms that are far away. Similarly, by concentrating on lending to firms in specific industries, the bank becomes more knowledgeable about these industries and is therefore better able to predict which firms will be able to make timely payment on their debt. (Fredrik Mishkin: 2007).

Monitoring and enforcement of Restrictive Covenant

Once a loan had been made, the borrowers have an incentive to engage in risky activities that make it less likely that the loan will be paid off. To reduce moral hazard financial institutions must adhere to the principle for managing credit risk that a lender should write provisions (Restrictive covenant) in to loan contracts that restrict borrower from engaging in risky activities. By monitoring borrower's activities to see whether they are complying with the restrictive covenants and by enforcing the covenants if they are not, lenders can make sure that borrowers are not taking on risks at their expense. The need for banks and other financial institutions to engage in screening and monitoring explains why they spend so much money on auditing and information collecting activities. (Fredrik Mishkin: Year -2007).

2.17. Credit Follow-Up

Credit Follow-up one the main tasks of Area Bank Manager. Once funds are disbursed, the concerned bank officers cannot afford to rest on their laurels and expect all payment to come in on the due dates without problem. Hence, it is important that we design a system whereby borrowers are persuaded to repay their loans regularly. We cannot give our customers the understanding and assistance required unless we know what their problems are. We can detect this only by having open and transparent discussion with them. They must be convinced that they should show us the plans they have worked out to overcome their problems at hand. They might even ask us to help them formulate such plans, which should be accepted i.e. we should demonstrate our concern and assistance by giving consultancy service, a key factor which we have adopted in credit operation. By doing so, we have to make them realize that the money lent to them is that of the depositors and they should utilize it in a wise investment. All our efforts should not be threatened or frighten them but to persuade and convince them to settle the loan.

2.18 Empirical Literature Review

There is a wealth of empirical literature examining the factors that influence non-performing loans, encompassing both external and bank-specific analyses. Below are some significant studies relevant to this research that have been reviewed:

Jimenez & Saurina (2005) studied on the Spanish banking sector from 1984 to 2003 nonperforming loans are determined by lenient credit terms. The authors indicated that the causes for the leniency were attributed to disaster myopia, herd behavior, moral hazard and agency problems that may entice bank managers to take risk and lend excessively during boom periods.

Goldstein and Turner (2006) stated that” the accumulation of non-performing loans is generally attributable to a number of factors, including economic down turns and macroeconomic volatility, terms of trade deterioration, high interest rate, excessive reliance on overly high priced inter bank borrowings, insider lending and moral hazard.

Bloem and Gorter (2001) indicated that non- performing loan (NPL) may rise considerably due to less predictable incidents such as the cost of petroleum products, price of key export products, foreign exchange rates change abruptly.

World Bank police research working paper on non-performing loans in sub-Saharan Africa revealed that bad loan is caused by adverse economic shocks coupled with high cost of capital and low interest margin (Fotach,2005).

Elias Firdawek(2013) assessed non-performing loan in development bank of Ethiopia in yirgalem branch. The purpose of research is to determining the problem and assessing factors that result in non- performing loan which reduce profitability and performance of the bank. To conduct the research the researcher used census survey data collection method and studied all population in order to obtain data from the organization.

Haile Selassie G/Mariam (2014) assessed non-performing loans in CBE in Adigrat branch, use simple random sampling technique to collect data from the employees of the bank. The researcher assessed many impacts of non-performing loans (NPLs) on loan lending have been occurring. It decreases the bank process of growing and profitability means that loan and

advances are granted and become doubtful, the banks will incur much cost to manage NPLs, because it devotes much time, money and man power.

Martha N, (2017) Factors Affecting Non-Performing Loans: -A case study of KCB Bank Kenya Limited Nairobi Region. The study found out that the interest rates offered by the bank caused the non-performing loans in KCB bank, but bank size and credit size did not influence non-performing loans statistically. The study also concluded that customer related factors, gender and age did not significantly influence non-performing loans.

Wondimagegnehu (2012) in his study “determinants of NPLs on commercial banks of Ethiopia” revealed that underdeveloped credit culture, poor credit assessment, aggressive lending, botched loan monitoring, lenient credit terms and conditions, comprising integrity weak institutional capacity unfair competition among banks.

CHAPTER THREE

3. THE RESEARCH METHODOLOGY

3.1 Research Design

The researcher employed a descriptive research design to capture the existing conditions and circumstances related to the study. The primary aim of this research is to understand the current state of non-performing loans within the specified context. A descriptive research design is ideal for capturing detailed descriptions of phenomena as they exist, making it easier to identify trends, patterns of NPLs. The insights gained from this descriptive study can serve as a foundation for future research.

