MANAGEMENT OF NON-PERFORMING LOANS AT DEVELOPMENT BANK OF ETHIOPIA

BY

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A Project Report submitted to the Director (SR & E), IGNOU,

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in partial fulfillment of the requirement for the Degree of Master of

Business Administration in Financial Management

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April, 2014

CERTIFICATE OF ORIGINALITY

This is to certify that the project titled "**Management of Non-performing Loans at Development Bank of Ethiopia**" is an original work of the Student and is being submitted in partial fulfillment for the award of the Master's Degree in Business Administration of Indira Gandhi National Open University. This report has not been submitted earlier either to this University or to any other University/Institution for the fulfillment of the requirement of a course of study.

Signature of Supervisor	**Signature of Student**
Place: ________________	**Place:** ____________________
Date: _________________	**Date:** ____________________

ACKNOWLEDGEMENT

First of all I may give my praise to the ALMIGHTY GOD who enabled me to start and finish this project report.

I also want to thank my employer Development Bank of Ethiopia (DBE) for giving me the opportunity and support to improve my knowledge and skills through the MBA program.

A special thanks to my supervisor Dr. Zenegnaw Abiy for his unreserved guidance and critical comments on this project.

I also wish to express my sincer appreciation to managers and senior staffs of DBE who cooperated me in filling the questionnaires prepared for this project and to all others without their support and active cooperation this project would not have been possible.

Finally my gratitude goes to my wife Aleganesh, my daughter Tsion and my son Amanuel. for their motivation and support during the whole MBA program.

Hunegnaw Zegeye

Addis Ababa, Ethiopia

April, 2014

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ABBREVIATIONS

ACPD: Asset Classification and Provisioning Directive

BOM: Board of Management

DBE: Development Bank of Ethiopia

DFIs: Development Finance Institutions

NBE: National Bank of Ethiopia

NRV: Net Recoverable Value

NPLs: Non-performing Loans

PRLR: Project Rehabilitation and Loan Recovery

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CHAPTER ONE: INTRODUCTION

1.1 Background to the Study

The bank failure has important consequences on the entire financial sector and on the entire economy. When bank failures happen on a larger scale and affect the entire banking system, becoming a bank crisis, the consequences can be disastrous for the entire economy. A number of financial literatures disclosed that the reasons for bank failures are various. Stioca and Capraru (2009) concluded that inefficient financial supervision, macroeconomic shocks, inadequate regulatory capital, improper credit evaluation, poor selection of borrowers, non-performing loans, deterioration in bank's capital position, disproportionate operational costs, heavy expenditures on bank's fixed assets, excessive exposure to real estate industry, politics (government) interventions, insufficient provisioning, management frauds and foreign exchange risk are major causes of bank failure cited in many literature.

Among the aforementioned causes of bank failure, the issue of non-performing loans (NPLs) has gained increasing attentions in the last few decades. Biabani, Gilaninia and Mohabatkhah (2012) found that the immediate consequence of large amount of NPLs in the banking system is bank failure. Failing banking institutions always have high level of NPLs prior to failure. It is argued that the NPLs are one of the major causes of the economic stagnation problems. The eradication of NPLs is, thus, a necessary condition for the survival of the banking institutions and to improve the economic status. If the NPLs are kept existing and continuously rolled over, the resources are locked up in unprofitable sectors; thus hindering the economic growth and impairing the economic efficiency.

This study assesses the management of non-performing loans (NPLs) of Development Bank of Ethiopia (DBE). The study aims to determine if the NPLs have declined along with the application of new Asset Classification and Provisioning Directive (ACPD) since 2010. It also aims to verify the effectiveness of Project Rehabilitation & Loan Recovery (PRLR) unit of the Bank in addressing the NPL problem.

1.2 Statement of the Problem

High level of NPLs creates financial instability and failure of the banking sector. Non-performing loans are one of the main reasons that cause insolvency of the financial institutions and ultimately hurt the whole economy of a country. The problem of NPLs is not limited to a particular country, but it prevails in many countries of the world.

Ethiopia is one of the many countries that have been suffering from this problem. Financial institutions operating in Ethiopia are among those institutions suffering from the same problem. A study conducted by Negera (2012) on the determinants of non-performing loans in the Ethiopian context disclosed that the ratio of NPLs as a percentage of total loans in all private and public banks had varied from 1.7 percent to 11.67 percent. According to this study, the highest ratio (11.67%) was that of

Development Bank of Ethiopia. The problem is, thus, the Bank has been experiencing high level of NPLs despite it desires to attain lower level of NPLs

1.3 Research Questions

The main research questions in this study are:

- What is the actual level of NPLs at DBE?
- How is the trend of NPLs at DBE?
- What is the effect of a separate Directive issued on Asset Classification and Provisioning for Development Finance Institutions (DFIs)
- Which sector of the economy has contributed to the accummulated NPLs of the Bank?
- What are the internal causes for NPLs?
- How is loan classification and provisioning made at DBE?
- Does the Bank hold adequate provisions for NPLs?
- What are the methods employed by the Bank in addressing NPLs? Are the methods effective in addressing NPLs problem?

1.4 Objectives of the Study

The general objective of the study is to make assessment of the management of NPLs at DBE. The specific objectives are:

- To reveal the actual level of NPLs of the Bank, the trend over time and know the effect of a separate Directive issued on Asset Classification and Provisioning for DFIs by the NBE on the trends of NPLs.
- To reveal which sector of the economy contributes more to the accummulated NPLs of the Bank;
- To identify bank specific reasons that lead new and/or performing loans to NPLs.
- To investigate loan classification and provisioning of the Bank and whether adequate provisions are held with respect to NPLs;
- To study the effectiveness of methods employed by the Bank in addressing non-performing loans.

1.5 Significance of the Study

The various research studies carried out so far regarding management of NPLs have indicated that there are no universally accepted standards to classify NPLs and the assignment of weight to each class of non-performing. The classification of NPLs and provisions held for them vary from country to country. Conducting a research study on NPLs even using the same research topic but under the context of a particular country will augment the present knowledge which may ultimately lead to derive globally acceptable standards for classification and provisioning of NPLs. The benefits of having such universal standards is obvious as it makes cross-country comparisons easier and may make all inclusive measures of reducing NPLs possible and prevent financial crises region-wise and/or worldwide.

The significance of this study also becomes apparent as one of its focus areas is identifying factors mainly internal factors that make new and/or performing loans become non-performing from an individual lending institution and where researches carried out so far in this respect are very limited.

In particular, this research would help in reducing the stock of existing NPLs of DBE as well in preventing the creation of new NPLs by suggesting workable solutions. The study also would help other public and private banks operating in the banking industry of Ethiopia and supervising bodies such as NBE and Public Financial Enterprises Agency (PFEA) get insight in the internal (management) problems of dealing with NPLs in the Ethiopian context.

1.6 Scope and Limitation of the Study

This study covers the management of NPLs in Ethiopian banks using DBE as a case study. The study is confined to examine the state of NPLs in DBE and a period of six years has been considered. The period to be covered in this study is from 2007/08 to 2012/13, which is before and after the issue of a separate directive on ACPD for DFIs by the NBE. This is to study the trends for about three years before the issue of the Directive and three years after the issue of the Directive. This is with the understanding that the time frame will only be fair and balance for studying the effect of the Directive on the trends of NPLs. It is also to ensure that the information and data used are timely, up to date and accurate enough to represent the current position of the Bank under study.

1.7 Operational Definition of Terms

The definitions of terms listed below are adapted from the ACPD of NBE and used in this study.

Development finance institution means an instituition which is engaged mainly in medium and long-term project finance business, with the purpose of promoting development in the industrial, agricultural, construction, services, commercial or other economic sectors.

Industry average recovery rate means aggregate net cash receipts plus total net market value of acquired properties, divided by the aggregate outstanding principal balance of the loans backed by the collateral at the time the collateral was seized, foreclosed, repossessed or otherwise acquired by all banks, including FDIs, operating in Ethiopia calculated over the period of 18 consecutive months preceding the date of determining minimum provision requirement.

Medium or long-term loans means loans with original repayment or maturity period of two years or more.

Non-accrual status means that a loan has been placed on a cash basis for financial reporting purposes. Interest on such loans accrued on the books of the development finance instituition, or for which a specific reserve (such as a suspended interest account) has been established by the development finance instituition to offset the full amount of interest being accrued, shall not be taken into income.

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

Net Recoverable Value is the product of the outstanding principal balance of the loan and the 'banking industry average recovery rate'.

Provisions for Loan Losses Account means a balance sheet valuation account established through charges to provision expense in the income statement in respect of possible losses in the loan portfolio.

Renegotiated Loans means loans which have been refinanced, rescheduled, rollerd-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. However, the term excludes loans held by projects under implementation.

Short-term loans means loans with original repayment or maturity period of less than two years.

Suspended interest account means an account where previously accrued but uncollected interest on loans required to be placed on non-accrual status is reserved out of the income of the development finance instituition

CHAPTER TWO: DEVELOPMENT BANK OF ETHIOPIA IN BRIEF

2.1 History

DBE is the sole national development bank operating in Ethiopia. The establishment of the Bank goes back to May 31, 1909. The bank with the name "The Societe' Nationale d' Ethiopie' Pour le Development de l' Agriculture et du Commerce" was established with an authorized capital of Birr 3,200, 000 and paid up capital of Birr 375,830. Emperor Menelik II and his wife Queen Etegi Tayetu was among the seven shareholders and founders of this private financial institution.

The Bank was re-organised in 1928 as banking and an industrial concern with 60 percent of its capital contributed by the French interest group and the remaing 40 percent by the Ethiopian Government. Its objective was to support the country's development in agriculture and trade. The Bank had ceased to operate for about ten years.

In 1945, the Ethiopian Government established Agricultural Bank of Ethiopia with an authorized capital of 1,000,000 Maria Theresa Dollar and 30 percent of which was paid by the Government and the remaining was to be paid on the request made by the Council of Directors. Manager of the former Bank which came to a close nine years ago before the establishment of this Bank was reappointed by the Government as manager of this bank. The purpose of this Bank which was fully owned by the Ethiopian government was to assist small land holders whose homes and farms were devastated during the Italian five years occupation. Besides, the Bank had extended its services to the industrial and commercial sectors that were related to agriculture.

