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COLLEGE OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING

**ASSESSMENT OF FACTORS CONTRIBUTING TO NON-PERFORMING LOANS IN THE
CASE OF COMMERCIAL BANK OF ETHIOPIA'S YEJOKA BRANCH,
WOLKITE.**

**A SENIOR ESSAY SUBMITTED TO THE DEPARTMENT OF ACCOUNTING AND
FINANCE IN PARTIAL FULFILMENT OF THE BACHLER OF ART (BA) DEGREE
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This is to certify that a thesis on the topic entitled “**assessment of factors contributing to non-performing loans at the commercial bank of Ethiopia's yejoka branch, wolkite.**” submitted Partial Fulfillment of the Requirements for the BA Degree in Accounting and Finance; the undergraduate program has been carried out by **HAYAT MUHAMMED**, under my supervision. Therefore, I recommend that the student has fulfilled the requirements and hence hereby can submit the thesis.

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Abstract

This study assesses the factors contributing to non-performing loans (NPLs) at the Commercial Bank of Ethiopia's Yejoka branch in Wolkite, addressing the growing concern of NPLs in the banking sector amidst economic challenges. The main objective is to identify key factors influencing NPLs, evaluate bank-specific characteristics, and assess the effectiveness of current credit assessment practices. Utilizing a mixed-methods approach, the research combines quantitative data from structured surveys with qualitative insights from interviews with branch managers. Major findings indicate that economic conditions, such as inflation and unemployment, significantly affect borrowers' repayment capabilities, while borrower characteristics, including credit history and income stability, are also crucial. The study recommends enhancing credit assessment procedures, improving loan monitoring systems, and fostering better interdepartmental communication to mitigate risks associated with NPLs.

Keywords: *Non-Performing Loans, Credit Risk, Commercial Bank of Ethiopia, Banking Sector.*

list of acronyms and abbreviations:

NPLs: Non-Performing Loans

GDP: Gross Domestic Product

MENA: Middle East and North Africa

IMF: International Monetary Fund

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Non-performing loans (NPLs) have emerged as a significant concern for the global banking sector, particularly following financial crises that have exposed vulnerabilities in lending practices. The global financial crisis of 2008 marked a pivotal moment, leading to a dramatic increase in NPLs across many countries. According to research, elevated levels of NPLs are closely associated with economic downturns, as borrowers struggle to meet repayment obligations amid rising unemployment and declining economic activity (Aiyar et al., 2015). The dynamics of NPLs during banking crises reveal that unresolved NPLs can severely impair bank balance sheets, restrict credit growth, and hinder economic recovery (Ari et al., 2020).

The determinants of NPLs are multifaceted, encompassing both macroeconomic factors—such as GDP growth rates, inflation, and interest rates—and bank-specific factors like capital adequacy and management practices (Klein, 2013). Studies indicate that while macroeconomic conditions significantly influence loan performance, internal bank characteristics often play a more critical role in determining the likelihood of defaults (Bayar, 2019). This duality highlights the need for banks globally to adopt robust risk management frameworks and proactive measures to mitigate the impact of economic fluctuations on loan performance.

In Africa, the challenge of non-performing loans is particularly pronounced due to a combination of economic instability and underdeveloped financial systems. The continent has experienced a steady rise in NPL ratios, attributed to factors such as political instability, fluctuating commodity prices, and inadequate regulatory frameworks (Rachid, 2019). For instance, countries in the Sub-Saharan region have reported NPL ratios exceeding 10%, which poses significant risks to financial stability and economic growth (World Bank, 2020). The impact of these loans extends beyond individual banks; high NPL levels can lead to reduced lending capacity across the banking sector, ultimately stifling economic development.

Moreover, research indicates that the global financial crisis exacerbated existing vulnerabilities in African banking systems. Many banks faced difficulties in managing credit risk due to poor governance structures and limited access to capital markets. As a result, addressing NPLs has become a priority for policymakers across the continent. Strategies such as enhancing regulatory frameworks and improving credit assessment processes are being implemented to tackle this issue effectively (IMF, 2016). The African perspective underscores the necessity for tailored solutions that consider local economic conditions and institutional capacities.

In Ethiopia, non-performing loans represent a growing concern within the banking sector. The country's rapid economic growth over the past decade has been accompanied by an increase in lending activity; however, this has also led to rising NPL ratios. Recent studies indicate that Ethiopia's banking sector faces challenges related to credit risk management and borrower assessment practices (World Bank, 2020). Factors such as high unemployment rates and limited access to financial services contribute significantly to loan defaults.

The Ethiopian government has recognized the importance of addressing NPLs as part of its broader economic reform agenda. Initiatives aimed at strengthening regulatory oversight and enhancing the capacity of financial institutions are underway. For instance, efforts are being made to improve data collection on loan performance and borrower profiles to facilitate better risk assessment (Klein, 2013). Additionally, there is a growing emphasis on developing financial literacy programs for borrowers to enhance their understanding of credit obligations. The Ethiopian context illustrates the interplay between rapid economic development and the challenges posed by non-performing loans, necessitating comprehensive strategies for sustainable financial stability.

1.2 Statement of the Problem

The issue of non-performing loans (NPLs) is a critical concern for financial stability worldwide, particularly in the aftermath of the 2008 global financial crisis. A study by Nkusu (2011) highlights that adverse macroeconomic conditions, such as declining GDP and rising unemployment, are significantly correlated with increasing NPL levels across advanced economies. The findings indicate that as economic performance deteriorates, borrowers' ability to service debts diminishes, leading to a vicious cycle where rising NPLs further exacerbate macroeconomic vulnerabilities. However, the study's limitation lies in its focus primarily on

advanced economies, which may not accurately reflect the dynamics in developing regions where different structural factors influence loan performance.

Moreover, while Nkusu's research provides valuable insights into the relationship between macroeconomic indicators and NPLs, it lacks a comprehensive examination of bank-specific factors that could also contribute to loan defaults. This gap suggests a need for further research that incorporates both macroeconomic and microeconomic variables to develop a more holistic understanding of NPL determinants globally (Nkusu, 2011).

In Africa, the determinants of non-performing loans have been explored with an emphasis on both macroeconomic factors and bank-specific characteristics. A study conducted by Rachid (2019) on the Middle East and North Africa (MENA) region found that bank-specific factors were more influential than macroeconomic variables in determining NPL levels. The research analyzed data from 74 banks across 11 MENA countries during periods of economic upheaval, concluding that internal governance issues and risk management practices significantly affect loan performance. However, this study's limitation is its regional focus, which may overlook unique challenges faced by individual countries within Africa.

Furthermore, while Rachid's findings underscore the importance of bank-specific factors, they do not adequately address how external shocks—such as commodity price fluctuations—affect loan quality in African economies reliant on natural resources. This gap indicates a need for more localized studies that explore how specific economic conditions impact NPLs in various African contexts (Rachid, 2019).

Additionally, existing literature often overlooks the impact of regulatory frameworks and institutional capacity on loan performance in Ethiopia. For instance, a study by Dagne Mulatu and Maru Shete (2016) investigates macroeconomic variables and bank-specific internal factors affecting NPLs in the Development Bank of Ethiopia. Their findings indicate that factors such as real interest rates, credit growth, and GDP growth significantly correlate with NPL levels. However, this research primarily utilizes data from a specific bank and does not comprehensively address the broader Ethiopian banking context.

This study aims to provide a detailed analysis of non-performing loans (NPLs) at the Commercial Bank of Ethiopia's Yejoka branch. By examining bank-specific factors, this research

will enhance understanding of what drives NPLs in Ethiopia. Additionally, it will look at how regulatory frameworks and the capacity of institutions affect loan performance. The insights gained from this study will be valuable for policymakers and banking institutions as they work to reduce risks associated with non-performing loans.