3.2 Data source and collection method

The paper utilized both primary and secondary data sources related to non-performing loans. Primary data is collected through a questionnaire administered to a select group of bank employees and customers, offering firsthand insights into the issue. Secondary data is gathered from various external sources, including books, annual reports, and loan manuals, providing additional context and historical perspectives on non-performing loans. This combination of data sources will allow for a comprehensive analysis of the topic.

3.3 Target population

In this study, the assessment of non-performing loans focused on the Commercial Bank of Ethiopia, Nifas silk district. The bank have been providing loan services to its customers since its establishment. This research focuses on two distinct target populations. The first group consists of the employees and managers of the commercial bank, specifically from various divisions: 1,374 from the credit wing, 21 from the wholesale relationships management wing, and 15 from the condominium loan department. The second group encompasses the bank's customers who have taken out loans, specifically targeting those with non-performing loans, totaling 4,539 individuals.

3.4 Sampling size and sampling technique

Sampling Technique

Given the **nature of the population** at the Commercial Bank of Ethiopia (Nifas Silk Branch), the study employs:

1. Employees:

- **Convenience Sampling** was used due to:
 - The large employee population and accessibility constraints.
 - The need to gather insights from employees with direct customer interaction experience.
- *Rationale:* This method ensures practical data collection from available respondents who meet the study's criteria (Kumar, 2019).

2. Customers:

- **Stratified Random Sampling** is recommended to ensure representation across customer segments (e.g., account types, transaction frequency).
- *Rationale:* The population is heterogeneous, and stratification reduces bias (Creswell & Creswell, 2018).

Sample Size Determination

The customer sample size was calculated using **Krejcie & Morgan's (1970) formula** for finite populations:

$$n = \frac{N}{1 + N(e)^2}$$

where: $N = 4539$

$$e = 0.1 \quad e^2 = (0.1)^2 = 0.01$$

$$n = \frac{4539}{1 + 4539(0.01)}$$

$$= \frac{4539}{46.39}$$

$$= 97.844$$

Final Sample: 98 customers (rounded for practicality).

the formula ensures a **95% confidence level** with a 10% error margin, balancing accuracy and resource limits.

3.5 Method of Data Analysis

The data will collect in different forms can be organize properly and examine by using both qualitative & quantitative data and shall be analyze properly by using descriptive method like percentages & tables.

In general, all the necessarily data, which will be organize and compile and the percent in a tabular for, shall be analyzed and described accordingly on theoretical basis.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

This chapter focuses on presenting and analyzing the data collected from secondary sources—specifically, the records and reports from CBE—and primary sources, which include responses gathered through questionnaires filled out by CBE customers and employees. The insights drawn from these two sources will be explored in detail, shedding light on valuable trends and perspectives, the primary respondent was selected by using convenience method for employees This approach was chosen because it allows for the efficient collection of data from individuals who are readily available and willing to participate. For the selection of customers, a statistical formula was employed to ensure that the sample size was both sufficient and statistically valid 60 respondents were examined.

4.1. Over all characteristic of respondent

The researcher distributed a total of 98 questionnaires to gather data for the study. However, only 60 completed questionnaires were successfully returned. Of the remaining 38 questionnaires, some were either incomplete or deemed defective due to errors or missing information, rendering them unsuitable for analysis. The general characteristic of respondent of the total sample can be categorized in selected group based on sex, educational level, and relation as a customer with CBE in years and types of loans.

4.2. Demographic features of respondent

N.B the total number of the respondents is 60

No	Particular	Character	No of respondent	Percentage
1.	Sex	Female	24	40%
		Male	36	60%
2.	Educational level	1-12	27	45%
		Certificate	19	32%
		Diploma	12	20%
		Degree and above	2	3%
3.	How long customer serve by CBE	Less than 5 years	21	35%
		More than 5 years	39	65%

4.	Type of loan	Short term	32	53%
		Medium	16	27%
		Long term	12	20%

Table 4.1:- Background of respondent

In the table 4.1 shown above 40% of respondents are females and 60% of respondents are males. In the demographic feature table 4.1 two regarding the educational level of respondents 45% are 1-12 and 32% of respondents are certificate the rest 20% are diploma. In the number of tables 4.1 shows how long a customer serving by CBE in year. This regarded 35% of the respondent serve below 5 year and the rest 65% of the respondent serve more than 5 years.