In its long history, the Bank has gone through various change of forms including the frequent change of focus areas before it has emerged to its present position. These changes and alignments of instituitional objectives with the times, other than those mentioned earlier, are briefly presented in the table as shown below.

Table 2.1 Historical Years at Which Development Bank of Ethiopia has gone through Changes

Naming	Date of Establishment	Authorized Capital	Objective
Development Bank of Ethiopia	March, 1951	ETDollar 13 million	To acceleratethe development of agriculture and industry sectors of the country by initiating the investment of private capital
The Ethiopian Investment Corporation Share Company	August, 1963	Birr 10 million	To finance development projects in the agriculture, industry and commercial sectors of the national economy
Agriculutural and Industrial Development Bank Share Company	August, 1970	Birr 100 million	To provide finance to all bankable activities to allsectors of the economy by mobilizing loanable funds from domestica and foreign sources.
Agriculutural and Industrial Development Bank	March, 1979	Birr 100 million	Accelerating the development of the country by extending credits to the agriculture and industry as well as other sectors.
Development Bank of Ethiopia	September, 1994	Birr 250 million	
Development Bank of Ethiopia	January, 2003	Birr 600 million	To provide finance to viable projects in line with the Government set priority areas by mobilizing loanable funds from domestica and foreign sources
Development Bank of Ethiopia	May, 2005 to date	Birr 1,800 million	To provide finance to viable projects in line with the Government set priority areas by mobilizing loanable funds from domestica and foreign sources

Source: Zena Lemat Bank Magazine, a special issue prepared for the 100th year anniversary of DBE.

2.2 Mission, Vision and Values

Promoting the national development agenda through development finance and providing technical support to viable projects originated from areas specified as priority by the government by mobilizing fund from domestic and foreign sources, and at the same time ensuring its sustainability is the *Mission* of Development Bank of Ethiopia (DBE).

To be 100 percent successful in all financed projects by 2020 is the *vision* of the Bank.

The *values* of DBE are:

- Commitment to mission
- Customer focus
- Integrity
- Team work
- High value to employees
- Learning organization
- Concern to environment

2.3 Organisation Structure

DBE has a process based organizational structure. At the apex is the Board of Management (BOM). It is the the supreme organ of the Bank. BOM of the Bank is made up of 9 Directors, all of them are appointed by the government for a period of 3 years renewable once. The Board is responsible for the conduct of the general operations of the Bank. Internal Audit Process is the only work unit that directly report to the Borad.

Under the Bank's organization chart the President is is next to BOM in the heirarchy of authority. The President is appointed by the BOM for unspecified period to execute policies and directives issued by BOM and to manage the the overall operations of the Bank. Following are the work units directly report to the President's Office.

- Compliance and Risk Management Process;
- Loan Approval Team;
- Project Appraisal Sub-process;
- Project Rehabilitation and Loan Recovery Sub-process;
- Legal Process;
- Ethics and Compliant Management Bureau;
- Change Management Bureau;
- Chief Engineer Bureau;
- Rural Financial Intermediation Program (RUFIP);

The president is assisted by four vice presidents to carry out the day-to-day activities of the Bank. These five persons form the Executive Management of the Bank. The vice presidents and the work units they comprise are listed below.

Vice President Credit Process

- Credit Process;
- Export Credit Guarantee and Special Fund Administration Bureau;

Vice President Corporate Services

- Strategic Planning and Development Effectiveness Process;
- HRM Process;
- Business Promotion and Communication Process;

Vice President Support Services

- Research Process;
- Information Technology Services Process;
- Finance and Accounts Management Process;
- International Banking Services Process;
- Fund Management Process;
- Property Management Process;

Vice President Branch Operations Coordination

- 5 Regional Offices
- 12 Main Branches;
- 20 Sub-branches;

2.4 Human Resource

The Bank's total regular Staff as at December 31, 2013 was 1183. Of this, 690 (58.33 percent) were professionals, 204 (17.24 percent) administration & semi-professionals, 212 (17.92 percent) manual & custodian, and 77(6.51 percent) technicians and skilled.

2.5 Financial Year

The financial year of DBE begins with July 1 and ends with June 30 of the subsequent calander year. The financial year is divided into four quarters for purpose of reporting operational and financial performances. Quarterly reports are prepared by the end of the months of September, December, March and June of a particular financial year. Annual reports are also prepared by the end of the month of June of each financial year. External auditors recruited by the Bank follows this financial year to prepare their audit reports.

CHAPTER THREE: LITERATURE REVIEW

3.1 Definitions and Concepts of Non-performing Loans

There is no universally accepted definition of nonperforming loans although there is most commonly used definition. The definition varies from one country to another country and even within a particular country. Ponnu & Ramakrishnan (2011) disclosed that the Central Bank of Malaysia (BNM) defines a loan as non-performing when the principal or interest is due and unpaid for six months or more from the first day of default.

Petersson & Wadman (2004) defined NPLs as defaulted loans, which banks are unable to profit from. Usually loans falls due if no interest has been paid in 90 days, but this may vary between different countries and actors.

Beck, R., Jakubik P & Piloiu, A (2013) mentioned that the the most commonly used definition of NPLs as a default that occurs when the bank considers that an obligor is unlikely to repay its credit obligations to the banking group in full, without recourse by the bank to actions such as realising security (if held); or the obligor is past due for more than 90 days on any material credit obligation to the banking group.

According to Bloem, A & Freeman, R (2005) a loan is nonperforming when payments of interest and/or principal are past due by 90 days or more, or interest payments equal to 90 days or more have been capitalized, refinanced, or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons-such as a debtor filing for bankruptcy-to doubt that payments will be made in full.

3.2 Measures of Nonperforming Loans

Balasubramaniam, C (2001) in his study of Non-performing assets and profitability of commercial banks in India stated that there are two types of non-performing assets (NPAs)-Gross NPA & Net NPA. Gross NPAs are the sum total of all loan assets. Gross NPA reflects the quality of the loans made by banks. It consists of all the nonstandard assets like as sub-standard, doubtful, and loss assets. It can be calculated by Gross NPAs Ratio = Gross NPAs / Gross Advances. Net NPAs are those type of NPAs in which the bank has deducted the provision regarding NPAs. Net NPA shows the actual burden of banks. It can be calculated by Net NPAs = Gross NPAs – Provisions / Gross Advances – Provisions

In the publication of AlexBank (2011) it was discosed that quality of the asset could be measured mainly with two indicators: Nonperforming loans to total loans and bank provision to nonperforming loans. The NPL ratio indicates the quality of their outstanding loans. A smaller NPL ratio indicates smaller losses for the bank, while an increasing ratio can mean larger losses for the bank as it writes off bad loans.

3.3 Loan Classification and Provisioning

The Wordld Bank (2002) stated that there exists no international consensus on loan classification approaches. The approaches used to classify loans are considered either a management responsibility or a regulatory matter.

Wu, X (2002) noted that current international standard divides NPLs in commercial banks into four categories: special mention, sustandard, doubtful and loss.

Mokhtar, M & Zakaria, Z (2009) noted that the regulations in each country differ and as a result the classification and management of non-performing loans differ from one jurisdiction to another. The treatment of NPLs, loss provision and disclosure are different as well. In general, however different the regulations are in every country, the objective of regulation in the end is to ensure the bank's soundness.

In a manual of International Finance Corporation (2011) it is stated that it is a good international practice and most countries require banks to classify their assets in five categories of acceptable, special mention, substandard, doubtful and loss.

Angklomkliew, S, George, J & Packer, F (2009) disclosed that loan loss provisioning levels and the adequacy of the reserve are only as good as the methodology used to estimate losses in the loan portfolio.

Dermine, J & De Carvalho, C (2007) revealed that a fair level of provisions on bad and doubtful loans is an essential input in mark-to market accounting, and in the calculation of bank profitability, capital and solvency. Loan-loss provisioning is directly related to estimates of loan-loss given default (LGD).

3.4 Causes of Nonperforming Loans

Lot of researches has been conducted on the factors responsible for accumulation of NPLs. Biabani, Gilaninia and Mohabatkhah (2012) classified factors responsible for increasing NPLs as internal, external and partially internal/external factors. According to this classification internal factors are factors caused by internal functions and activities of bank, and are due to decisions and practices of officials and staff's functions. These factors are controllable and managers can prevent them by using suitable method, determination of weakness and elimination them and improvement of process. External factors, on the other hand, are factors that can be controlled by bank hardly and are caused by external environment and its effect on implementation of decisions and also government policies. Unexpected events, changing in rules and obligations, political and economic changes (inflation and slump) are external factors. The third category of this classification refers to factors that although are similar to internal factors that are controllable but control of them is partially and because some of political and social expedients bank has to accept them.

Fofack (2005) found that trade deterioration, inflation, real interest rate, growth rate of GDP per capita, net interest margins, return on assets, interbank loans were the leading causes of NPLs during the economic and banking crises that affected a large number of countries in Sub-Saharan Africa in the 1990s.

3.5 Impacts of Nonperforming Loans

Kawalec S (2002) revealed that if the portion of non-performing loans is significant and this income gap is not counterbalanced by income from performing loans and other sources, the bank is incurring losses and capital loss increases.

Mehta, T (2009) noted that increasing NPLs have a negative and a cascading impact on the economy of the country. When NPLs rise, banks not only hesitate in giving loans but are also compelled to divert their existing resources and manpower in resolving this problem. As a result, banks potentially lose out on their ability to capitalize on productive opportunities such as finding new and promising areas of investment that may yield higher returns. Further, when there is an increase in NPLs, the entire capital of a bank gets tied up, giving rise to a credit crisis and a liquidity crunch in the economy. With lower liquidity in the market, the economy shows a downward trend, people take less financial risks, their purchasing power goes down and the economy is adversely affected as a whole. Banks begin to recall loans and companies and individuals who are unable to make repayments start defaulting, resulting in a further rise in NPLs.

The USAID study (2011) revealed that elevated levels of NPLs adversely affect banks' ability to lend by absorbing their capital resources, depleting their earnings through losing revenues from unpaid interest and setting aside a portion of current income as reserves against potential losses, straining banks' liquidity and increase funding costs and draining resources. According to this study, systemic concerns about insolvency and illiquidity of the banking system arise where there are elevated NPL levels at a number of banks. At the macro level, elevated levels of problem loans in banking systems lead to lower levels of economic growth or to economic stagnation.