1.3 Research Questions

1. What are the primary factors contributing to the rise of non-performing loans at the Commercial Bank of Ethiopia's Yejoka branch?
2. What bank-specific characteristics influence the likelihood of loan defaults at the Yejoka branch?
3. How effective are the current credit assessment practices at the Commercial Bank of Ethiopia?

1.4 Research Objectives

1.4.1 General Objective

The general objective of the study is to assess the factors contributing to non-performing loans at the Commercial Bank of Ethiopia's Yejoka branch, wolkite.

1.4.2 Specific Objectives

1. To assess the key factors that contribute to non-performing loans at the Yejoka branch.
2. To assess the impact of bank-specific characteristics, including capital adequacy and risk management practices at the Yejoka branch.
3. To examine the effectiveness of current credit assessment practices employed by the Commercial Bank of Ethiopia.

1.5 Significance of the Study

This study holds significant importance for multiple stakeholders, including policymakers, banking institutions, and researchers. By providing a comprehensive analysis of the factors contributing to non-performing loans at the Commercial Bank of Ethiopia's Wolkite branch, the research aims to enhance understanding of both macroeconomic and bank-specific influences on loan performance. Policymakers can utilize the findings to develop targeted strategies that improve regulatory frameworks and promote financial stability within the banking sector. For

banking institutions, particularly the Commercial Bank of Ethiopia, the insights gained will inform better credit assessment and risk management practices, ultimately leading to improved loan recovery rates and reduced NPL ratios. Additionally, this study contributes to the academic literature on non-performing loans in Ethiopia, filling existing gaps and paving the way for future research in this critical area of financial stability.

1.6 Scope of the Study

The scope of this study was defined by methodological, thematical, and geographical parameters. Methodologically, the study employed a mixed-methods approach, integrating both quantitative data from surveys and qualitative data from interviews. This allowed for a comprehensive understanding of the factors influencing non-performing loans at the Commercial Bank of Ethiopia's Yejoka branch. The study focused on gathering data directly from bank staff to capture their perceptions and experiences, as well as reviewing existing literature to provide a broader context.

Thematically, the study centered on identifying the key drivers of non-performing loans, with a particular emphasis on bank-specific factors. It explored the impact of credit assessment practices, risk management strategies, and internal governance on loan performance. While macroeconomic factors were acknowledged, the study primarily investigated the internal dynamics of the bank. Geographically, the research was limited to the Yejoka branch of the Commercial Bank of Ethiopia in Wolkite, providing a focused analysis of a single branch's operations and challenges related to non-performing loans.

1.7 Limitations of the Study

This study has several limitations that should be acknowledged. Firstly, the research focuses exclusively on the Yejoka branch of the Commercial Bank of Ethiopia, which may limit the generalizability of the findings to other branches or banks in Ethiopia. Additionally, the reliance on self-reported data from bank staff could introduce response bias, as participants may provide answers they believe are more favorable or acceptable. The mixed-methods approach, while comprehensive, may also encounter challenges in integrating quantitative and qualitative data effectively. Furthermore, the rapidly changing economic environment in Ethiopia can affect the relevance of the findings over time, as external factors influencing non-performing loans may evolve. Lastly, the study primarily examines internal factors; thus, external macroeconomic

variables, such as government policies and global economic trends, may not be fully explored, potentially affecting the overall understanding of NPL dynamics.

1.8 Organization of the Study

This study organized into five chapters. Chapter One introduces the research background, problem statement, objectives, significance, scope, and organization of the study. Chapter Two provides a comprehensive literature review on non-performing loans, examining global, African, and Ethiopian perspectives. Chapter Three outlines the research methodology, detailing the data collection methods, analytical techniques, and the rationale for the chosen approach. Chapter Four presents the findings and analysis of the data collected from the Commercial Bank of Ethiopia's Wolkite branch. Finally, Chapter Five discusses the implications of the findings, offers recommendations for practice and policy, and suggests areas for future research. This structured approach ensures a coherent flow of information and facilitates a thorough understanding of the factors influencing non-performing loans in the context of Ethiopian banking.

CHAPTER TWO

REVIEW OF LITERATURE

2.1 Theoretical Framework

The theoretical framework for understanding non-performing loans (NPLs) encompasses several key theories that explain the dynamics of loan defaults and their implications for banking stability. This framework integrates concepts from economics, finance, and banking management to provide a comprehensive understanding of the factors influencing NPLs. The primary theories relevant to this discussion include the Adverse Selection Theory, Moral Hazard Theory, and Information Asymmetry Theory. Each of these theories offers insights into the mechanisms that lead to loan defaults and the subsequent impact on financial institutions.

2.1.1 Adverse Selection Theory

Adverse selection is a fundamental concept in economics that describes a situation where there is asymmetric information between buyers and sellers, leading to suboptimal market outcomes. In the context of lending, adverse selection occurs when lenders cannot accurately differentiate between high-risk and low-risk borrowers due to insufficient information (Akerlof, 1970). This situation often results in lenders extending credit to borrowers who are more likely to default, thereby increasing the overall risk of non-performing loans within their portfolios.

The implications of adverse selection are particularly pronounced in environments where borrowers have better knowledge of their financial situations than lenders do. When interest rates rise or lending standards tighten, higher-risk borrowers are more likely to seek loans, while lower-risk borrowers may withdraw from the market due to unfavorable terms (Rothschild & Stiglitz, 1976). Consequently, as lenders inadvertently attract more high-risk borrowers, the likelihood of defaults increases, leading to higher NPL ratios.

To mitigate adverse selection, banks can implement rigorous credit assessment processes that include thorough background checks and financial evaluations of potential borrowers. By enhancing their information-gathering mechanisms, lenders can better identify low-risk clients

and reduce their exposure to defaults. Additionally, employing advanced data analytics tools can aid in assessing borrower risk profiles more accurately.

In summary, adverse selection theory highlights the challenges faced by lenders in distinguishing between good and bad borrowers, ultimately contributing to the prevalence of non-performing loans. Addressing this issue requires improved information transparency and robust credit assessment practices.

2.1.2 Moral Hazard Theory

Moral hazard refers to the risk that one party engages in risky behavior or fails to act in good faith because they do not bear the full consequences of their actions (Jensen & Meckling, 1976). In lending contexts, moral hazard arises when borrowers take on excessive risks after securing a loan because they believe that any potential losses will be absorbed by the lender or other stakeholders. This behavior can lead to defaults and increased levels of non-performing loans.

For instance, once a borrower receives a loan, they may engage in riskier business ventures or fail to manage their finances prudently, believing that any negative outcomes will not significantly impact them due to limited personal liability (Cottarelli et al., 2005). This misalignment of incentives can create a situation where borrowers prioritize short-term gains over long-term repayment obligations, ultimately leading to higher default rates.

To combat moral hazard, lenders can implement various strategies such as monitoring borrower activities post-loan disbursement and incorporating covenants into loan agreements that restrict certain behaviors (Kraft & Jankov, 2005). By establishing clear expectations and conditions for loan usage, lenders can encourage responsible borrowing practices and reduce the likelihood of defaults.

Furthermore, aligning borrower incentives with lender interests through performance-based repayment structures can help mitigate moral hazard issues. For example, offering lower interest rates or favorable terms for timely repayments may encourage borrowers to prioritize their financial obligations.

In conclusion, moral hazard theory underscores the importance of aligning incentives between lenders and borrowers to minimize risks associated with non-performing loans. Effective monitoring and contractual agreements play crucial roles in addressing this challenge.

2.1.3 Information Asymmetry Theory

Information asymmetry theory posits that one party in a transaction possesses more or better information than the other party, leading to imbalances in decision-making (Akerlof, 1970). In lending scenarios, this asymmetry often manifests when lenders lack complete information about borrowers' creditworthiness or financial health. As a result, lenders may inadvertently extend credit to high-risk individuals or businesses who are less likely to repay their loans.