Q. no 4 in table 4.1 shows the type of loan granted, regarding these 53% took short term loan, and 27% medium term loan and the rest 20% took long term loan.

Table 4.2: purpose of loan to the borrowers

Rating scale	No of respondent	Percentage
Service	6	10%
Industry	14	23%
Agriculture	31	52%
Trade/Merchandise	9	15%
Total	60	100%

Table 4.2: - Source: Own survey

As observed in table 4.2 regarding the purpose of loan 10% of the borrowers used for service, 23% of respondent uses for industry, 52% of the respondent uses for agriculture, and the rest 15% uses the loan for trade/merchandise.

Table 4.3: Does the loan is spent on the intended purpose?

Rating scale	No of respondents	Percentage
Yes	28	43%
No	32	57%
Total	60	100%

Table 4.3: - Source: Own survey

The summarized answer regarding whether the borrowers use the debt for the intended purpose or not.43% of the respondent says yes, the rest 57% of the respondent does not use the loan for the intended purpose this is indicator of diversification of funds. This diversification of funds is

either for productive or productivity purpose. If the borrowers use funds for nonproductive purpose, they cannot able to repay the debt.

Table 4.4: - Consultancy service provided by bank

Questions	Response	No of respondent	Percentage
Are you aware of the consultancy?	Yes	52	86%
	No	8	14%
Have used before?	Yes	45	75%
	No	15	25%

Table 4.4: - Source: Own survey

As shown on the table 4.4 above, regarding to the consultancy service of CBE 86% of the respondents aware the service of offered by the bank but 14% of the respondents have no idea about it, in addition to this regarding to the consultancy service of the bank 75% of respondents says yes, the rest of 25% says no from this it is clearly shows that CBE gives consultancy service to its borrowers.

Table 4.5: How do you evaluate the interest rate of bank?

Rating scale	No of respondent	Percentage
Fair	48	80%
Not fair	12	20%
Total	60	100%

Table 4.5: - Source: Own survey

Regarding to the bank interest rate 80% of the respondents say it is fair the rest 20% of the respondents says it is not fair. Most of the borrower says the bank interest rate is fair to other banks this shows the respondents agreed the interest rate of the bank relative to another bank.

Table 4.6: Are you paying back the loan on time?

Rating scale	No of respondent	Percentage
Yes	22	37%
No	38	63%
Total	60	100%

Table 4.6: - Source: Own survey

Regarding timely repayment of loan 63% of the respondents say no the rest 37% of the respondents says yes, the reason for repay the debt on time is market failure and diversification of funds.

Table 4.7: What is time duration the CBE takes in granting the loan?

Rating scale	No of respondent	Percentage
Less than one month	-	-
Between one and three months	15	25%
More than three months	45	75%
Total	60	100%

Table 4.7: - Source: survey

In the above table we can understand that regarding to time duration of granting the loan 75% of the respondent says it takes more than three month and other 25% say between one and three months.

Table 4.8: What do you think of the time taken for loan processing?

Rating scale	No of respondent	Percentage
Fair	32	53%
Lengthy	20	34%
Unfair	8	13%
Total	60	100%

Table 4.8: - Source: Own survey

As we observed table 4.8 53% of the respondent says comparing other bank is the loan processing time of CBE is fair, 34% of the respondent says the processing is lengthy, and the rest 13% of the respondent says the process is unfair.

Table 4.9: Does the bank's loan officer follow the loan?

Rating scale	No of respondents	Percentage
Yes	48	80%
No	12	20%
Total	60	100%

Table 4.9: - Source: Own survey

As we observe from the above table 80% of the respondents say yes. The rest of 20% of the respondent say no. Even if 80% of the respondent says yes, there is a problem of follow up procedure after the loan disbursed. This imitates the borrower to use the loan for unintended purpose.

Table 4.10: Does the bank give the requested amount of loan fully?

Rating scale	No of respondents	Percentage
Yes	49	81%
No	11	19%
Total	60	100%

Table 4.10: - Source: Own survey

As shows on the table 4.10 above 81% of the respondents say yes and the remaining 19% says no. this refers just the bank even if not effectively and efficiently gives the requested amount of loan fully. slightly CBE trying to give the requested amount in some extent.

Table 4.11: Are you satisfied by loan processing system of the bank?

Rating scale	No of respondents	Percentage
Yes	56	94%
No	4	6%
Total	60	100%

Table 4.11: - Source: Own survey

From above table shows 94% of the respondents are satisfied and the rest 6% of respondents are not satisfied the reason for this the lengthy processing of loan.