3.6 Disposing of Nonperforming Loans

According to Lindgren et al. (1999) impaired assets may either be held and dealt with by the financial institutions themselves or sold to special companies or agencies created to handle bad assets. The same study reveals that the optimal strategy for managing and disposing of impaired assets has many variations, depending on factors such as the nature of the problem assets, their overall size and distribution, the structure of the banking system, the legal framework, and available management capacity in the banks and in the public sector. There is no single optimal solution but rather a combination of solutions for each country that may vary over time and for each bank.

CHAPTER FOUR: RESEARCH METHODOLOGY

4.1 Research Design

The research design used to carry out this study is both descriptive and analytical researches although there may be relative emphasis between the two.

4.2 Sample and Sampling Techniques

A judgment sampling method was employed to obtain opinion of staff of DBE on factors causing NPLs and on the overall management of NPLs in the Bank. Twenty-seven managers and thirty-four senior staffs working in six work units at head office were considered to be taken as sample. However, the questionnaire was eventually delivered to twenty-six management staff and thirty-two non-management staff since some of the remaining staff was recently transferred to one of these selected work units and some others were on long leave while the questionnaire was being distributed. The selection of senior staffs as sample for this study was based on the expectation that they would have a relatively better knowledge of factors causing NPLs and knowledge of how the Bank has been managing its NPLs through the experiences they have acquired by working in the units involved in loan processing, project appraising, loan work out, loan reviewing, loan approving or auditing.

4.3 Instruments for Data Collection

A combination of instruments was used in collecting data for this research project. This is with a view to upsetting inherent limitations in one with the other. The instruments used in collecting data include questionnaires and documentary sources.

Two semi-structured questionnaires each contain two sections were prepared for management and non-management staff. The questionnaire prepared for mangers contains four questions in Section I and twenty-nine questions in Section II whereas the questionnaire prepared for non-management staff holds four questions in Section I and thirty-two questions in Section II.

This research relied mainly on the secondary data like database of risk management work unit, annual operations reports, other records kept by different work units of DBE, directives issued by NBE and the Bank itself.

4.4 Procedure for Administration of Research Instruments

The questionnaires were administered by distributing them in person to each manager of the selected work units (departments) and through him to each selected subordinates (supervisors and/or senior officers). The collection of the self-administered questionnaires were also made through managers of the same work units. The questionnaires were provided to the respondents with a letter that explains what the questionnaire is about and why its completion is of value.

Frequent contacts were made between the managers who were responsible to distribute and collect the questionnaires filled by the respondents of their respective work units and the researcher to timely collect the filled questionnaires.

4.5 Data Analysis Methods and Procedures

Tabular presentation and analysis, calculation of percentages or ratios and presentation of charts are methods employed to analyse the data collected for this research project.

Data on total outstanding loans, gross NPLs, total loan provisions, and NPLs restructured were collected from database of Risk Management Process, whereas data on NPLs transferred to loan workout unit, and NPLs restructured and disposed were gathered from records and reports of PRLR Sub-process. The aforementioned secondary data are authentic and reliable to make the analysis meaningful for drawing a conclusion.

CHAPTER FIVE: DATA ANALYSIS AND INTERPRETATION

5.1 Introduction

In this study, different sources are employed to collect primary and secondary data on the management of NPLs at DBE. The primary data source comes from the Opinion Survey of managers and senior officers of the Bank. The sources for secondary data are databases on loan classification and provisioning kept by concerned work unit of the Bank, annual performance and audit reports and various directives of the Bank and NBE's directives issued in different years. The primary data obtained through the questionnaires is used to analyse the perspective of the mangers and senior officers on the overall management of NPLs in order to show how their perception matches with the secondary data where this is possible, and to fill the data gap that are created by accessing secondary sources.

Secondary sources such as databases on loan classification and provisioning and annual performance and audit reports are reviewed to reveal the actual situations and to get an idea of the weaknesses that existed in managing NPLs.

5.2 Findings of Questionnaires

5.2.1 Respondents Background

A sample of the fifty-eight staff was selected, based on the operational area where they currently work and the current positions they held in their respective work units. The respondents were purposively selected middle and low levels managers (26 in number) and senior staff (32) from six work units of the Bank located at head office.

Out of the twenty-six management staff and thirty-two non-management staff who received the questionnaire, about 85 percent of managers and 78 percent of senior staffs responded by filling the questionnaires.

From the management staff that filled the questionnaire, about 86 percent of managers do have overall work experience of over 11 or more years and about 45 percent of them have 11 or more years experience in different management positions. The result also shows that about 86 percent of management staff have acquired overall experience in two or more operational areas and management experience in one or more operational areas (See Appendix A & B).

Likewise, 96 percent of non-magement staff are those who have an overall experience of 5 years or more and 48 percent of them have worked 5 years or more at senior post. In terms of operational areas where they have worked, about 64 percent of them have overall experience in two or more operational areas and experience at senior position in one or more operational areas. In short the analysis made above shows that the selection of management and non-management staff was as intended. i.e., staff with rich and diversified experience in key and pertinent operational areas and those who were capable to fill the questionnaires properly.

5.2.2 Level and Trend of NPLs

Table 4.1 shows that majority of management (57 percent) and non-management staff (74 percent) of DBE rated the level of NPLs at the Bank is close to the NPL ratio set by NBE which is 5 percent. This implies that both management and non-management staffs believe that NPLs are managed well at DBE.

Table 4.1 Observation of Management & Non-management Staff on the Level and Trend of NPLs at DBE

Issue	Level	Management	Non-mgmt Staff
Level of non-performing loans at DBE	Above the NPL ratio set by NBE	57%	22%
	Close to the NPL ratio set by NBE	38%	74%
	Below the NPL ratio set by NBE	5%	4%
Trend of NPLs at DBE	Continuous decrease in the ratio of NPLs has been observed	59%	58%
	Rise and fall in the ratio of NPLs has been observed	41%	34%
	Continuous increase in the ratio of NPLs has been observed	0%	4%
	A constant trend in the ratio of NPLs has been observed	0%	4%

The same table signifies that almost an equivalent percentage of management (59 percent) and non-management (58 percent) staff think that there has been a continous decrease in the ratio of NPLs at DBE for the last three financial years. This almost identical observation of majority of the two parties on the trend of NPLs reveals that there has been an improvement in the managemnt of NPLs from year to year over the aforementioned period.

5.2.3 Change Brought by the New Directive

As Table 4.2 shows, out of the twenty-two management staff responded 59 percent of them believe that the ACPD issued separately for DFIs has brought a tremendous improvement on the NPLs ratio of DBE. This means that the NPLs ratios recorded in three years period after the issue of the Directive are far better than those NPLs ratios recorded for similar period before the issue of the new Directive.

Table 4.2 Opinion of Management on the Changes brought by Asset Classification & Provisioning Directive Issued for Development Finance Institutions

Issue	Status	Non-mgmt Staff
Change observed in NPLs ratios of DBE after the issue of NBE's Directive	NPLs ratio of DBE has shown tremendous improvement	59%
	NPLs ratio of DBE has shown improvement but not significant	36%
	NPLs ratio of DBE has shown no improvement at all	5%
	NPLs ratio of DBE has increased further	0%
NPLs ratio of DBE compared to other banks working in the Ethiopian banking industry	Best of all the banks	0%
	Better than majority of the banks	5%
	Better than some of the banks	33%
	Better than none of the banks	33%
	I have no idea	29%

On the other hand, only 5 percent of management staff think that NPLs ratio of the Bank is better than majority of the other banks working in the Ethiopian banking industry. This means that although a tremendous improvement has been brought by the new Directive, the improvement, however, could not enable the Bank have a remarkable position in terrms of NPLs in the banking sector of Ethiopia.

5.2.4 Economic Sectors Contributing to NPLs

Among the various projects that the Bank has financed in the past operational years many of them are originated from the manufacturing, agriculture and service sectors of the economy. Of these three major economic sectors, the manufacturing sector is the most beneficiary of the Bank's finance.

Table 4.3 Economic Sectors Contribution to Non-performing Loans

Issue	Sector	Management Staff
Sector of the economy contributed much to NPLs problem of DBE	Manufacturing	71%
	Agriculture	10%
	Service	5%
	Others	0%
	I have no idea	14%

As Table 4.3 shows, about 71 percent of management staff identified that projects originated from the manufacturing sector had contributed much to NPLs problem of DBE in the past recent three financial years in general. This implies that the industry sector is the leading sector in terms of contributing to NPLs problem of the Bank.

5.2.5 Factors Responsible for Causing Non-performing Loans at DBE

As shown in Table 4.4, out of twenty-two management staff and twenty-five non-management staff who were asked to identify factors responsible for NPLs problem at DBE, 100 percent and 92 percent of them respectively were responded that both external and internal factors were responsible for the problem. This signifies that internal factors are not less important than external factors for the problem of NPLs observed at the bank level.

Table 4.4 Internal Factors for Nonperforming Loans at DBE

Issue	Responsible Factors	Mgmt Staff	Non-mgmt Staff
Factors responsible for NPLs problem	External factors	0	4%
	Internal factors	0	4%
	Both external & internal factors	100%	92%
Internal factors responsible for causing nonperforming loans	Inadequate screening process of potential borrowers	91%	60%
	Unable to appraise adequately the various aspects of projects submitted by prospective clients to the Bank due to capacity limitations	80%	56%
	Lack of proper supervision and reporting of projects under implementation and taking corrective actions timely	91%	76%
	Insufficient efforts made to collect loans as per the repayment schedules after the financed projects have started commercial production.	80%	44%
	Delay in releasing approved loans after the necessary requirements are fulfilled by the borrower.	23%	20%
	Failure to hold adequate collateral as per the Collateral Policy of the Bank	41%	12%
	Improper documentation of collateral items such as mortgage agreements, landholding certificates and deeds of vehicles that enables the Bank liquidates collaterals legally in case of loan default.	23%	24%
	Overestimation of the value of fixed assets pledged as collateral security by the Bank.	32%	33%
	Problems attached with ethics of staffs engaged in credit operations	4%	4%

Both categories of respondents i.e., management and non-management staff identified nine reasons as internal factors for NPLs problem observed at DBE in response to a question presented to them to cite internal factors responsible for causing NPLs at DBE. Although the weight given to individual factors by the respondents varies, four internal factors scored over 50 percent of the views of both categories of respondents.