This lack of transparency can lead to increased default rates as lenders struggle to accurately assess borrower risk profiles. Information asymmetry is particularly problematic in developing economies where credit histories are often limited or nonexistent (Nkusu, 2011). Without reliable data on borrower behavior and repayment history, banks face significant challenges in making informed lending decisions.

To mitigate information asymmetry issues, financial institutions can invest in comprehensive credit scoring systems that aggregate data from various sources to provide a holistic view of borrowers' financial situations. Additionally, fostering partnerships with credit bureaus can enhance data sharing and improve overall credit assessment processes.

Moreover, educating borrowers about their financial responsibilities and providing them with resources for effective money management can help reduce information gaps. By empowering borrowers with knowledge about loan terms and repayment expectations, banks can foster more transparent relationships that ultimately lead to improved loan performance.

In summary, information asymmetry theory highlights the critical role of transparency in lending practices. By addressing information gaps through enhanced data collection and borrower education initiatives, banks can reduce their exposure to non-performing loans.

2.1.4 Integration of Theories

The integration of adverse selection theory, moral hazard theory, and information asymmetry theory provides a comprehensive framework for understanding the dynamics surrounding non-performing loans. These theories collectively illustrate how various factors contribute to loan defaults and highlight the need for effective risk management strategies within banking institutions.

By recognizing that adverse selection leads to an influx of high-risk borrowers while moral hazard encourages irresponsible borrowing behavior post-loan approval, banks can develop targeted interventions aimed at mitigating these risks. Additionally, addressing information asymmetry through improved data collection and transparency initiatives can enhance lenders' ability to make informed decisions regarding credit extensions.

Furthermore, policymakers can leverage these theoretical insights when formulating regulations aimed at strengthening the banking sector's resilience against NPLs. For instance, implementing stricter lending standards based on empirical data regarding borrower behavior may help reduce adverse selection risks while promoting responsible borrowing practices among consumers.

In conclusion, understanding the theoretical underpinnings related to non-performing loans is essential for developing effective strategies that address both individual borrower behavior and systemic risks within financial institutions. By integrating these theories into practice, banks can enhance their risk management frameworks and contribute positively toward overall economic stability.

2.2 Empirical Review

The empirical investigation of non-performing loans (NPLs) has garnered significant attention from researchers worldwide, leading to a plethora of studies aimed at understanding the determinants and consequences of NPLs in various banking contexts. This section reviews key empirical studies that explore the factors influencing NPLs, the impact of NPLs on financial performance, and the effectiveness of different management strategies. The discussion is organized into subsections focusing on macroeconomic factors, bank-specific factors, regional studies, and the implications of NPL management.

2.2.1 Macroeconomic Factors Influencing Non-Performing Loans

Numerous empirical studies have established a strong relationship between macroeconomic conditions and the levels of non-performing loans. For instance, Nkusu (2011) conducted a comprehensive analysis involving 26 advanced economies from 1998 to 2009, revealing that economic growth, unemployment rates, and asset prices are significant determinants of NPLs. The study found that as economic growth declines, the ability of borrowers to repay loans diminishes, leading to an increase in NPL ratios. Specifically, higher unemployment rates

correlated positively with rising NPLs, highlighting the vulnerability of borrowers during economic downturns.

Similarly, Louzis et al. (2012) investigated the impact of macroeconomic variables on non-performing loans in Greece's banking sector between 2003 and 2009. Their findings indicated that GDP growth, unemployment rates, interest rates, and public debt significantly influenced loan performance across various loan categories, including mortgages and consumer loans. The study underscored that adverse economic conditions lead to increased defaults as borrowers struggle to meet their financial obligations.

Other studies have focused on emerging markets to explore the macroeconomic determinants of NPLs. For example, research conducted in Eastern European countries demonstrated that inflation and currency depreciation significantly impacted loan performance (Curak et al., 2013). High inflation erodes real income levels for borrowers, making it challenging for them to service their debts. The cumulative evidence from these studies suggests that macroeconomic stability is crucial for maintaining healthy loan portfolios within banking institutions.

In conclusion, macroeconomic factors play a pivotal role in influencing non-performing loans across various contexts. Policymakers must recognize the interconnectedness between economic health and loan performance when formulating strategies to mitigate the risks associated with NPLs.

2.2.2 Bank-Specific Factors Affecting Non-Performing Loans

In addition to macroeconomic influences, bank-specific factors have also been identified as critical determinants of non-performing loans. A study by Chege and Bichanga (2017) focused on commercial banks in Kenya and found that internal bank characteristics such as capitalization levels, operating costs, and bank size significantly affected financial performance as measured by return on assets (ROA). The research highlighted that banks with stronger capital positions were better equipped to manage credit risk and absorb potential losses from non-performing loans.

Another empirical investigation by Wondimu (2012) examined Ethiopian banks and identified several internal factors contributing to NPLs. The study revealed that poor credit assessment practices, inadequate loan monitoring systems, and lenient credit terms significantly increased the likelihood of defaults among borrowers. Additionally, aggressive lending practices without

proper due diligence were found to exacerbate the issue of non-performing loans within Ethiopian banks.

Furthermore, a comparative analysis conducted by Chen et al. (2022) across banks in the Middle East and North Africa region indicated that bank-specific factors were more sensitive than macroeconomic variables in determining NPL levels during periods of economic stress. The study utilized a two-stage system generalized method of moments estimator to analyze data from 74 banks over a fifteen-year period (2005-2020). The findings emphasized the importance of effective risk management practices within banks to mitigate the effects of rising NPLs.

2.2.3 Regional Studies on Non-Performing Loans

Regional studies have provided valuable insights into the dynamics of non-performing loans across different geographical contexts. For instance, research focusing on commercial banks in Tanzania revealed a negative association between non-performing loans and profitability (Mugisha et al., 2021). The study highlighted that rising NPL levels adversely impacted banks' earnings potential by increasing provisioning costs and reducing available capital for new lending activities.

In Nepal, an empirical study conducted by Shrestha et al. (2020) examined the effect of non-performing loans on commercial banks' profitability. The findings indicated a statistically significant negative relationship between NPLs and profitability metrics such as ROA and return on equity (ROE). This study emphasized that effective credit risk management practices are essential for maintaining financial stability within banks operating in challenging economic environments.

Moreover, a study conducted by Awoyemi (2014) analyzed credit risk management practices among commercial banks in Nigeria and their impact on financial performance. The results demonstrated that effective credit risk management strategies significantly reduced the occurrence of non-performing loans while enhancing overall profitability. This research highlights the importance of proactive measures in managing credit risk to mitigate potential losses associated with NPLs.

2.2.4 Implications for Non-Performing Loan Management

The empirical findings regarding non-performing loans carry significant implications for financial institutions and policymakers alike. First and foremost, there is a clear need for enhanced risk management frameworks within banks to address both macroeconomic and bank-specific factors contributing to NPLs. By implementing robust credit assessment processes and monitoring systems, banks can better identify high-risk borrowers early on and take proactive measures to mitigate potential defaults.

Additionally, policymakers should focus on creating an enabling environment that promotes economic stability through sound fiscal policies and regulatory frameworks. Ensuring macroeconomic stability is vital for reducing borrower defaults; thus, governments must prioritize measures that support economic growth while minimizing inflationary pressures.

Furthermore, enhancing financial literacy among borrowers can play a crucial role in reducing non-performing loans. Educational initiatives aimed at improving borrowers' understanding of credit products can empower them to make informed borrowing decisions and manage their finances more effectively.

Finally, ongoing research into the determinants of non-performing loans is essential for adapting strategies in response to changing economic conditions and banking environments. Continuous monitoring of both macroeconomic indicators and bank-specific characteristics will enable financial institutions to remain agile in their approach to managing credit risk effectively.

In conclusion, empirical studies provide valuable insights into understanding non-performing loans' dynamics across various contexts. By addressing both macroeconomic conditions and bank-specific factors while promoting borrower education, stakeholders can work collaboratively towards mitigating the risks associated with non-performing loans.