4.3 Question forwarded for employees

N.B the total number of respondents is 20 by using convenience sampling

Table4Table4.12: Sex distributions of respondents.

Sex	No. of respondents	%
Male	15	75%
Female	5	5%
Total	20	100%

Source: -questionnaire, 2025

From the above total sex distribution of the non-performing loans (NPL's) 75% respondents are male the remaining 5% respondents are female. From this table the research can observe that most of them are run by male rather than female.

Table 4.13: Age distributions of respondents

Age	No. of respondents	%
18-30	18	90%
31-45	2	10%
46 and above	-	-
Total	20	100%

Source: -questionnaire 2025

From the age distribution shown in above table it indicates that 90% respondents are ranged from 18-30 and the remaining 10% are ranged from 31-45 and there is no ranged from 46 and above. Most of the respondents are belongs to under the age of 18-30.

Table 4.14: Educational background of respondents

Educational level	No. of respondents	%
Diploma	-	-
Degree	14	70%
Masters	6	30%
Total	20	100%

Source: - questionnaire 2025

From the above table what we have seen that, there is no diploma respondent, 70% of respondents are degree holders and 30% respondents are masters. This data indicates that most of the employers' educations are degree level. From this, the researcher concluded that as the employees of the bank are enough educated to work and able to manage their customers and the overall asset management of the bank. Since the employees of the bank are in a degree level, they are expected to be efficient and effective in their work. This helps the bank to easily achieve their objectives and goals.

Table 4.15: The time of the respondents stay as employees in the bank

	Description	No. of Respondents	%
For how long have you been worked in CBE?	Less than one year	3	15%
	1-2 years	5	25%
	2-4 years	7	35%
	4-7 years	4	20%
	Over seven years	1	5%
	Total	20	100%

Source: -questionnaire, 2025

From the respondent's time stay in the bank shown in above table indicates that, 15% respondents stayed in the bank less than one year, 25% respondents stayed in the bank from 1 to 2 years, 35% respondents 2 to 4 years, 20% respondents 4 to 7, and the remaining of 5% respondent over seven years. This indicates that, most of the respondents were being employed for a long time.

Table 4.16: Comment on loan amount

	Description	No. of Respondents	%
What is your opinion on the approved loan compared to your profession?	Over financed	5	25%
	Under financed	5	25%
	As requested,	10	50%
	Total	20	100%

Source: -questionnaire, 2025

From the total respondents, 25% of them respond as the loan was over financed, 25% under financed, and the rest 50% of the respondent as requested. Based on the response given by the respondent, the researcher concludes that approval of loan is based on the amount that the customers have requested. This helps the bank to reduce the amount of NPLs because the requested is based on their paying ability.

Table 4.17: Punctuality of customer to pay their loan

How your customers repay their loan on time?	Description	No of respondent	%
How your customers repay their loan on time?	Fully repay	7	35%
	Partially repays	7	35%
	Most of the loan remains unpaid	3	15%
	Most of the loan paid	3	15%
	Total	20	100%
	What is the factors for loan repayment process by borrowers	Lack of follow up of customer strategy	6
What is the factors for loan repayment process by borrowers	Less business of borrowers	6	30%
	Increment of cost of return	4	20%
	Ineffective credit management	2	10%
	Diversion of loan by borrowers	2	10%
	Total	20	100%

Source: -questionnaire, 2025

Based on the collected data, 30% of the respondent responded that the customer fully repay their loan, 30% of the respondent responded that partially repays, 10% of the respondent said that most of the loan remain unpaid and the reaming 30% of the respondent said most of the loan paid. This data indicates that most the customer pays their loan on time.

In relation to the unpaid loan the researcher ask the respondent about the reason that leads the customer to remain unpaid their loan, as shown in the above table for this question 30% of respondent replied that the reason that leads the loan remains unpaid is less business of borrowers, 20% of respondents replied that increment of cost of return , 30% of respondents replied that lack of follow up of customer strategy , 10% of respondents replied that ineffective credit management and the remaining 10% of respondents replied that diversion of loan by borrowers.

From the above results the researcher understood that all of the above listed factors are the reason that leads the loan remains unpaid.

Table4.18: Evaluation on customer handling

How do you evaluate the bank in customer handling?	Description	No. Respondents	%
	Poor	-	-
	Fair	3	15%
	Good	7	35%
	V. good	4	20%
	Excellent	6	30%
	Total	20	100%

Source: - questionnaire 2025

From the above table the respondents evaluated that, 15% were fair in customer handling, 35% have said good, 20% very good and 30% are excellent in handling customers.