These are i) lack of proper supervision and reporting of projects under implementation and taking corrective actions timely ii) inadequate screening process of potential borrowers iii) unable to appraise adequately the various aspects of projects submitted by prospective clients to the Bank due to capacity limitations and iv) insufficient efforts made to collect loans as per the repayment schedules after the financed projects have started commercial production. Thus, these are the major internal reasons for NPLs of the Bank as the data analysis reveals.

5.2.6 Systems for Early Identification and Prevention

With regard to the existence of preventative systems and procedures that are aimed at reducing the creation of new NPLs at the bank level, 77 percent of management staff agreed that the Bank does have the said systems and procedures as seen in Table 4.5. Similarly, 70 percent of non-management staff agreed that the Bank does have the systems and procedures. Although majority of both categories of respondents agreed that the Bank has the systems and procedures, there are also staffs from both categories that they don’t agree that the Bank has the systems and procedures. This may pose a question how these respondents could deny the systems and procedures existences if there are.

Table 4.5 Views of Management and Non-managemnt Staff on Systems Avaiable to Prevent the Creation of New Non-performing Loans

Issue	Response Choices	Mgmt Staff	Non-mgmt Staff
Preventative systems and procedures	Yes, it does have	77%	70%
	No, it doesn't have	18%	17%
	I have no idea	5%	13%
Effective early warning system	Yes, it does have	73%	-
	No, it doesn't have	18%	-
	I have no idea	9%	-
Checklist for warning signs of borrower and loan distress	Yes, it does have	41%	57%
	No, it doesn't have	32%	24%
	I don't know	27%	19%

The analysis of data in the same table indicates that 73 percent of management staff believes that the Bank does have an effective early warning system. Although majority of the respondents think that the Bank does have effective early warning system, it is only 54 percent of these respondents who could jot down some *unclear* and *varied* items as key elements of an effective early warning system.

On the other hand, only 41 percent of management staff agreed that the Bank does have a checklist for warning signs of borrower and loan distress whereas 57 percent of non-management staff believes that the bank has the said checklist.

The data summarized in Table 4.5 clearly indicates that there is doubt in the existence of effective systems and procedures in DBE to prevent occurrence of NPLs. This is highly supported by the failure of both categories of respondents to write clearly key warning signs in the space provided in the questionnaires. Only 27 percent of management staff and 48 percent of non-management staff attempted to write few but *unclear* and *dissimilar* warning signs. Thus, the management staff observation with regard to a checklist for warning signs of borrowers and loan distress seems close to the reality i.e., nonexistence of clear and/or well understood warning signs.

5.2.7 Work Units for Early Identification of NPLs

Out of twenty management staff 82 percent and 59 percent of them identified Credit Process & main branches and Risk Management Process as work units responsible for early identification of problem loans or NPLs respectively (see Table 4.6). About 45 percent of these respondents believe that both lending units engaged in delivering loans and Risk Management Process are responsible units for early identification of non-performing loans. This means that there are at least two different work units which work on and present report on non-performing loans to Top Management of the Bank which indicates confusion in assignment of a specific work to a particular unit with distinct responsibility and accountability.

Table 4.6 Management Staff's View on the Responsible Work Unit for Non-performing Loans

Issue	Work Unit	Mgmt Staff
Work unit(s) responsible for early identification of NPLs	Credit Process & main branches	82%
	PRLR Sub-process & regional PRLR teams	5%
	Risk Management Process	59%
	Any Other	5%

5.2.8 Loan Classification as per the New Directive

As seen in Table 4.7, out of twenty-two management staff 67 percent of them expressed that all loans at DBE are properly and timely identified, and classified.

Similarly, the same category of respondents disclosed that 50 percent of NPLs are properly and timely identified, and classified.

Table 4.7 Observation of Management & Non-management Staff on the Loan Classification at DBE

Issue	Classification Status	Mgmt Staff	Non-mgmt Staff
All Loans Classification	All loans are properly classified periodically	67%	42%
	Majority of loans are properly classified periodically	33%	54%
	Some are properly classified periodically	0	4%
	None are properly classified periodically	0	0
NPLs Classification	All NPLs are properly and timely identified, and classified	50%	29%
	Majority of NPLs are properly and timely identified, and classified	50%	63%
	Some of NPLs are properly and timely identified, and classified	0	8%
	None of NPLs are properly and timely identified, and classified	0	0

On the other hand, 54 percent of the other category of respondents i.e., non-management staff revealed that majority of loans are properly classified periodically. Likewise, 63 percent of them disclosed that majority of NPLs are properly and timely identified, and classified.

The above analysis signifies that not all but majority of the loans and NPLs are properly and timely identified, and classified. This implies that there is imperfection in loan classification practice of the Bank since there are respondents in both categories that don't accept the expression that all loans and all NPLs are properly and timely identified, and classified.

5.2.9 Non-performing Loans Transfer Practices

Out of the twenty-two management staff, 77 percent and 54 percent of them believe that the Bank have a well-thought-out and well-understood set of NPLs transfer criteria & procedures and the transfer of NPLs from the units where the loans originated to the workout or recovery units is made quickly to majority of NPLs (See Table 4.8).

Table 4.8 Opinion of Management and Non-management Staff on Existence of NPLs Transfer Criteria and Transfer Procedure

Issue	Response Choices	Mgmt Staff	Non-mgmt Staff
Presence of NPLs transfer criteria and procedures	Yes, it does have	77%	79%
	No, it doesn't have	23%	17%
	No idea	0	4%
Transfer of NPLs	The transfer is made quickly to all NPLs	14%	8%
	The transfer is made quickly to majority of NPLs	54%	25%
	The transfer is made quickly to some of NPLs	9%	25%
	The transfer is not made quickly to all NPLs	23%	42%

Although 79 percent of non-management staff believe that the Bank have a well-thought-out and well-understood set of NPLs transfer criteria & procedures, it is, however, only 8 percent and 25 percent of them observed that the transfer is made quickly to all NPLs and majority of NPLs respectively. The analysis clearly reveals that although the Bank does have a well-thought-out and well-understood set of NPLs transfer criteria and procedures, their applications, however, are ineffective.

5.2.10 Use of NBE Directive in Categorizing Renegotiated NPLs

As Table 4.9 shows, only 50 percent of management staff agrees that DBE's use of NBE's Directive in categorizing renegotiated non-performing loans as a substandared in the past recent three financial years is perfect.

Table 4.9 Observation of Respondents with Regard to Varies Activities of Renegotiating of Short-term Loan

Issue	Response Choices	Mgmt Staff	Non-mgmt Staff
Categorizing renegotiated non-performing loans	Perfect	50%	-
	Imperfect	18%	-
	No idea	32%	-
the use of NBE's Directive in categorizing renegotiated nonperforming loans	DBE has properly used NBE's Directive in categorizing renegotiated nonperforming loans as substandared	91%	-
	DBE has never properly used NBE's Directive in categorizing renegotiated nonperforming loans as substandared	9%	-
Effecting NBE's Directive in categorizing renegotiated NPLs	DBE has properly implemented the Directive	-	72%
	DBE has never properly implemented the Directive	-	12%
	I have no idea	-	16%

The same Table reveals that 91 percent of management staff believes that DBE has properly used NBE's Directive in categorizing renegotiated NPLs as substandared over the past recent three financial years.

As the analysis of data on the Bank's activities related to renegotiating NPLs disclose that the observation of management staff is contradictory. Although 91 percent of management staff believes that the Bank has properly used NBE's Directive, however, it is only about 50 percent of the same category of respondents believes that the application of the Directive is perfect.

Likewise, only 72 percent of non-management staff believes that the Bank has implemented the Directive properly. The analysis in general implies that there is imperfection in the utilization of the Directive in categorizing renegotiated NPLs as a substandared at the bank level since the perspective on the proper utilization of the Directive is not all-embracing.

5.2.11 Loan Workout Methods

As far as loan workout methods is concerned,Table 4.10 reveals that loan repayment rescheduling is a method which is principally applied by the Bank's workout units to rehabilitate sick projects and thereby reduce NPLs as well as the most effective means of reducing NPLs. Out of the twenty-two management staff who responded to the questionniare 68 percent of them indicated that loan repayment scheduling is a principal loan workout method employed by the Bank and 56 percent of them mentioned that loan repayment scheduling is also a project rehabilitation mechanism which the Bank has effectively emloyed to alleviate its stock of NPLs.

Table 4.10 Principal and/or Effective Loan Workout Methods based on Observation of Management Staff

Issue	Method	Mgmt Staff
Method *principally applied* by the Bank's workout units	Loan repayment scheduling	68%
	Provision of additional loan	44%
	Loan transfer to third party	44%
	Reorganization	12%
	Management intervention	32%
	Debt restructuring	12%
	Any combination of the above mechanisms	48%
	Any other	
Most effective mechanism of project rehabilitation	Loan repayment scheduling	56%
	Provision of additional loan	20%
	Loan transfer to third party	20%
	Reorganization	8%
	Management intervention	8%
	Debt restructuring	12%
	Any combination of the above mechanisms	58%
	Any other	4%

5.2.12 Loan Rescheduling Frequency

With regard to the frequency of rescheduling, restructuring or renegotiating a short-term loan to a borrower, 45 percent of respondents believe that the frequency is more than three times although 50 percent of the respondents believe that the frequency is less than three times. This implies that there are occasions in which rescheduling, restructuring or renegotiating of short-term loan is performed beyond the maximum limit stated in the NBE's Asset Classification and Provisioning Directive.