2.3 Global Perspective on Non-Performing Loans

2.3.1 Definition and Characteristics of Non-Performing Loans

Non-performing loans (NPLs) are defined as loans where the borrower has failed to make scheduled payments of principal or interest for a specified period, typically 90 days or more. According to the International Monetary Fund (IMF), NPLs can also include loans that are less than 90 days overdue but exhibit high uncertainty regarding future payments. This classification

is critical for financial institutions as it directly impacts their balance sheets and overall financial health. When a loan is classified as non-performing, it indicates that the likelihood of recovering the owed amounts is significantly diminished, which can lead to increased provisions for loan losses on the bank's financial statements.

The characteristics of NPLs vary, but they generally signify a deterioration in the borrower's financial situation. Factors leading to NPL status can include economic downturns, loss of employment, or significant changes in market conditions that affect the borrower's ability to repay. The classification of loans as non-performing is crucial not only for banks but also for regulatory bodies that monitor the health of financial systems globally. High levels of NPLs can indicate systemic risks within a banking sector, prompting regulatory interventions to stabilize the economy.

NPLs can be categorized into various types based on their characteristics and circumstances surrounding their defaults. Common categories include substandard loans, which show signs of deterioration but may still be recoverable; doubtful loans, which are at a higher risk of default; and loss loans, which are deemed uncollectible and have been written off by lenders. Understanding these classifications helps banks manage risk more effectively and develop strategies for recovery.

The implications of high NPL levels extend beyond individual banks. They can affect the entire banking system's stability, leading to reduced lending capacity and economic growth. As banks face increasing NPL ratios, they may tighten lending standards, which further constrains credit availability for consumers and businesses alike.

2.3.2 Causes of Non-Performing Loans

The causes of non-performing loans are multifaceted and can be broadly categorized into macroeconomic factors, borrower-specific factors, and bank-specific factors. Macroeconomic conditions play a significant role in influencing loan performance; for instance, economic recessions typically lead to higher unemployment rates and decreased consumer spending power, resulting in increased defaults on loans. Research has shown that countries experiencing economic downturns often see a corresponding rise in NPL ratios as borrowers struggle to meet their repayment obligations (Aiyar et al., 2015).

Borrower-specific factors also contribute significantly to the occurrence of NPLs. These include individual circumstances such as job loss, medical emergencies, or poor financial management practices that hinder borrowers' ability to make timely payments. Additionally, borrowers with inadequate financial literacy may struggle to understand their loan terms or manage their debts effectively, leading to defaults.

Bank-specific factors are equally important in understanding NPL dynamics. Poor lending practices, such as inadequate credit assessments or insufficient monitoring of borrower performance, can increase the likelihood of defaults. For example, if a bank fails to conduct thorough due diligence before approving loans or neglects to monitor borrowers' financial health post-disbursement, it may face higher levels of non-performing loans (Klein, 2013). Furthermore, governance issues within banks—such as lack of accountability or ineffective risk management frameworks—can exacerbate the problem.

2.3.3 Consequences of Non-Performing Loans

The consequences of high levels of non-performing loans extend beyond individual financial institutions and have broader implications for the economy as a whole. One immediate effect is the impact on bank profitability; when loans become non-performing, banks must allocate greater reserves for potential losses, which diminishes their earnings and reduces capital available for new lending (Corporate Finance Institute, 2023). This reduction in profitability can lead to tighter credit conditions as banks become more cautious in their lending practices.

Moreover, elevated NPL ratios can create a ripple effect throughout the economy. As banks tighten lending standards in response to rising NPLs, businesses may find it increasingly difficult to secure financing for operations or expansion plans. This credit squeeze can stifle economic growth by limiting investment opportunities and reducing consumer spending power (European Central Bank [ECB], 2023). In extreme cases, widespread defaults can lead to banking crises that necessitate government intervention or bailouts.

Additionally, high levels of non-performing loans can damage public confidence in the banking system. When consumers perceive banks as unstable due to rising NPL ratios, they may withdraw deposits or refrain from seeking loans altogether. This lack of confidence can further exacerbate liquidity issues within banks and contribute to a negative feedback loop affecting overall economic stability.

Regulatory authorities closely monitor NPL levels as part of their oversight responsibilities because they recognize the potential systemic risks associated with high NPL ratios. To mitigate these risks, regulators often implement measures aimed at improving banks' risk management practices and enhancing transparency regarding loan performance.

2.4 African Perspective on Non-Performing Loans

2.4.1 Overview of Non-Performing Loans in Africa

Non-performing loans (NPLs) have emerged as a significant challenge for the banking sector across Africa, with implications for financial stability and economic growth. The definition of NPLs varies slightly from country to country, but generally, a loan is classified as non-performing when payments of principal or interest are overdue by 90 days or more. In many African nations, the prevalence of NPLs is particularly concerning due to the vulnerability of their economies to external shocks and macroeconomic instability (Zeng, 2012). For instance, countries like Nigeria have experienced a dramatic rise in NPL ratios, which has been linked to past financial crises and systemic vulnerabilities within their banking systems.

The structure of the banking sector in many African countries often exacerbates the issue of NPLs. A few large banks typically dominate the market, leading to increased systemic risk; if one major bank faces insolvency due to high NPL levels, it can trigger a domino effect throughout the entire financial system (Jiménez et al., 2017). This concentration can result in a lack of competition and innovation within the sector, further contributing to poor lending practices and increased defaults. As such, understanding the dynamics of NPLs in Africa requires a nuanced approach that considers both macroeconomic factors and the specific characteristics of local banking systems.

Moreover, the economic conditions in many African countries often lead to high levels of NPLs. Factors such as inflation, currency depreciation, and political instability can create an environment where borrowers struggle to meet their repayment obligations. For example, in West Africa, rising inflation rates have made it increasingly difficult for borrowers to service their debts, resulting in higher default rates (Adeola & Ikpesu, 2017). This situation highlights the need for effective risk management strategies within banks to mitigate potential losses associated with NPLs.

2.4.2 Causes of Non-Performing Loans in Africa

The causes of non-performing loans in Africa can be broadly categorized into macroeconomic factors, borrower-specific issues, and bank-specific characteristics. Macroeconomic instability is a significant driver of NPLs across the continent. Economic downturns often lead to increased unemployment rates and reduced consumer spending power, making it difficult for borrowers to meet their debt obligations (Caporale et al., 2014). For instance, during periods of economic contraction or political unrest, many borrowers may experience income loss or reduced business revenues, leading to defaults on loans.

Borrower-specific factors also play a crucial role in determining loan performance. In many African countries, borrowers often lack adequate financial literacy and access to information about credit products. This lack of understanding can result in poor borrowing decisions or mismanagement of funds (Ghosh, 2017). Additionally, personal circumstances such as health issues or family emergencies can significantly impact an individual's ability to repay loans on time. The combination of these borrower-specific challenges increases the likelihood of defaults and contributes to rising NPL ratios.

On the bank side, several institutional factors contribute to the prevalence of non-performing loans. Many banks in Africa have historically engaged in lax lending practices without stringent credit assessments or risk management protocols (Nwosu et al., 2021). Poor governance structures within banks can lead to inadequate monitoring of loan performance and insufficient responses to early signs of distress among borrowers. Additionally, some banks may prioritize short-term gains over long-term sustainability by approving loans without thorough due diligence.

2.4.3 Consequences of High Non-Performing Loans

The consequences of high levels of non-performing loans extend beyond individual banks and can significantly impact entire economies across Africa. One immediate effect is on bank profitability; as NPL ratios rise, banks are forced to allocate more capital reserves for potential losses. This allocation reduces their capacity for new lending and investment opportunities (Nwosu et al., 2021). Consequently, banks may tighten credit conditions further, exacerbating the credit crunch that businesses and consumers face during economic downturns.