Effective discussion process helps to identify and solve problems that might have smooth operation of credit facility at their beginning stage.

Table 4.19: -Loan Category

For what types of investment, the bank gives priority for lending the loan?	Description	No. Respondents	%
	Agriculture	8	40%
	Manufacturing	4	20%
	Service	5	25%
	Merchandise	2	10%
	All	1	5%
	Total	20	100%
Criteria for loan advices to be borrowers bank			
	Easily contact with them	3	15%

relationship?	Existence of more customers	4	20%
	Clearness to assess their performance	7	35%
	Truthfulness to repay loan on time	3	15%
	All	3	15%
	Total	20	100%

Source: - questionnaire 2025

According to the above table, 40% of the respondents have responded agricultural sector, 20% of the respondent responded manufacturing sector, 25% of the respondent responded service sector, 10% of the respondents responded trade/merchandise sector, and the remaining 5% of the respondents are for all types of investments. From this, the researcher has concluded that, most of the time the bank gives a loan priority for the agricultural sector followed by merchandise, manufacturing and service sector.

With respect to lending a loan to the selected types of investment sector and gives priority for them. The bank takes some consideration such as easily contact with them, existence of more customers, clearness to assess their performance and truthfulness to repay loan on time. As indicated in the above table majority 15% of respondent said that to select the investment sector the bank mostly considers their clearness to assess their performance, followed by 20% of respondent said that easily contact with them, 35% of respondent said that existence of more customer, 15% of respondent said that truthfulness to repay loan on time and the remaining 15% all of the above listed criteria are consider by the bank.

From the above result, the researcher understood that assessing the performance and the characteristics of the organization those involves in the investment sector and the need a loan is very important for the success and effectiveness of the bank and to improve its loan repayment process.

Table 4.20: Problems exist during payment of loan

Is there any problem that the bank faced in the process of loan repayment?	Description	No. Respondents	%
	Yes	14	70%
	No	6	30%
	Total	20	100%
What are the Problem?	Poor credit policies and procedure	4	20%
	Ineffective credit management	7	35%
	Inadequate information about the performance of customer	6	30%
	Lack of training provision of employee	3	15%
	Total	20	100%

Source: - questionnaire 2025

Based on the above table, 70% of respondents have respond as there was encounter problem and the remaining 30% of respondent respond as there was no problem, while payment of loans provided by the bank. The researcher has, therefore, understood as there was a problem that obstacle the customers for paying the loan.

As indicated in the above table majority 20% of respondent replied that the major problem the bank faced in the loan repayment process is ineffective credit management, 35% of respondent replied that inadequate information about the performance of the customer, 30% of the respondent replied that poor credit policies and procedures, and the remaining 15% of the respondent said that lack of training provision of employees. Based on above result, the researcher concludes that ineffective credit management is the major problem that the bank mostly faced. This implies the assessment of credit worthiness and financial performance of customer in the bank is low.

To reduce the above problem that the bank faced in loan repayment process, the respondents are forward their recommendation as follow; create awareness for customers, the bank must know the credit worthiness and financial performance of the customers, frequent follow up of customers, revise effectiveness of credit management and assess different qualification of customer before giving a loan.

Table 4.21 what are the significance factor causing non-performing loan?

Rating scale	No of respondents	Percentage
In adequate risks management	6	30%
Natural disaster	4	20%
Poor credit monitoring	1	5%
Technology	4	20%
Governmental regulation	2	10%
Low capitalization	2	10%
Total	20	100%

Source: - questionnaire 2025

Respondent highlighted that 40% significant factor causing non perform loan were natural disaster and technology, 5% of respondents are poor credit monitoring, 10% of the respondents are government regulation and the rest 45% were caused by inadequate risks management, low capitalization and technology.

Table 4.22 what is time duration the CBE takes in granting the loan?

Rating scale	No of respondents	Percentage
Less than one month	6	30%

Between one and two months	7	35%
More than two months	7	35%
Total	20	100%

Source: - questionnaire 2025

In the above table we can understand that regarding to time duration of granting the loan 40% of the respondent says it takes more than two months, 40% of respondent says it takes between one and two months and the remaining 20% of respondent says less than one months.

Table 4.23 what do you think of the time taken for loan processing?