Table 4.11 Observation of Manasgement and Non-management Staff on Loan Rescheduling

Issue	Collection Status	Mgmt Staff	Non-mgmt Staff
Frequency of rescheduling, restructuring or renegotiating short-term loans	Less than three times	50%	-
	Just three times	5%	-
	More than three times	45%	-
Interest collection during rescheduling, restructuring or renegotiating short-term loans	It collects the entire amount of interest in arrears in cash	72%	80%
	It collects a portion of the amount of interest in arrears in cash	14%	16%
	It does not collect the entire amount of interest in arrears in cash at all	0%	0%
	I have no idea	4%	4%
Collection of entire amount of interest in arrears in cash plus a minimum of 25% of outstanding principal balance before rescheduling, restructuring or renegotiating short-term loans	Yes, it does	-	40%
	No, it doesn't	-	40%
	I have no idea	-	20%
Collection of entire amount of interest in arrears in cash plus a minimum of 50% of outstanding principal balance before rescheduling, restructuring or renegotiating short-term loans	Yes, it does	-	20%
	No, it doesn't	-	60%
	I have no idea	-	20%

Majority of both categories of respondents i.e., management (72 percent) and non-management staff (80 percent) observed that the Bank collects the entire amount of interest in arrears in cash before rescheduling, restructuring or renegotiating a short-term loan. Although majority of both categories of respondents believe that the Bank collects interest in arrears as per the Directive, 40 percent and 60 percent of non-management staff, however, discloses that the Bank doesn't collect the entire amount of interest in arrears in cash plus a minimum of 25% and 50% of outstanding principal balance before rescheduling, restructuring or renegotiating a short-term loan for the second and third time respectively. This analysis indicates that the Bank does not comply with the NBE Directive while it reschedules, restructures or renegotiates a short-term loan.

5.2.13 Effectiveness of Methods Employed to Reduce NPLs

According to the results stated in Table 4.12 most of management staff (80 percent) and non-management staff (68 percent) believes that taking over management of a defaulting company has helped DBE to some extent to solve its NPLs problem.

On the other hand, 86 percent of management staff and 64 percent of non-management staff agreed that the Bank has been successful in disposing NPLs for the last recent three financial years. Likewise, 86 percent of management staff and 67 percent of non-management staff think that taking possession of the mortgaged assets of loan defaulters largely without the intervention of the courts has helped DBE considerably to solve its NPLs problem.

Table 4.12 Staff Observation on Varies Methods Employed to Reduce Nonperforming Loans

Issue	Response Choices	Mgmt Staff	Non-mgmt Staff
Taking over management of a defaulting company	helped DBE significantly to solve its NPLs problem	10%	18%
	helped DBE to some extent to solve its NPLs problem	80%	68%
	has not helped DBE to solve its NPLs problem at all	5%	14%
	Any different idea	5%	0
DBE's successfulness in disposing NPLs	Yes, it has been.	86%	64%
	No, it hasn't been.	9%	20%
	I don't know	5%	16%
Taking over of mortgaged assets	It has helped DBE considerably to solve its NPLs problem	86%	67%
	It has helped DBE a little to solve its NPLs problem	9%	29%
	It has not helped DBE to solve its NPLs problem at all	0%	4%
	Any different idea	5%	0
the process of writing-off NPLs	Lengthy	70%	60%
	Fair	30%	32%
	Short	0%	8%
Workout units performance in reducing NPLs	Their performance is above expectation	0%	-
	Their performance as expected	60%	-
	Their performance is below expectation	25%	-
	I have no idea	15%	-

The same Table reveals that the writing-off NPLs at DBE is a lengthy process. Seventy percent of management staff and 60 percent of non-management staff classify writing-off NPLs as a prolonged process.

The Table also unveils that only 60 percent of management staff surveyed feel that the performance of workout units of the Bank in reducing NPLs of the Bank is as expected. The above analysis points out that taking possession of the mortgaged assets of loan defaulters largely without the intervention of the courts and disposing

NPLs were effective methods to mitigate the stock of NPLs at DBE whereas taking over management of a defaulting company and writing-off NPLs were ineffective.

5.2.14 Placement of Non-performing Loans on Non-accrual Status

As Table 4.13 shows majority of non-management staff (58 percent) don't know whether the Bank has considered uncollectable accruals as income or not in the last recent three financial years. This means that many of these staffs don't have an information access on this specific issue or lack knowledge of this issue. On the other hand, 62 percent of management staff learnt that earnings are accurately reflected by placing all non-performing loans on non-accrual status.

As the analysis of data on the Bank's activities related to restoring NPLs placed on non-accrual status to accrual status discloses that the observation of management staff is different from the observation of non-management staff. Although 72 percent of management staff believes that the Bank has properly used NBE's Directive, however, 57 percent of non-management staff believes that the Bank has sometimes deviated from the Directive in restoring NPLs placed on non-accrual status to accrual status. The Directive specifies that a nonperforming loan placed on non-accrual status may be restored to accrual status only when i) none of the outstanding principal and/or interest is pas due; and ii) for negotiated loans, where all past due interest is paid up by the borrower in cash at the time of renegotiation and the loan is not classified as 'substandard'.

Table 4.13 Staff Opinion on Placing of NPLs on Non-accrual Status

Issue	Response Choices	Mgmt Staff	Non-mgmt Staff
Uncollectable accruals	DBE has never considered uncollectable accruals as income	-	29%
	DBE has considered uncollectable accruals as income	-	12%
	No idea	-	58%
Reflecting accuracy of earnings by placing NPLs on non-accrual status	It has been made to accurately reflect earnings by assuring that all loans categorized as non-performing are placed on non-accrual status	62%	-
	It has not been made to accurately reflect earnings by assuring that all loans categorized as non-performing are placed on non-accrual status	19%	-
	No idea	19%	-
Use of NBE's Directive in restoring non-performing loans placed on non-accrual status to accrual status	DBE has always properly implemented NBE's Directive	72%	39%
	DBE has sometimes deviated from NBE's Directive	28%	57%
	DBE has always deviated from NBE's Directive	0%	4%

5.2.15 Adequacy of Loan Provisioning

The results disclosed in Table 4.14 show that 95 percent of mangers say that provisions held by the Bank for NPLs in the past recent three financial years has been adequate to absorb potential losses. Similarly, 84 percent of non-management staff expresses that the Bank maintains the minimum provision percentages against the outstanding principal amount of each loan or advance as per the NBE Directive.

With regard to profit and capital reported in an Audited Annual Reports of the Bank, 67 percent and 52 percent of management and non-management staff believe that the reported profit and capital are the reflections of true level of provisions held on

NPLs. Results disclosed above signify in general that the Bank holds adequate provisions, and profit and capital reported in its Audited Annual Reports reflects the right level of provisions held on NPLs.

Table 4.14 Opinion of Management and Non-management Staff on Adequacy of Loan Provision

Issue	Response Choices	Mgmt Staff	Non-mgmt Staff
Adequacy of provisions held for NPLs	It has been adequate to absorb potential losses	95%	-
	It has not been adequate to absorb potential losses	5%	-
Whether the Bank maintains the minimum provision percentages as per NBE's Directive	Yes, it does	-	84%
	No, it doesn't	-	4%
	No idea	-	12%
Reported profit and capital of DBE	They are the reflections of true level of provisions held on NPLs	67%	52%
	They aren't the reflections of true level of provisions held on NPLs	9%	20%
	No idea	24%	28%

5.3 Findings from the Numerical Data Collected

5.3.1 The Level and Trend of NPLs at DBE

Table 4.15 shows the trend of nonperforming loans of DBE over the period 2007/08-2012/13. NPL ratio of the Bank was in the range of 10.80 to 55.55 percent.

As per the amended NBE's Asset Classification and Provisioning Directive, 22.34 perecent of the Bank's outstanding loans were NPLs by the end of 2012-13. The ratio of NPLs to total outstanding loans over the six years period has remained much higher than the norm set by NBE which is 5 percent. The NPL ratios presented in the table are derived by investigating the loan classification database of the Bank. The figures are quite different from the officially reported figures. As an illustration, the NPLs ratios, according to the Bank's Annual Performance reports, at June 30, 2011, June 30, 2012 and June 30, 2013 were 11.67%, 7.45% and 8.62% respectively. These officially reported ratios of NPLs don't reflect the full extent of the problem.

Before the issue of a separate directive for development finance institutions, the level of NPLs was continuosly rising. However, in the first two years of implementation of the new directive the level of NPLs had shown a decreasing trend. Particularly there was a significant decrease in the NPLs of DBE in 2011-12. The reclassification of the alreasdy existing loans according to the newly issued directive led to a sharp decline in the ratio of total NPLs to total loans to 32.35 per cent at the end of June 2011 from 55.55 per cent at the end of June 2010. A further decline in the NPL ratio to 10.80 percent at the end of June 2012 is mainly attributed to the amendment of the new directive. The new directive was further amended after a year which resulted a sharp drop in the NPL ratio. The directive has become lenient.

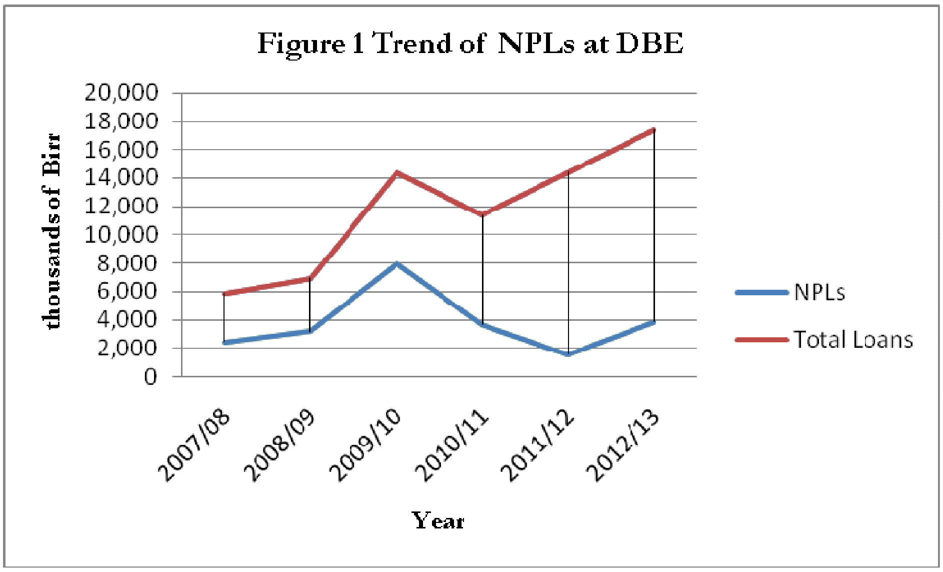
Table 4.15 The Trend of Nonperforming Loans at Development Bank of Ethiopia

('000 Birr)

Year	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
NPLs	2,450	3,193	8,005	3,683	1,556	3,884
Total Loans	5,897	6,975	14,409	11,383	14,403	17,388
%age	41.55	45.78	55.55	32.35	10.80%	22.34%

Source: Loan Classification & Provisioning Database, Risk Management Process and own computation.