Moreover, elevated NPL levels can lead to systemic risks within the banking sector. A banking crisis often follows a significant accumulation of non-performing loans; if one major bank fails due to high NPL ratios, it can trigger a cascade effect that threatens the stability of other banks (Jiménez et al., 2017). This interconnectedness highlights the importance of maintaining healthy loan portfolios across all financial institutions within a country.

The broader economic implications are equally concerning. High levels of non-performing loans can stifle economic growth by limiting access to credit for businesses and consumers alike (Caporale et al., 2014). When banks become overly cautious about lending due to rising NPLs, businesses may struggle to secure financing needed for expansion or operations. This situation ultimately leads to decreased investment levels and slower economic recovery during periods of crisis.

Furthermore, public confidence in the banking system may erode as consumers witness rising NPL ratios and potential bank failures. This loss of trust can result in decreased deposits as individuals withdraw their savings from banks perceived as unstable (Ghosh, 2017). The cumulative effect is a weakened financial system that struggles to support economic development initiatives.

2.5 Ethiopian Perspective on Non-Performing Loans

In Ethiopia, non-performing loans (NPLs) are defined under the National Bank of Ethiopia (NBE) banking directives as loans whose credit quality has deteriorated such that the full collection of principal and/or interest in accordance with the contractual repayment terms is in question (NBE, 2008). This definition aligns with international standards, where a loan is classified as non-performing if payments of interest and/or principal are overdue by 90 days or more. The regulatory framework surrounding NPLs is crucial for maintaining financial stability within the banking sector, as it provides guidelines for banks on how to classify and manage these loans.

The increasing trend of NPLs in Ethiopia has raised concerns among regulators and policymakers. For instance, the Development Bank of Ethiopia (DBE) has reported a significant rise in its NPL ratio, which escalated from 9.9% in 2013/14 to approximately 40% by 2018 (Geletta, 2021). This alarming increase not only threatens the bank's solvency but also poses risks to the broader economic landscape, as the DBE plays a vital role in financing development

projects across various sectors. The regulatory framework aims to mitigate these risks by enforcing stringent capital adequacy requirements and encouraging banks to adopt effective risk management practices.

2.5.2 Causes of Non-Performing Loans in Ethiopia

The causes of non-performing loans in Ethiopia can be attributed to a combination of macroeconomic factors, borrower-specific issues, and bank-specific characteristics. Macroeconomic instability is a significant driver of NPLs; fluctuations in inflation rates, currency depreciation, and overall economic performance can adversely affect borrowers' ability to repay their debts (Arega et al., 2016). For example, during periods of high inflation, borrowers may find their real income eroded, making it difficult to meet loan obligations. Additionally, political instability and uncertainty can lead to reduced investment and economic activity, further exacerbating the problem of loan defaults.

Borrower-specific factors also play a crucial role in determining loan performance. Many borrowers in Ethiopia face challenges related to financial literacy and access to information about credit products. A lack of understanding regarding loan terms can lead borrowers to take on debts they cannot afford or mismanage their finances (Geletta, 2021). Furthermore, personal circumstances such as health issues or family emergencies can significantly impact an individual's ability to repay loans on time. These borrower-specific challenges increase the likelihood of defaults and contribute to rising NPL ratios.

On the bank side, several institutional factors contribute to the prevalence of non-performing loans. Many banks in Ethiopia have engaged in lax lending practices without stringent credit assessments or risk management protocols (Wondimagegnehu, 2012). Poor governance structures within banks can lead to inadequate monitoring of loan performance and insufficient responses to early signs of distress among borrowers. Additionally, aggressive lending practices without proper due diligence have resulted in increased exposure to credit risk.

CHAPTER THREE:

RESEARCH METHODOLOGY

3.1 Research Design

The research design for this study was descriptive and exploratory, aimed at assessing the determinants of non-performing loans (NPLs) at the Commercial Bank of Ethiopia's Yejoka branch in Wolkite. This design was appropriate as it allowed for a comprehensive examination of both qualitative and quantitative data, facilitating an understanding of the various factors that contributed to NPL levels. By employing a mixed-methods approach, the study gathered rich insights from staff experiences and perspectives while also quantifying key variables related to loan performance. This dual approach enhanced the reliability of findings and supported the formulation of actionable recommendations for improving loan management practices within the bank.

3.2 Research Approach

The research approach adopted for this study was a mixed-methods approach, integrating both qualitative and quantitative research methodologies. This approach enabled the researcher to collect a diverse range of data, providing a more holistic understanding of the factors influencing NPLs. The quantitative component involved structured questionnaires distributed to all employees, allowing for statistical analysis of their responses regarding perceptions of loan performance and risk factors. The qualitative component consisted of semi-structured interviews with branch managers and senior staff, offering deeper insights into strategic decision-making processes and challenges faced in managing NPLs. By combining these methodologies, the study aimed to triangulate data and enhance the validity of the findings.

3.3 Data Type and Source

3.3.1 Primary Data

Primary data was collected directly from the staff at the Yejoka branch through surveys and interviews. The structured questionnaires included closed-ended questions to quantify staff perceptions about NPL determinants, while open-ended questions allowed for more detailed responses regarding their experiences and insights. Additionally, semi-structured interviews with

branch managers provided qualitative data that illuminated managerial perspectives on NPL management strategies and challenges. This firsthand data collection was essential for understanding current practices within the bank and identifying specific factors that contributed to non-performing loans.

3.3.2 Secondary Data

Secondary data was gathered from existing literature, including academic journals, industry reports, regulatory documents, and previous studies related to non-performing loans in Ethiopia and other relevant contexts. These sources provided a theoretical framework for understanding NPL dynamics and helped contextualize the primary data collected in this study. By reviewing secondary literature, the research identified established trends and findings that informed the analysis of primary data, thereby enriching the overall understanding of non-performing loans within the banking sector.

3.4 Population and Sample Size

3.4.1 Population

The population for this study consisted of all employees at the Yejoka branch of the Commercial Bank of Ethiopia, totaling 32 staff members. This population included various roles within the bank, such as loan officers, credit analysts, customer service representatives, and managerial staff who were involved in lending processes or had insights into loan performance and borrower behavior.

3.4.2 Sample Size

The sample size for this research was fixed at 32 participants since it encompassed all employees at the Yejoka branch. By including every staff member in the sample, the study ensured comprehensive representation of perspectives regarding non-performing loans within this specific banking context. This census approach allowed for detailed insights into various factors influencing NPL levels while enhancing the reliability of findings due to full participation.

3.5 Sampling Technique

A census sampling technique was employed for this study, meaning that all 32 staff members at the Yejoka branch were included in the sample. This approach ensured that every individual who had relevant experience or knowledge about non-performing loans contributed to the data

collection process, thereby enhancing the validity and reliability of the findings. By utilizing a census sampling method, researchers captured a complete picture of employee perspectives on NPLs without missing any critical insights from specific roles within the bank.

3.6 Method of Data Analysis

Data analysis involved both descriptive statistical analysis and frequency distribution techniques to summarize responses from questionnaires effectively. Quantitative data collected from surveys was analyzed using descriptive statistics to identify trends related to non-performing loans among employees at the Yejoka branch. This analysis included calculating measures such as means, medians, modes, and standard deviations to understand employee perceptions quantitatively. Additionally, frequency tables were created to present how often specific responses occurred across different categories, providing clear visual representations of key findings.

Qualitative data obtained from interviews with branch managers was coded thematically to extract key themes and insights regarding managerial perspectives on NPL management strategies. Thematic analysis allowed researchers to identify patterns within qualitative responses that revealed underlying issues or effective practices related to managing non-performing loans.

3.7 Ethical Considerations

Ethical considerations were crucial in conducting this research to ensure that participants' rights were protected throughout the study process. Informed consent was obtained from all participants before data collection began, ensuring they understood the purpose of the study, their role in it, and their right to withdraw at any time without consequence. Confidentiality was maintained by anonymizing responses and securely storing data to prevent unauthorized access or disclosure.