Rating scale	No of respondents	Percentage
Fair	6	30%
Lengthy	9	45%
Unfair	5	25%
Total	20	100%

Source: - questionnaire 2025

As we observed table 45% of the respondent says comparing other bank is the loan processing time of CBE is lengthy, 30% of the respondent says the process is fair, and the rest 25% of the respondent says the process is unfair.

4.4. Over all nonperforming loan of CBE with its percentage.

Table 4.24: Secondary data

Year	2022/23	2023/24	2024/25
Total loan	1,968,273,100.66	1,476,018,153.37	1,116,375,217.9
Non-performing loan	227,729,197.75	290,037,567.13	315,152,724.01
Performing loan	1,740,543,902.91	1,185,980,586.23	801,222,493.88
NPL/total loan	11.57%	19.65%	28.23%

Source: - CBE, Nefas silk district

From table 4.24 the trend in total loan shows in year 2022/23 is higher (1,968,273,100.66) than from the fiscal year 2023/24 by birr492,254,947.29 increase and it continues its growth by slowing the growth rate from fiscal year 2023/24 to 2024/25 by birr 359,642,935.47. the

performing loan amount shows from 2022/23 in birr 1,740,543,902.91 (88.42%) to in 2023/24 birr 1,185,980,586.23 (80.34%) shows decline by 8.08%. However, in the last three years the total non-performing amount is in 2022/23 was birr 227,729,197.75 (11.57%), in the year 2023/24 was birr 290,037,567.13 (19.65%), but in the year 2024/25 increase to birr 315,152,724.01 (28.23%). this shows higher NPL amount are recorded in year 2024/25.

4.5. Data collected by interview

In addition to gathering insights from the bank's customers and employees, an interview was conducted with Mr. Yared Melese, the customer service manager, who provided valuable information regarding the bank's Non-Performing Loans (NPLs).

According to Mr. Yared, the district currently serves 2,843 customers, out of which 110 have been classified as NPLs. During the interview, several key reasons were identified for customers defaulting on their loans. The most frequently cited cause was business failure due to diversion of funds, which aligns with the responses from other participants. Another major factor was macroeconomic instability, including price fluctuations and inflation, which negatively impacted borrowers' ability to repay.

Additionally, the research highlighted social trust issues in business transactions. New entrepreneurs often struggle to gain credibility, as customers prefer buying from established businesses or relatives they trust. Meanwhile, unpredictable natural disasters, though less frequent, can cause severe financial losses—sometimes exceeding the impact of other factors—but due to their rarity, they were ranked lower in occurrence.

When customers default, the bank follows a structured approach:

1. **Initial contact** – Reminding them of their payment deadline.
2. **Formal warning** – Summoning them for an urgent meeting.
3. **Collateral liquidation** – If repayment remains unresolved, the bank auctions the pledged assets.

The bank also has strict **loan approval criteria**, assessing applicants based on their **financial history, business plan viability, and financial statements** before granting loans.

Regarding the bank's portfolio, Mr. Yared noted a **steady yearly growth**, driven by an increasing number of new customers.

1 **Bank Policies for Managing NPLs**

To mitigate NPL risks, the bank implements several strategies:

- **Business consultation** – Helping customers restructure their operations.
- **Repayment extensions** – Offering adjusted timelines for struggling borrowers.
- **Loan evaluations** – Carefully reviewing requested amounts before approval.
- **Additional loans** – In some cases, providing further financing to cover existing debts.

2 **Impact of NPLs on the Bank**

Mr. Yared emphasized that NPLs significantly affect the bank's operations by:

- **Reducing working capital**, which limits liquidity.
- **Disrupting cash flow**, affecting both inflows and outflows.
- **Discouraging further investments** due to increased financial risk.

This structured approach helps the bank manage defaults while supporting customers through financial difficulties.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.1 CONCLUSION

The major activities of banking industry among other things are to mobilized deposit and channel to the economy in the form of loans. The core activity and the source of economy in the primary source of income to commercial banks are loans.

This study aimed to analyze and evaluate the issue of non-performing loans (NPLs) at the Commercial Bank of Ethiopia, Nefasilk District. Based on the findings presented in Chapter Four, the following conclusions have been drawn:

A timely and planned loan contributes to the profitability and financial sustainability of any lending institution, the strength of which is believed to enhance economic development effort. the formal credit market in Ethiopia has still long ways to go in its development endeavors. The bank most of its loans on the due date and provides a credit service for all sector such that agriculture, industry, service, and merchandise sector. The overall nonperforming loan average rates during three years for all sectors as shows in the table 4.24. In 2022/23 was birr 17,607,283.43(17.57%) in the year 2023/24 was birr 28,695,407(29.88%) but in year 2024/25 NPL was increase to birr 35,694,005.52(41.22%) this shows high percentage NPL was recorded in CBE Nifasilk district. Currently CBE has recorded high non performing loan than previous years.