The ratio, however, has bagan to show an increasing trend even after the implementation of the new directive and its amendement although the NPLs ratios observed in the three years before the issue of the directive has been generally lower than those ratios observed in the three years of implementation of the new directive. The gross NPLs of DBE increased from 10.80 per cent of total loans in 2011-12 to 22.34 per cent in 2012-13. The increase was mainly due to deterioration in the quality of loans extended to the manufacturing sector. This high rate of NPLs in fact reflects the incapability of the Bank to move towards achieving the desired rate, although a reduction in NPLs in general has been noticed after the issuance and further amendment of the new directive (see also Figure 1).



5.3.2 The Effect of the New Directive

The new directive, which became effective on August 5, 2010, was the one which replaced the ACPD issued by NBE in January, 2008. The former directive was equally applicable to all banks operating in the Ethiopian economy. Whereas the new is specifically issued for FDIs. Both directives require banks to classify their loans in five catagories namely, pass, special mention sub-standard, doubtful and loss. However, there is a difference between the former directive and the new one. The former directive is tight in classifying loans. According to this directive loans were classified as nonperforming when they are past due 90 days or more regardless of the type of loan. Whereas, the new directive had required development finance institutions to classify medium and long-term loans as nonperforming when the loan is past due 180 days or more.

As the new directive couldn't bring the desired result after a year's implementation, it has been amended further before it serves two years or more. The amendment was performed by extending the number of days required to classify loans into the five categories. According to the amended directive, medium and long-term loans past due 12 months (360 days) or more are classified as NPLs (See Table 4.16).

Table 4.16 Asset Classification and Provisioning Directives Used for Classification and Provisioning of DBE's Loans, 2008-2013

Loan Category	Directive No.		
	SBB/43/2008	SBB/48/2010	SBB/52/2012
Pass	Any loan or advance, or portion thereof, which is fully secured by cash or cash substituite	Short-term loans past due for less than 30 days; Medium & long-term loans past due for less than 90 days;	Short-term loans past due for less than 30 days; Medium & long-term loans past due for less than 180 days;
Special Mention	Past due 30 days or more	Short-term loans past due 30 days or more, but less than 90 days; Medium & long-term loans past due 90 days or more but less than 180 days, ;	Short-term loans past due 30 days or more, but less than 90 days; Medium & long-term loans past due 180 days or more but less than 360 days;
Substandard	Past due 90 days or more	Short-term loans past due 90 days or more, but less than 180 days; Medium & long-term loans past due 180 days or more but less than 360 days, ;	Short-term loans past due 90 days or more, but less than 180 days; Medium & long-term loans past due 360 days or more but less than 540 days;
Doubtful	Past due 180 days or more	Short-term loans past due 180 days or more, but less than 360 days; Medium & long-term loans past due 360 days or more but less than 3 years;	Short-term loans past due 180 days or more, but less than 360 days; Medium & long-term loans past due 540 days or more but less than 1095 days;
Loss	Past due 360 days or more	Short-term loans past due 360 days or more; Medium & long-term loans past due3 years or more;	Short-term loans past due 360 days or more; Medium & long-term loans past due3 years or more;

Source: Loan Classification & Provisining Directives issued in 2008, 2010 & 2012, NBE.

5.3.3 Loan Classification

The NBE directive requires a development financial institution to classify its loans into five categories namely, pass, special mention, doubtful and loss. Table 4.17 reveals how loan classification is actually performed at DBE. As the table shows 19.87 percent and 12.73 percent of medium & long-term loans and of total loans respectively were inappropriately classified. This inppropriate classification was done by placing a particular loan in pass category instead of special mention, substandard, doubtful or loss or by classifying a loan as special mention in place of pass, substandard or doubtful and so on diregarding the age of the loan. The result disclosed above indicates that there is mismanagement in classifying loans specifically medium & long-term loans at DBE although there is a regulatory requirement.

Table 4.17 Inappropriatley Classified Loans as at June 30, 2013

Description	Short-term Loans	Medium & Long-term Loans	Total
Total number of classified loans	1009	1716	2,725
Number of inappropriately classified loans	0	347	347
Inappropriately classified loans in percent	0	19.87%	12.73%

Source: Loan Classification & Provisioning Database, Risk Management Process.

5.3.4 Non-Performing Loans by Economic Sectors

The bulk of the Bank's NPLs is in the industry sector as illustrated in Table 4.18. The industry sector took the lion share in terms of both NPLs and total outstanding loans during the post implementation period of the directive. In year 2012-13 during which the NPLs of the Bank peaked, the industry sector accounted for 78.67 percent of total NPLs followed by the agriculture sector (16.71 percent). In terms of total outstanding loans, the industry sector accounted for the majority of total loans at 83.38 percent, while the agriculture sector accounted for 12.14 percent. The increase observed in the NPLs of the industry sector coincides with growth of the loan extended to the sector.

Table 4.18 Sectoral Distribution of Total Outstanding Loan and Nonperforming Loans

'000 Birr

Description	June 30, 2011	June 30, 2012	June 30, 2013
Total Non-performing Loans at Bank Level	3,683,050	1,556,167	3,884,294
Non-performing Loans by Sector			
Agriculture	854,520	655,123	649,017
Service	280,115	162,630	178,483
Industry	2,468,292	727,886	3,055,986
Others	80,123	10,528	808
Share of Nonperforming Loans by Sector			
Agriculture	23.20%	42.10%	16.71%
Service	7.61%	10.45%	4.60%
Industry	67.02%	46.77%	78.67%
Others	2.17%	0.68%	0.02%
Total Outstanding Loans at Bank Level	11,382,510	14,402,640	17,387,842
Outstanding Loans by Sector			
Agriculture	2,452,054	3,203,131	2,110,190
Service	852,355	881,927	729,661
Industry	7,940,023	10,274,294	14,498,405
Others	138,078	43,288	49,586
Share of Outstanding Loans by Sector			
Agriculture	21.54%	22.24%	12.14%
Service	7.49%	6.12%	4.20%
Industry	69.76%	71.34%	83.38%
Others	1.21%	0.30%	0.28%

Source: Loan Classification & Provisioning Database, Risk Management Process and own computation.

The agriculture sector is the major contributor to the NPLs problem of the Bank. As seen from Table 4.19, the NPL ratios of the agriculture sector in the three years after the issuance of the new directive and its amendment were 34.85 percent, 20.45 percent and 30.76 percent followed by the service sector with NPL ratios of 32.86 percent 18.44 percent and 24.46 respectively.

However, with the financing of huge manufacturing projects, the contribution of the industry sector to the NPLs problem of the Bank has began to rise dramatically. The sector's NPL ratio has risen to 21.08 percent at the end of June, 213 from 7.08

percent at the end of June, 2012. The main reasons for this surge in NPL's is the failure of huge textile investment projects to settle the working capital loans they received from the Bank for purpose of purchasing raw cotton. The projects failed to meet their debt obligations because of the fluctuations observed in the prices of raw cotton, textile and yarn in the international markets.

Table 4.19 Nonperforming Ratios by Economic Sector, 2010/11-2012/13

'000 Birr

Sector	June 30, 2011	June 30, 2012	June 30, 2013
Agriculture			
Total Outstanding Loans	2,452,054	3,203,131	2,110,190
Total Non-performing Loans	854,520	655,122	649,017
NPLs Ratio	**34.85%**	**20.45%**	**30.76%**
Services			
Total Outstanding Loans	852,355	881,927	729,661
Total Non-performing Loans	280,114	162,630	178,483
NPLs Ratio	**32.86%**	**18.44%**	**24.46%**
Industry			
Total Outstanding Loans	7,940,023	10,274,294	14,498,405
Total Non-performing Loans	2,468,292	727,886	3,055,986
NPLs Ratio	**31.09%**	**7.08%**	**21.08%**
Others			
Total Outstanding Loans	69,272	28,712	37,499
Total Non-performing Loans	13,475	8,226	433
NPLs Ratio	**19.45%**	**28.65%**	**1.15%**

Source: Loan Classification & Provisioning Database, Risk Management Process and own computation.

5.3.5 Non-performing Loans by Term Loans

Almost all the Bank's NPLs are originated from medium and long-term loans extended to finance development projects both in the public and private sectors. As Table 4.20 presents, medium and long-term loans accounted for over 99 percent of the NPLs of the Bank over the three years period i.e., from 2010-11 to 2012-13 whereas the share of short-term loans was less than 0.16%. As the principal mission of the Bank is to extend medium and long-term loans to finance priority sector projects, the size of nonperforming go along with the volume of such loans. Like the immense share medium and long-term loans hold out of total NPLs, these loans also accounted for not less than 99 percent of the total loan portfolio of the Bank over the aforementioned period.

Table 4.20 Distribution of Nonperforming Loan by Term Loans, 2010/11-2012/13

'000 Birr

End of Financial Year	Total Non-performing Loans	Non-performing Loans		Share of Nonperforming Loans	
		Short-term	M & Long-term	Short-term	M & Long-term
June 30, 2011	3,683,050	483	3,682,567	0.01%	99.99%
June 30, 2012	1,556,167	2,302	1,553,865	0.15%	99.85%
June 30, 2013	3,884,294	375	3,883,919	0.01%	99.99%

Source: Loan Classification & Provisioning Database, Risk Management Process and own computation.

Table 4.21 indicates which category of term loans has contributed more to accumulated NPLs of the Bank regardless of the different classification criteria used to classify the two loan categories. As shown in the table, NPL ratio of medium and long-term loans was above 22 percent for all years except year 2011-12 whereas NPL ratio of short-term loans was below 5 percent except year 2011-12 (which was almost 16 percent). Thus medium and long-term loans are found to be major source to NPLs problems of the Bank despite the loose classification criteria set for them.

Table 4.21 Nonperforming Ratios by Term loans, 2010/11-2012/13

'000 Birr

	June 30, 2011	June 30, 2012	June 30, 2013
Short Term Loans			
Total Outstanding Loans	11,788,567	14,576,629	12,087,185
Total Non-performing Loans	483,411	2,301,898	374,668
NPLs Ratio	**4.10%**	**15.79%**	**3.10%**
Medium & Long-term Loans			
Total Outstanding Loans	11,370,721,872	14,388,063,140	17,375,754,979
Total Non-performing Loans	3,682,567,132	1,553,865,140	3,883,919,265
NPLs Ratio	**32.39%**	**10.80%**	**22.35%**

Source: Loan Classification & Provisioning Database, Risk Management Process and own computation.