Participants were also assured that their feedback would only be used for academic purposes and not disclosed in any identifiable form outside of this context. Additionally, ethical guidelines set forth by relevant institutional review boards or ethics committees were adhered to throughout all phases of research design, data collection, analysis, and reporting.

CHAPTER 4:

DATA ANALYSIS AND FINDINGS

4.1 Introduction

This chapter presents the analysis of data collected from employees of the Commercial Bank of Ethiopia, Wolkite Yejoka Branch. The data is structured into demographic responses, key factors contributing to non-performing loans (NPLs), bank-specific characteristics, and the effectiveness of current credit assessment practices. Each section includes statistical tables along with interpretation.

A total of 32 questionnaires were distributed to employees at the Wolkite Yejoka Branch, out of which 30 were completed and returned, resulting in a 93.75% response rate. This high response rate ensures that the findings are representative of the employees' perspectives and provide reliable insights into the factors affecting non-performing loans at the bank.

4.2 Demographic Characteristics

The demographic profile of respondents provides essential context for understanding their perspectives on receivable management and non-performing loans. This section examines gender distribution, age, education level, years of experience, and job roles at the bank. These factors play a crucial role in shaping employees' insights into credit assessment and loan performance.

table 4. 1 response to Demographic Characteristics question

<i>Demographic Variables</i>	<i>Categories</i>	<i>Frequency</i>	<i>Percentage (%)</i>
<i>Sex</i>	Male	18	60%
	Female	12	40%
<i>Age</i>	Under 25	5	17%
	25-34	12	40%
	35-44	8	27%
	45-54	4	13%
	55 and above	1	3%
<i>Education Level</i>	High School Diploma	3	10%
	Bachelor's Degree	15	50%

<i>Years of Experience</i>	Master's Degree	10	33%
	Doctorate	2	7%
	Less than 1 year	2	7%
	1-3 years	8	27%
	4-6 years	12	40%
<i>Position at the Bank</i>	More than 6 years	8	27%
	Loan Officer	10	33%
	Credit Analyst	8	27%
	Managerial Staff	7	23%
	Support Staff	5	17%

Source: own survey,2025

The sample consisted of 60% male and 40% female respondents, indicating a fairly balanced representation of gender among employees. This gender distribution suggests that both male and female employees contribute to the bank's receivable management processes, ensuring diverse perspectives in handling non-performing loans.

The majority of respondents (40%) were between 25 and 34 years old, indicating that most employees are in their early to mid-career stage. The next significant group (27%) belonged to the 35-44 age range, followed by 13% aged 45-54 and a small proportion of employees (3%) aged 55 and above. These findings suggest that the bank has a workforce that consists mainly of young and mid-career professionals, who likely have relevant expertise in financial and credit management.

A significant portion of employees (50%) hold a bachelor's degree, while 33% have attained a master's degree. Additionally, 7% of respondents have a doctorate, showing a strong academic background among employees. This high level of education suggests that employees have received formal training in finance, banking, and credit risk management, which is crucial for effective loan assessment and recovery.

The results indicate that 40% of respondents have been working for 4-6 years, while 27% have more than 6 years of experience. This suggests that a considerable portion of employees has sufficient practical knowledge in credit and receivable management. Meanwhile, 27% have 1-3 years of experience, and 7% are newcomers with less than one year of experience. This mix of experienced professionals and newer employees ensures that the bank benefits from both fresh perspectives and seasoned expertise.

The majority of respondents (33%) were loan officers, followed by 27% who were credit analysts. 23% held managerial positions, and 17% were support staff. Loan officers and credit analysts are the primary personnel involved in evaluating creditworthiness, approving loans, and monitoring repayment trends. Their responses provide direct insight into the challenges of receivable management and non-performing loans.

The demographic data collected indicates a well-balanced workforce in terms of age, education, and experience, ensuring that the study's findings are informed by knowledgeable and experienced banking professionals. With most employees possessing bachelor's and master's degrees and having substantial work experience, their insights are valuable in understanding the factors influencing loan performance at the Wolkite Yejoka Branch.

4.3 Factors Contributing to Non-Performing Loans

Non-performing loans remain a significant concern for the bank, influenced by multiple factors. This section explores the impact of economic conditions, borrower characteristics, and external financial shocks on loan repayment. Additionally, it examines the role of inadequate loan monitoring and the effectiveness of lending policies in mitigating default risks. Understanding these factors is essential for implementing effective risk management strategies.

table 4. 2 response to Factors Contributing to Non-Performing Loans questions

<i>Question</i>	<i>Response Categories</i>	<i>Frequency</i>	<i>Percentage (%)</i>
<i>Economic conditions contribute to NPLs</i>	Not at all	1	3%
	Slightly	4	13%
	Moderately	8	27%
	Very much	9	30%
	Extremely	8	27%
<i>Impact of borrower characteristics on loan repayment</i>	Never	1	3%
	Rarely	3	10%
	Sometimes	8	27%
	Often	9	30%
	Always	9	30%
<i>Impact of external economic shocks on NPL levels</i>	Not significant at all	2	7%
	Slightly significant	4	13%
	Moderately significant	7	23%
	Very significant	10	33%

<i>Inadequate monitoring and follow-up on loans contribute to NPLs</i>	Extremely significant	7	23%
	Strongly Disagree	1	3%
	Disagree	3	10%
	Neutral	7	23%
	Agree	9	30%
<i>Bank's lending policy affects NPL rates</i>	Strongly Agree	10	33%
	Not at all	1	3%
	Slightly	3	10%
	Moderately	8	27%
	Very much	9	30%
	Extremely	9	30%

Source: own survey,2025

The findings suggest that economic conditions and borrower characteristics are major contributors to NPLs. More than 57% of employees believe economic conditions contribute very much or extremely to loan defaults. Inflation, employment instability, and other macroeconomic factors may negatively affect borrowers' ability to meet their financial obligations, increasing the risk of loan delinquency.

Borrower characteristics, including income stability and credit history, were also identified as important factors in loan repayment performance. 60% of respondents indicated that these characteristics often or always influence repayment behavior. This highlights the importance of conducting thorough background checks and assessing borrower creditworthiness before granting loans.

External economic shocks, such as global financial crises, currency devaluation, and market instability, were perceived as significant contributors to NPLs. 56% of respondents rated these shocks as very significant or extremely significant. These results indicate that the bank should implement risk mitigation strategies, such as diversifying its loan portfolio and adjusting credit policies during periods of economic downturns, to minimize exposure to external shocks.

Additionally, 63% of employees agreed or strongly agreed that inadequate monitoring and follow-up on loans contribute to NPLs. This suggests that enhancing the bank's loan tracking systems and conducting regular follow-ups with borrowers can help minimize delinquency rates.

The impact of the bank's lending policy was also considered significant. 60% of employees rated the lending policy as affecting NPL rates very much or extremely. This finding suggests that

reviewing and refining lending criteria, including stricter borrower assessments and clearer loan repayment terms, could improve loan performance.

The data confirms that a combination of economic factors, borrower characteristics, internal bank policies, and external financial events plays a crucial role in shaping NPL trends at the Wolkite Yejoka Branch. To mitigate these risks, the bank should adopt stronger credit assessment tools, flexible repayment structures, regular loan monitoring, and enhanced follow-up systems that can proactively identify and manage loan risks before they escalate into defaults.

One of the interviewed managers highlighted that *"the economic instability in the country, coupled with inflation and the rising cost of living, has significantly affected borrowers' ability to repay their loans on time."* Another manager noted that *"many customers struggle due to the lack of stable employment and the fluctuating market conditions."* These responses confirm the survey findings, where more than **57% of employees** identified economic conditions as a major factor contributing to NPLs.

The insights from the interviews emphasize that macroeconomic conditions, including inflation and unemployment, directly affect borrowers' ability to meet their loan obligations. The bank must consider economic trends when assessing loan applications and introduce **adaptive repayment structures** that provide flexibility during economic downturns.