This is because of: -

- Most of the borrowers do not use the loan for the intended purpose. i.e diversification of fund or debt. This diversification of fund might be used for non-producing purpose the debtor will not be repay their loans.
- Due to lack of sufficient knowledge about the loan most of the borrower wants to expand their business rather than paying the debt in time. This leads to a raise in the non-performing loan of the banks.
- Because of the able to market failures most of the debtors will not able to the debt.

- On the evaluation stage most borrowers do not present update financial statement this leads during the feasibility stage the bank use over stated financial statement of debtors. This will affect the loan approval form by over stated the grant loan amount.

Due to the above reasons CBE has portfolio problems and this problem lead the bank. Unable to grant loan for new creditors. This affects the profitability of the bank on the other hand it reduces growth of investment this also leads to reduction of the major government revenue. This government revenue reduction affects the government expenditure for the country. i.e welfare of the society. The reduction individual investment due to the reduction of loan reducers the national and personal income. This has a negative impact for personal saving and further investment.

5.2 Recommendation

Based on the data described the researcher forwarded the following recommendation.

The non-performing loan affects the profitability and competition from other banks. In order to manage the loan effectively the bank is expected to strength the manpower of the credit department for timely follow up of the loan after disbursement whether the borrower is used the debt for the intended purpose or not. This reduces the bank credit risk.

To mitigate valuation challenges, the bank should establish a dedicated collateral estimation committee. This specialized team would ensure accurate asset appraisals, thereby reducing the need for loan settlements through foreclosure proceedings.

The bank should decide rapidly to collect the loan by foreclosed the defaulters' collaterals before it value depreciate and deteriorated through time.

Financial institutions should give due consideration to external economic variables, especially market price fluctuations, during their client selection process.

The bank may reschedule and may consider injection of additional loan to reduce the non-performing loan when the defaulter faces market failure due to price, inflation and weather condition so on especial for short term loan.

The findings underscore the need for deeper investigation into loan management systems, especially concerning NPLs, which remain both a problem area and central function for banking institutions.

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APPENDIX
WOLKITE UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE

QUESTIONNAIRE ON NONE PERFORMING LOANS-To employees

Dear respondents

First of all I would like to thank you in advance for your corporation &for your timely scarification in participating on this study.

This study is intended to serve for academic purpose only . This questionnaire is prepared for the purpose of collecting data that can be used as an input for the activity of research on the assessment and trend analysis of nonperforming loans in case of CBE bank.

N.B please put sign (✓) in the answer box provided for yes or no question and writes your opinion idea in appropriate manner for explanation.

Full name; Tigist Ayele

Part One. Background of respondents

1. Sex:-Male Female
2. Age:-18-30 31-45 46 and above
3. Level of education
- Diploma degree masters
4. For how long have you been worked in CBE?
- Less than one year 1-2 year 2-4 year
- 4-7 years over seven years

Part Two: Company specific questions

5. What is your opinion on the approval of loan to customers?
- Over financed as requested
- Under financed as requested
- 6.How your customers repay their loan on time?
- Fully repay partially repay
- Most of the loan remain unpaid most of the loan paid
7. What is the factors for loan repayment process by borrowers?

Lack of follow up of customer strategy

Less business of borrowers

Increment of cost of return

Ineffective credit management

Diversion of loan by borrowers

If other-----

8. How do you evaluate the Banks's customer handling?

Poor Good Excellent

Fair Very Good

9. For what types of investment the bank gives priority for lending the loan?

Agriculture Service

Manufacturing Trade/Merchandise

Other-----

10. Criteria for loan advices to be borrowers bank relationship?

A easily contact with them

B existence of more customers

C clearness to assess their performance

D truthfulness to repay loan on time

E All

11. Is there any problem that the bank faced in the process of loan repayment?

Yes No

12. If your answer is yes on question No.11 above, what are the problems?

Poor credit policies and procedure

Ineffective credit management

Inadequate information about the performance of customer

Lack of training provision of employee

E if other-----

13. What are significance factor causing non performing loan?

Inadequate risks Management... Technology

Natural disaster Governmental regulation

poor credit monitoring .. Low capitalization ...