5.3.6 Loan Provisioning for Non-performing Loans

The loss provision at DBE is based on the percentage specified by NBE in accordance to their period of defualt and classification. The percentage of provision doesn't vary with the type of loans. For both short-term and Medium & long-term loans a provision of 1%, 3%, 20%, 65% and 100% is held for loans classified as pass, special mention, substandard, doubtful and loss respectively.

As per the amended directive, medium and long-term loans that have been in default for 360 days but less than 540 days are classified as substandard and are given a 20 percent provision after deducting suspended interest and net recoverable value (NRV) of a physical collateral from them. Loans that have been in default for 540 days but less than 1095 days are classified as doubtful and the amount of specific provision is 65 percent after deducting the same items mentioned above and for loans that have been in default 1095 days (3 years) or more are classified as loss loan and are given a 100 percent specific provision after the said deductions are made.

Also, a short-term loan past due 90 days or more, but less than 180 days is classified as substandard and is given a 20 percent provision. A short-term loan past due 180 days or more, but less than 360 days is classified as doubtful and the amount of specific provision is 65 percent and for loan past due 360 days or more is classified as loss loan and is given a 100 percent specific provision. However, like medium & long-term loans, suspended interest and NRV of a physical collateral are deducted from the total of each loan before a specific provison rate is applied to that particular loan.

Table 4.22 Ratio of Provisions to Nonperforming Loans, 2011-2013

'000 Birr

Year	Total Provision Held[1]	Gross NPLs[2]	Ratio of Provison to NPLs
June 30, 2011	89,347	3,683,050	2.42%
June 30, 2012	296,042	1,556,167	19.20%
June 30, 2013	90,530	3,884,294	2.33%

Sources: [1]Published Annual Audit Reports (for the Year Ended June 30, 2011 & June 30, 2012) & trial balance (for the Year Ended June 30, 2013).

[2] Loan Classification & Provisioning Directive Database, Risk Management Process.

As shown in Table 4.22, while the volume of NPLs increases from 1,556 million Birr to 3,884 million Birr, ratio of provision to NPLs has dropped from 19.20 percent to 2.33 percent. In a situation in which NPLs increases, the normal practice in loan provisioning is to set aside more provisions to cover NPLs increases. However, what happened at DBE was the opposite. One can see from the table a dramatical increase in NPLs and at the same time a dramatical fall in provisions to NPLs. This indicates that provisioning is inadequate-the symptom for beginning of financial crises episode at the level of the Bank. The results in the last column also reveals that the provisions set aside to cover NPLs were less than 2.5 percent for the two years except for 2011/12.

5.3.7 Restructuring and Disposal of Non-Performing Loans

When financed projects whose loan have become non-performing are transferred to the loan workout units of the Bank i.e., PRLR Sub-process and PRLR teams from the lending units i.e., Credit Process and main branches for treatment, the units investigate the problem and propose a suitable rehabilitation mechanism which may restore the loan to performing status eventually. The units then implement the method after they have got the respective approval of the Loan Approval Team at head office and Loan Approval teams at region level.

PRLR Sub-process at head office is the principal work unit among the units engaged in loan workout. The other five are teams structured under each region. The Sub-process receives NPLs from the primary lending organ of the Bank i.e., Credit Process while PRLR teams receives NPLs from branches operating under their respective region. Following is the analysis made to illustrate, through this Sub-process, how the Bank restructure and dispose NPLs and at the same to determine its effectiveness in resolving NPLs problem.

Of the total NPLs of Birr 617 million in the hands of this Sub-process at the beginning of 2012/13, only 17.83 percent of NPLs was restructured by employing loan repayment rescheduling method, and providing additional loan to sick projects. According to data secured from the Sub-process, NPLs amounting to Birr 22 million was restructed through loan repayment rescheduling method, and NPLs amounting to Birr 88 million was restructed by providing additional loan to sick projects. Thus, the restructuring was mainly performed through provision of a new fund to the defualting project or client. The unit couldn't resolve at least 50 percent of the NPLs within a year. This indicates that the unit is slow in resolving the problem of NPLs.

In addition to restructuring NPLs, the Sub-process and the teams will take subsequent actions if the methods they have proposed fail to rehabilitate the projects and thereby recover the NPLs. The actions are to seize the project's properties and other properties held as collateral and to foreclose them, and to dispose properties acquired by the bank after several attempts to foreclose them have failed.

Table 4.23 NPLs Recovered Through Foreclosure and Disposal of Acquired Properties, 201011-2012/13

'000 Birr

Description	2010/11	2011/12	2012/13
Amount of loan collected by foreclosure & disposal of acquired properties	30,000	33,202	84,600
Total NPLs at the beginning of the year	560,821	617,272	710,054
NPLs recovered	5.35%	5.38%	11.91%

Source: PRLR Sub-process.

Table 4.23 shows the performance of PRLR Sub-process in terms of reducing the volume of NPLs of the Bank through foreclosing properties held as security including the projects themselves and disposal of acquired proprties. As seen from the table, NPLs recovered by foreclosure and disposal of acquired assets was less than 10

Percent except for 2012/13 which was 13.70 Percent. This particular inrease in recovered NPLs loans was due to a relatively high inrease in amount of loan collected through these measures during the year and less increament in volume of NPLs.

The least performance of the unit is due to its preference to let NPLs of projects roll simply by collecting what the projects can repay in the course of time instead of recovering the loans by taking foreclosure measure and disposal actions promptly.

CHAPTER SIX: SUMMARY OF FINDINGS, CONCLUSIONS & RECOMMENDATIONS

6.1 Summary of the Findings

Findings from *the analysis of responses received through the questionnaires* are summarized below. The analysis reveals that majority of management and/or non-management staff of DBE believe that

- NPLs are managed well at DBE
- a continous decrease in the ratio of NPLs at DBE has been observed for the last three financial years. Thus, there has been an improvement in the managemnt of NPLs from year to year over the aforementioned period.
- the Asset Classification and Provisioning Directive issued separately for development finance institutions has brought a tremendous improvement on the NPLs ratio of DBE.
- although a tremendous improvement has been brought by the new Directive, the improvement, however, could not enable the Bank to have a remarkable position in terrms of NPLs in the banking sector of Ethiopia.
- the manufacturing sector had contributed much to NPLs problem of DBE in the past recent three financial years in general.

- Both external and internal factors are responsible for the problem of nonperforming loans observed at the bank level and internal factors are not less important than external factors in this regard.
- Nine internal factors are responsible for NPLs problem of the Bank of which i) lack of proper supervision and reporting of projects under implementation and taking corrective actions timely ii) inadequate screening process of potential borrowers iii) unable to appraise adequately the various aspects of projects submitted by prospective clients to the Bank due to capacity limitations and iv) insufficient efforts made to collect loans as per the repayment schedules after the financed projects have started commercial production.
- the Bank does have the systems and procedures for early identification and prevention of the creation of new NPLs;
- the Bank does have an effective early warning system, although only 54 percent of these respondents who could jot down some *unclear* and *varied* items as key elements of an effective early warning system.
- the Bank doesn't have a checklist for warning signs of borrower and loan distress;
- there at least two different work units which work on and present report on non-performing loans to Top Management of the Bank;

- all loans and NPLs at DBE are properly and timely identified, and classified despite a different response received from non-management staff when questions on nonperforming loan classification were made to be specific;
- the Bank have a well-thought-out and well-understood set of NPLs transfer criteria & procedures and the transfer of NPLs from the units where the loans originated to the workout or recovery units is made quickly to majority of NPLs;
- although the Bank does have a well-thought-out and well-understood set of NPLs transfer criteria and procedures, their applications, however, are ineffective;
- DBE's use of NBE's Directive in categorizing renegotiated non-performing loans as a substandared in the past recent three financial years is perfect;
- loan repayment rescheduling is a method which is principally applied by the Bank's workout units to rehabilitate sick projects and thereby reduce NPLs as well as the most effective means of reducing NPLs;
- the frequency of rescheduling, restructuring or renegotiating a short-term loan is within the limit stated in the NBE Asset Classification and Provisioning Directive;
- the Bank does not comply with the NBE Directive while it reschedules, restructures or renegotiates a short-term loan;
- taking possession of the mortgaged assets of loan defaulters largely without the intervention of the courts and disposing NPLs were effective methods to mitigate

the stock of NPLs at DBE whereas taking over management of a defaulting company and writing-off NPLs were ineffective;

- the Bank holds adequate provisions, and profit and capital reported in its Audited Annual Reports reflects the true level of provisions held on NPLs;
- the Bank reflects earnings accurately by placing all non-performing loans on non-accrual status;

The analysis of the numerical data collected exposes that

- The ratio of NPLs of DBE is around 22 percent;
- Rise and fall is seen in the trend of NPLs although a reduction in the ratio of NPLs in general has been noticed after the issuance and further amendment of the new directive.
- the new directive couldn't bring the desired result after a year's implementation as a result the Directive has been made lenient through amemndement before it serves two years or more;
- the Bank's loans specifically medium & long-term loans are not classified properly although there is a regulatory requirement;
- the agriculture sector is the major contributor to the NPLs problem of the Bank despite the fact that the bulk of the Bank's non-performing loan is in the industry sector;

- medium and long-term loans are major source to nonperforming loans problems of the Bank despite the loose classification criteria set for them;
- loan provisioning at DBE is inadequate;
- restructuring of NPLs is mainly performed through loan repayment rescheduling and particularly through provision of a new fund to the defualting project or client.
- the performance of PRLR Sub-process in terms of restructuring NPLs and reducing the volume of NPLs of the Bank through foreclosing properties held as security including the projects themselves and disposal of acquired proprties was unsatisfactory.

6.2 Conclusions

There is a great discrepancy between the observation of the Bank's staff and the actual situation of NPLs management. This implies that the problems of NPLs managemnt have not been well realized by the staff particularly by those who are responsible to make the right decisions with regard to NPLs and follow-up the execution of the decisions.

The Bank's NPLs is much higher than the prudential limit of five per cent and officially reported level. The NPLs of DBE has clearly reached alarming level that will result in a rapid reduction in the Bank's capital if adequate provisions are held which in turn can limit the Bank's ability to make new loans. This signals a strong possibility that the Bank will fail although there is no a definite rule established to determine when NPLs are reaching a dangerous level for a single bank or for the banking system as a whole.