4.4 Impact of Bank-Specific Characteristics

Internal banking operations play a critical role in managing NPLs. This section evaluates the bank's capital adequacy, risk management practices, internal audit frequency, staff training, and interdepartmental communication. These aspects determine the bank's ability to assess, approve, and monitor loans effectively while minimizing default risks. The findings help identify areas where operational improvements can enhance loan performance.

table 4. 3 response to Impact of Bank-Specific Characteristics questions

<i>Question</i>	<i>Response Categories</i>	<i>Frequency</i>	<i>Percentage (%)</i>
<i>Capital adequacy in managing NPLs</i>	Very Poor	2	7%
	Poor	5	17%
	Average	9	30%
	Good	8	27%
	Excellent	6	20%

<i>Effectiveness of risk management practices in reducing loan defaults</i>	Not at all effective	2	7%
	Slightly effective	5	17%
	Moderately effective	8	27%
	Very effective	9	30%
	Extremely effective	6	20%
<i>Frequency of internal audits assessing loan performance</i>	Never	1	3%
	Rarely	4	13%
	Sometimes	8	27%
	Often	10	33%
	Always	7	23%
<i>Adequacy of staff training on credit assessment and risk management</i>	Strongly Disagree	2	7%
	Disagree	4	13%
	Neutral	7	23%
	Agree	9	30%
	Strongly Agree	8	27%
<i>Effectiveness of interdepartmental communication in preventing loan defaults</i>	Very Ineffective	2	7%
	Ineffective	5	17%
	Neutral	7	23%
	Effective	9	30%
	Very Effective	7	23%

Source: own survey, 2025

The findings suggest that capital adequacy plays a critical role in managing NPLs, but employee opinions are mixed. While 47% of respondents rated the bank's capital adequacy as good or excellent, a significant proportion (37%) found it poor or very poor, suggesting that some employees believe the bank may lack sufficient financial reserves to absorb loan losses.

Risk management practices were seen as moderately effective by most respondents, with 50% rating them as very effective or extremely effective. However, 24% of employees indicated that the bank's risk management strategies are only slightly or not at all effective, highlighting a need for better credit risk evaluation and mitigation techniques.

Internal audits were identified as an essential tool in monitoring loan performance. 56% of employees reported that audits were conducted often or always, whereas 16% indicated that audits were rarely or never performed. These findings suggest that strengthening internal

auditing mechanisms and ensuring frequent review of loan performance can help reduce NPL risks.

Employee training in credit assessment and risk management is another crucial factor influencing loan performance. 57% of employees agreed or strongly agreed that current training programs are adequate, while 20% believed training efforts were insufficient. This suggests that enhanced training programs focusing on credit risk identification, fraud detection, and borrower profiling could further improve loan assessment accuracy.

Interdepartmental communication was another critical factor affecting loan performance. 53% of respondents found communication between departments to be effective or very effective, while 24% found it ineffective or very ineffective. Poor communication between departments, particularly between the credit approval and collections teams, can contribute to inefficient loan monitoring and delayed recovery efforts. The findings highlight the need for improved coordination between departments to streamline loan tracking and default prevention efforts.

Overall, the data suggests that capital adequacy, risk management, internal audits, staff training, and interdepartmental coordination significantly influence NPL levels. Addressing these factors by enhancing financial reserves, strengthening risk mitigation strategies, ensuring regular audits, improving staff competency, and fostering better departmental collaboration can contribute to a more efficient and sustainable loan management system.

When asked about risk management practices, a senior manager stated, *"We have internal credit risk assessment protocols, but sometimes they are not strictly followed, which leads to an increased number of high-risk loans."* Another interviewee mentioned that *"periodic risk audits are conducted, but there is a need for more frequent evaluations to ensure that high-risk loans are flagged early."*

These insights suggest that while risk management frameworks are in place, their implementation needs to be strengthened. More frequent audits and improved compliance with risk protocols could help reduce the occurrence of non-performing loans by identifying potential defaults at an earlier stage.

4.5 Effectiveness of Current Credit Assessment Practices

Credit assessment is a fundamental component of the bank’s loan approval and monitoring process. This section analyzes how effectively the bank evaluates loan applications, identifies potential defaults, and incorporates customer feedback. Additionally, it assesses the role of technology in enhancing credit evaluation accuracy. Strengthening credit assessment practices can contribute to improved loan performance and reduced non-performing loans.

table 4. 4 Effectiveness of Current Credit Assessment Practices responses

<i>Question</i>	<i>Response Categories</i>	<i>Frequency</i>	<i>Percentage (%)</i>
<i>Evaluation of current credit assessment practices</i>	Very Poor	2	7%
	Poor	6	20%
	Average	8	27%
	Good	10	33%
	Excellent	4	13%
<i>Effectiveness of monitoring practices in identifying defaults</i>	Not at all effective	3	10%
	Slightly effective	5	17%
	Moderately effective	9	30%
	Very effective	8	27%
	Extremely effective	5	17%
<i>Frequency of management review on loan assessments</i>	Never	2	7%
	Rarely	5	17%
	Sometimes	8	27%
	Often	9	30%
	Always	6	20%
<i>Customer feedback considered in credit assessment improvement</i>	Strongly Disagree	2	7%
	Disagree	4	13%
	Neutral	7	23%
	Agree	10	33%
	Strongly Agree	7	23%
<i>Utilization of technology in credit assessment</i>	Very Poorly	2	7%
	Poorly	5	17%
	Average	8	27%
	Well	9	30%
	Very Well	6	20%

Source: own survey,2025

The findings suggest that the current credit assessment practices are moderately effective, with 46% of employees rating them as good or excellent. However, 27% rated the practices as

average, and 27% found them poor or very poor, indicating the need for improved credit evaluation procedures to minimize the risk of bad loans.

The effectiveness of monitoring practices in identifying potential defaults before they occur was also assessed. 44% of employees rated the monitoring system as very effective or extremely effective, while 27% found it moderately effective. However, 27% of respondents believed monitoring practices were slightly effective or ineffective, suggesting a need for enhanced loan tracking systems and real-time risk detection mechanisms.

The frequency of management review on loan assessments was another critical factor. 50% of respondents indicated that management reviews assessments often or always, while 24% stated that reviews occur only sometimes, rarely, or never. This shows that while periodic reviews are conducted, there is room for improvement in ensuring that loan assessments are consistently evaluated for accuracy and effectiveness.

The study also examined whether customer feedback is considered in refining credit assessment processes. 56% of employees agreed or strongly agreed that customer insights play a role in improving credit evaluations, while 20% disagreed or strongly disagreed. This finding suggests that while customer feedback is acknowledged, there is an opportunity to enhance its integration into the decision-making process to tailor credit policies more effectively.

The role of technology in credit assessment was another crucial area of investigation. 50% of respondents indicated that technology is well or very well utilized, while 27% rated it as average. However, 24% of employees believed that technology is poorly or very poorly utilized, suggesting a need for increased automation, digital credit scoring tools, and predictive analytics to improve risk assessments.

A manager pointed out that *"while the bank has a structured credit assessment framework, it does not always consider the full financial history of borrowers, leading to misjudgments in loan approvals."* Another respondent stated, *"We receive customer feedback, but it is not systematically integrated into our credit policies."*

These findings indicate that improvements in borrower evaluation techniques are necessary. Implementing a more comprehensive credit scoring system and systematically analyzing

customer feedback could enhance the accuracy of loan approvals and reduce the likelihood of defaults.

Overall, the data suggests that credit assessment practices, loan monitoring, management oversight, customer feedback integration, and technology utilization significantly impact the bank's ability to manage NPLs. Strengthening these areas through advanced credit evaluation frameworks, real-time risk detection, automated loan processing, and enhanced customer insight analysis can lead to more efficient and reliable credit management.