14 What is time duration the CBE takes in granting the loan?

Less than one month.. between one and three months

More than three months

15 What do you think of the time taken for loan processing?

Fair.. Lengthy.. Unfair..

16. What do you recommend as solution to solve the major lead you to non-performing loans problems? Please Justify

WOLKITE UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE
INTERVIEW ON NON PERFORMING LOANS

BY: TIGIST AYELE

ID NO SSR/1652/14

Made with loan officers and credit clerk

1. What is the major reason for customers to be NPL in your bank?
2. What action do you take when these customers become NPL?
3. How do you evaluate the amount of loan request by the customer to be approved?
4. How do you see the bank credit portfolio from year to year?
5. What is the contribution of the bank policies and procedures to handle NPL?
7. What is the effect of NPL on your bank?

ወልቂጤ ዩኒቨርሲቲ

ቢዝነስ እና ኢኮኖሚክስ ኮሌጅ

አካውንቲንግ እና ፋይናንስ ትምህርት ክፍል

ይህ መጠይቅ በኢትዮጵያ ንግድ ባንክ ያልተሰበሰቡ ብድሮች ለይ በሚደረግ ጥናት ከባንኩ ደንበኞች መሰጃ ለማሰባሰብ የተዘጋጀ።

ይህጥናት ወልቂጤ ዩኒቨርሲቲ በአካውንቲንግ እና ፋይናንስ የድግሪ ተማሪ መመሪያዎ ጽሁፍ የሚያገለግልነው

የሚሰጡት መረጃ ለዚህ አላማ ብቻ እንደሚውል እየገለፁኩኝ ለሚያደርጉልኝ ትብብር በቅድሚያ ከልብ አመሰግናለሁ።

መመሪያ

.ስምመፃፍአያስፈልግም

.በሚፈልጉትምርጫላይይህንንምልክትያድርጉ

ክፍል 1:- ስለደንበኛው የግል መረጃ

1. ፆታ: ወንድ ሴት

2. የትምህርት ደረጃ: 1-12 ሰርተፍኬት ዲፕሎማ ድግሪና ከዚያ በላይ

3. በኢትዮጵያ ንግድ ባንክ መገልገል ከጀመሩ ምን ያህል ጊዜ ሆኖታል?

አምስት አመት በታች ከአምስት አመት በላይ

4. ብድር የወሰዱት ለምን ያህል ጊዜ ነው? የመካከለኛ ጊዜ የረዥም ጊዜ

ክፍል 2:- ደንበኛው ከባንኩ ጋር ሰላላ ለውግ ነገሮች

1. የተበደሩት ለምን አላማ ነው ?

ለኢንዱስትሪ ለንግድስራ ለግብርናሰራ ለሌላከሆነይግለፁ_____

2. የተበደሩትን ብድር ለተበደሩበት ጉዳይ አውለውታል ?

አዎ አይደለም

አይደለም ከነምክንያቱን ይግለፁ-----

3. ባንኩ የሚሰጣቸው አገልግሎቶች ግንዛቤ አሉት ?

አዎ አይደለም

አዎካሉያብራሩ_____

4. ከባንኩ የምክር አገልግሎት ያገኛሉ ?

አዎ አይደለም

5. የባንኩን ወለድ እንዴት ይገመግሙታል ?

ተመጣጣኝነው ተመጣጣኝ አይደለም

6. የተበደሩት ብድር በሰአቱ ይመልሳሉ ?

አዎ አይደለም

አይደለም ካሉ ለምን ያብራሩ_____

7. ባንኩ የተጠየቀውን ብድር ለመስጠት ምን ያህል ጊዜ ይፈጅብታል ?

ከአንድወርበታች ከሁለትወር እስከሦስትወር ከሦስትወር በላይ

8. በብድር ስርአት ውስጥ የሚፈጅበት ጊዜ እንዴት ያይታል ?

ተመጣጣኝነው ተመጣጣኝ አይደለም ረጅም ጊዜ ይወስዳል

9. የባንኩ የብድር ክፍል ብድሩን በአግባቡ ይከታተላል ?

አዎ አይደለም

10. ብድር በአግባቡ ለመመለስ የሚያጋጥሞት ችግር ምንድነው ?

የስራ መደራረብ የገንዘብ እጥረት ተፈጥሮአዊ ችግር

ሌላ ከሆነ ይግለጹ-----

11. በባንኩና በእርሶ መካከል ያለው የብድር ግንኙነት አለ የሚሉት ዋናዎና ተግዳሮቶች ምንድናቸው?