CHAPTER 5:

CONCLUSION AND RECOMMENDATIONS

This chapter presents the conclusions drawn from the study and offers recommendations based on the findings. The research focused on assessing the factors contributing to non-performing loans (NPLs) and the effectiveness of credit assessment practices at the Commercial Bank of Ethiopia, Wolkite Yejoka Branch.

5.1 Conclusion

The study identified several key factors influencing the rise of non-performing loans. Economic conditions, borrower characteristics, and external financial stocks were found to be major contributors to loan defaults. Fluctuations in inflation, unemployment, and global economic downturns significantly affected borrowers' ability to repay their loans. Additionally, inadequate risk assessments and inconsistencies in credit monitoring practices led to an increased likelihood of loan delinquency.

Bank-specific factors, including capital adequacy, risk management strategies, and internal audit frequency, played a crucial role in determining the bank's ability to handle non-performing loans. While some employees found the bank's risk management framework effective, others believed improvements were needed, particularly in refining credit assessment models and strengthening interdepartmental coordination.

The effectiveness of credit assessment and monitoring practices also emerged as a key area requiring improvement. While credit evaluations were generally rated as moderately effective, gaps in monitoring potential defaults, management oversight, and customer feedback utilization were identified. Many employees emphasized the importance of enhanced credit scoring models, automated risk detection systems, and the integration of customer insights into credit assessment policies.

Furthermore, the adoption of technology in credit evaluation and loan monitoring was found to be inconsistent. While digital tools were utilized to some extent, employees indicated that advanced automation, predictive analytics, and data-driven decision-making could significantly enhance credit assessment efficiency and reduce default risks.

5.2 Recommendations

Based on the study's findings, the following recommendations are proposed to strengthen receivable management and reduce non-performing loans at the Commercial Bank of Ethiopia, Wolkite Yejoka Branch:

- **Enhance Credit Assessment and Risk Evaluation**
 - Implement a more comprehensive borrower risk profiling system that incorporates both financial and behavioral credit analysis.
 - Utilize predictive analytics and machine learning models to assess loan default probabilities before approval.
 - Strengthen due diligence processes by requiring in-depth financial documentation and background checks for high-risk applicants.
- **Improve Loan Monitoring and Follow-up Mechanisms**
 - Develop an automated loan tracking system that provides real-time alerts on overdue payments and potential defaults.
 - Conduct regular loan performance reviews and ensure more frequent interdepartmental communication to improve monitoring effectiveness.
 - Establish structured follow-up policies that include personalized engagement strategies for delinquent borrowers.
- **Strengthen Risk Management and Internal Controls**
 - Increase the frequency of internal audits to assess credit portfolio performance and identify potential risk areas.
 - Adopt a proactive risk mitigation framework that enables the bank to adjust its lending strategies based on macroeconomic conditions.
 - Improve staff training programs to equip employees with the necessary skills to evaluate and manage credit risks effectively.
- **Enhance Technology for Credit Assessment**

- Integrate AI-driven credit scoring models to automate borrower risk assessment and improve accuracy.
- Enhance the use of big data analytics to predict repayment trends and detect potential defaults early.
- Develop a digital credit risk management system that enables real-time tracking of loan performance across all branches.
- **Incorporate Customer Feedback into Credit Policies**
 - Establish a structured feedback loop where borrowers' repayment experiences are analyzed to improve future credit policies.
 - Conduct periodic customer satisfaction surveys to assess how lending policies impact borrower behavior.
 - Introduce flexible loan repayment options based on borrower financial conditions to reduce default rates.

5.3 Future Research Directions

While this study focused on factors affecting NPLs and credit assessment effectiveness, future research could explore:

- Comparative studies between multiple branches of the Commercial Bank of Ethiopia to assess regional variations in loan performance.
- The impact of fintech and mobile banking innovations on reducing non-performing loans.
- A longitudinal analysis of borrower repayment behavior to develop more precise credit scoring models.

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Questionnaire completion by employees of the Yejoka branch

This questionnaire is designed to gather insights into the factors contributing to non-performing loans (NPLs) at the Yejoka branch of the Commercial Bank of Ethiopia. As the banking sector faces increasing challenges related to loan defaults, understanding the underlying causes is essential for developing effective strategies to mitigate risks and enhance financial stability. The questionnaire aims to explore various dimensions, including macroeconomic conditions, bank-specific characteristics, and the effectiveness of current credit assessment practices.

Please answer all questions honestly and to the best of your ability.

Section 1: Demographic Questions

1. Sex
 Male Female
2. age
 Under 25 25-34 35-44 45-54 55 and above
3. highest level of education?
 High School Diploma Bachelor's Degree Master's Degree Doctorate
4. years of experience
 Less than 1 year 1-3 years 4-6 years More than 6 years
5. position at the bank
 Loan Officer Credit Analyst Managerial Staff Support Staff

Section 2: Key Factors Contributing to Non-Performing Loans

1. To what extent do you believe economic conditions (e.g., inflation, unemployment) contribute to non-performing loans at the Yejoka branch?
 Not at all Slightly Moderately Very much Extremely
2. How often do you think borrower characteristics (e.g., income stability, credit history) impact loan repayment performance?
 Never Rarely Sometimes Often Always

3. In your opinion, how significant is the impact of external economic shocks (e.g., global financial crises) on NPL levels at the bank?
 Not significant at all Slightly significant Moderately significant Very significant Extremely significant
4. Do you believe that inadequate monitoring and follow-up on loans contribute to the rise of non-performing loans?
 Strongly Disagree Disagree Neutral Agree Strongly Agree
5. To what extent does the bank's lending policy affect the rate of non-performing loans?
 Not at all Slightly Moderately Very much Extremely

Section 3: Impact of Bank-Specific Characteristics

1. How would you rate the capital adequacy of the bank in relation to managing non-performing loans?
 Very Poor Poor Average Good Excellent
2. To what extent do you believe that risk management practices at the bank are effective in reducing loan defaults?
 Not at all effective Slightly effective Moderately effective Very effective Extremely effective
3. How frequently are internal audits conducted to assess loan performance and identify potential non-performing loans?
 Never Rarely Sometimes Often Always
4. Do you think that staff training on credit assessment and risk management is adequate for mitigating non-performing loans?
 Strongly Disagree Disagree Neutral Agree Strongly Agree
5. How effective is the communication between departments regarding loan performance in preventing defaults?
 Very Ineffective Ineffective Neutral Effective Very Effective

Section 4: Effectiveness of Current Credit Assessment Practices

1. How would you evaluate the current credit assessment practices used by the bank for evaluating loan applications?
 Very Poor Poor Average Good Excellent

2. To what extent do you believe that current monitoring practices effectively identify potential defaults before they occur?
 Not at all effective Slightly effective Moderately effective Very effective Extremely effective

3. How often does management review loan assessments for accuracy and effectiveness?
 Never Rarely Sometimes Often Always

4. Do you believe that customer feedback is considered in improving credit assessment practices at the bank?
 Strongly Disagree
 Disagree
 Neutral
 Agree
 Strongly Agree

5. In your opinion, how well does the bank utilize technology in its credit assessment processes?
 Very Poorly
 Poorly
 Average
 Well
 Very Well

Appendix 2 Interview questions

This section presents a series of interview questions designed for managers at the Yejoka branch of the Commercial Bank of Ethiopia. The purpose of these interviews is to gain insights into their perspectives on the factors contributing to non-performing loans (NPLs), the effectiveness of current risk management practices, and the overall credit assessment processes. The responses will provide valuable qualitative data to complement the quantitative findings from the employee survey, ultimately contributing to a comprehensive understanding of NPL dynamics within the bank.

1. What do you believe are the main external factors contributing to non-performing loans at the Yejoka branch?
2. How do you assess the impact of borrower characteristics, such as credit history and income stability, on loan performance?
3. What risk management practices does the bank currently employ to minimize loan defaults?
4. In your opinion, how does staff training on credit assessment and risk management affect loan performance?
5. Can you provide examples of how customer feedback has been integrated into improving credit assessment practices