There were ups and downs in the NPLs ratios of the Bank in the past six years. Neither a continous rising nor a continous fall in the ratios was observed. However, a rising tendency in the ratio of NPLs has been observed towards the end of this six years period, and this seems to continue in the coming years assuming that an amendment would not be made on the directive besides management problems.

The issuance of a separate directive for DFIs and its revision has brought a substantial decrease in the NPLs ratios of the Bank compared to the NPLs ratios before the execution of the new directive,. However, the observed reduction in the NPLs ratio wouldn't be permanent as long as the existing directive continues to serve in future.

Although the agriculture sector was the major source to the NPLs problem of the Bank in the past years, there is a less possibility that this tendency will continue in the future. Rather there is a great likelihood for the industry sector to take the place of the agriculture sector because of the rapid growth being observed in the volume of loan extended to this sector.

The NPLs problem at DBE is not only the result of external factors but also of internal factors. Nine internal factors are responsible for NPLs problem of the Bank of which i) lack of proper supervision and reporting of projects under implementation and taking corrective actions timely ii) inadequate screening process of potential borrowers iii) unable to appraise adequately the various aspects of projects submitted by prospective clients to the Bank due to capacity limitations and iv) insufficient efforts made to collect loans as per the repayment schedules after the financed projects have started commercial production are the major ones.

The assessment of Bank's staff observation has brought to light that there are flaws in every step of managing non-performing loans at DBE. In particular loan classification and provisioning, which are key activities in the process of NPLs management, are not performed properly as per the Directive of the supervisory body (NBE). This in turn indicates that the supervisory body doesn't perform a thorough investigation on the implementastion of its directive by financial institutions and suggest or take appropriate remedial measures before the situations lead to failure.

Both the Opinion Survey and the numerical data collected indicated that loan repayment rescheduling and provision of additional loan to a defualting client are major methods that the Bank employs to address its NPLs problem; and loan repayment rescheduling is frequently performed beyond the limit set for rescheduling the repayment of a an individual loan. This may lead to the conclusion that the Bank practices *'evergreening'* by classifying non-performing loan as performing through rescheduling and concealing a non-performing loan simply by making a new loan cover the repayment.

PRLR sub-process couldn't resolve at least 50 percent of the NPLs at hand within a year by employing the various methods of NPLs restructuring. Moreovert, the NPLs recovered through foreclosure and disposal of acquired properties out of the NPLs transfeerred to the PRLR Sub-process is insignificant. This means that a large proportion of the NPLs had been parked rather than being dealt with. This indicates that the work unit was slow in managing NPLs.

6.3 Recommendations

Based on the findings disclosed and the conclusions made earlier, the followings are recommended.

The *Bank* to:

- Create a system whereby all concerned staff of the Bank become aware of the real situation with regard to NPLs and encourage them to make their own conributions towards achieving the desired result.
- Make the right adjustments on the existing management system of NPLs by scrutinizing the system thoroughly and identifying weaknesses.
- Devise appropriate strategies to remove existing NPLs from the Bank's books as well as to prevent creation of new NPLs, and strenghen control to ensure the proper implemention of the strategies.
- Pay special attention, while managing loans, to loans extended/to be extended to the industry sector as the sector will become the major source of NPLs in the near future due to the large amount of loans it has been receiving from the Bank;
- To pay attention to internal factors responsible for NPLs problem specially to lack of proper supervision and reporting of projects under implementation,

inadequate screening process of potential borrowers, capacity limitations to appraise projects of prospective borrowers and insufficient efforts made to collect loans as per the repayment schedules;

- Ensure that regulatory norms are properly followed in classifying and provisioning of loans paricularly NPLs;
- Ensure that the Bank doesn't practice *'evergreening'* by classifying non-performing loan as performing through rescheduling and concealing a non-performing loan simply by making additional loan cover the repayment;
- Consider the restructuring of its loan workout units to create a successful loan workout units that provide a sustainable solution to a sick project or company's problem, not one that will need to be revisited repeatedly every few years.

The *regulatory body i.e., NBE* to:

- require periodically detailed disclosure from the Bank on loan classification and provisions calculations;
- take appropriate remedial actions to address any deficiencies in provisions for NPLs including rescheduled and/or restructured loans if there is evidence of restructuring or rescheduling for the purpose of "ever-greening" loans.

6.4 Suggested Areas for Further Studies

This project report has brough to light that it is possible to make a bank to have good image in terms of NPLs by prolonging the time in which the Bank's loan can be classified as nonperforming. What would be the the long-term effects on an individual bank or the banking sector as a whole if a loan classification directive issued by a regulatory body, where this is practiced, is made lenient from time to time by extending the time in which a particular loan can be classified as NPL is a researchable question. .

Many literatures on nonperforming loans indicate that a high level of NPLs leads to immediate failure of a financial instituition although it is one of the many factors for failure. However, it is seen that banks continue to operate for a number of years without facing such failure despite the high ratio of NPLs they bear. This is another area that requires further study.

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Appendix A Staffs Overall Experience and Experience at Senior Position/as Manager in Number of Years

Experience	Number of Years	Non-management Staff		Management Staff	
		Number	Percentage	Number	Percentage
Overall	Less than 5 years	1	4	0	0
	5 to 10 years	16	64	3	14
	11 to 20 years	4	16	4	18
	Over 20 years	4	16	15	68
	Total	25	100	22	100
at Management/ Senior Position	Less than 5 years	13	52	5	23
	5 to 10 years	10	40	7	32
	11 to 20 years	2	8	6	27
	Over 20 years	0	0	4	18
	Total	25	100	22	100

Appendix B Staffs by Number of Operational Areas Where They have got Overall Experience and Where They have Worked at Senior Position/as Manager

Staff Category	Description	Number	Percentage
Non-management	Overall experience in one operational area and experience at senior position in one operational area	9	36
	Overall experience in two or more operational areas and experience at senior position in one operational area	7	28
	Overall experience in two or more operational areas and experience at senior position in two or more operational areas	9	36
	Total	25	100
Management	Overall experience in one operational area and management experience in one operational area	3	14
	Overall experience in two or more operational areas and management experience in one operational area	6	27
	Overall experience in two or more operational areas and management experience in two or more operational areas	13	59
	Total	22	100

Appendix C Questionnaire to Obtain Views of Management Staff

Dear Management Staff,

MANAGEMENT OF NON-PERFORMING LOANS AT DEVELOPMENT

BANK OF ETHIOPIA

This questionnaire is designed to obtain your view on the management of non-performing loans of Development Bank of Ethiopia (DBE) for a research report to be presented to the Coordinator (Projects) School of Management Studies, IGNOU in partial fulfillment of the requirement for the Degree of Master of Business Administration in Financial Management.

You as a manager have been nominated to fill the attached questionnaire taking into account the knowledge and experience you have acquired through a long time service in the various operational areas of the Bank particularly credit operations and/or operations which have connections with the credit operations and/or non-performing loans.

Please take a few minutes to complete the questionnaire as accurately and honestly as possible. The questionnaire has two sections. The first section is about your experience. In the second section you are required to give your response with regard to each question by placing a tick (√) mark in the boxes of your choice from the possible answers listed under each question. Your response will be kept *strictly confidential.*

Please return the material to me at your earliest convenience.

I appreciate your willingness to fill this questionnaire.

Sincerely,

Hunegnaw Zegeye

SECTION ONE

Please *tick the items* representing the most appropriate responses for you.

1. Overall experience you have at DBE

- ☐ Less than 5 years
- ☐ 5-10 years
- ☐ 11-20 years
- ☐ Over 20 years

2. Work experience at different management positions in DBE

- ☐ Less than 5 years
- ☐ 5-10 years
- ☐ 11-20 years
- ☐ Over 20 years

3. Operational areas you have acquired work experience (you can tick more than one)

- ☐ Loan processing
- ☐ Project appraising
- ☐ Loan workout
- ☐ Loan approving
- ☐ Loan reviewing
- ☐ Internal auditing

4. Operational areas you have worked as a manager (you can tick more than one)

- ☐ Loan processing
- ☐ Project appraising
- ☐ Loan workout
- ☐ Loan reviewing
- ☐ Internal auditing

SECTION TWO

1. How do you rate the level of non-performing loans at DBE in the past recent three financial years in general?
   - ☐ Above the NPL ratio set by NBE
   - ☐ Close to the NPL ratio set by NBE
   - ☐ Below the NPL ratio set by NBE
2. What do you say about the trend of NPLs at DBE since a separate Directive issued by NBE for development finance institutions on Asset Classification and Provisioning
   - ☐ Continuous decrease in the ratio of NPLs has been observed
   - ☐ Rise and fall in the ratio of NPLs has been observed
   - ☐ Continuous increase in the ratio of NPLs has been observed
   - ☐ A constant trend in the ratio of NPLs has been observed
3. When you compare NPLs ratios of DBE in the three financial years period before the issue of NBE's Directive with the three years period after the the issue of NBE's Directive, what do you say in general?
   - ☐ NPLs ratio of DBE has shown tremendous improvement
   - ☐ NPLs ratio of DBE has shown improvement but not significant
   - ☐ NPLs ratio of DBE has shown no improvement at all
   - ☐ NPLs ratio of DBE has increased further
4. Which sector of the economy has contributed much to NPLs problem of DBE in the past recent three financial years in general?
   - ☐ Manufacturing
   - ☐ Agriculture
   - ☐ Service
   - ☐ Others (please specify) ____
   - ☐ I have no idea
5. Which factors are responsible for NPLs problem at DBE?
   - ☐ External factors
   - ☐ Internal factors
   - ☐ Both external & internal factors

6. What are the internal factors responsible for causing nonperforming loans at DBE?
   - ☐ Inadequate screening process of potential borrowers
   - ☐ Unable to appraise adequately the various aspects of projects submitted by prospective clients to the Bank due to capacity limitations
   - ☐ Lack of proper supervision and reporting of projects under implementation and taking corrective actions timely
   - ☐ Insufficient efforts made to collect loans as per the repayment schedules after the financed projects have started commercial production.
   - ☐ Delay in releasing approved loans after the necessary requirements are fulfilled by the borrower.
   - ☐ Failure to hold adequate collateral as per the Collateral Policy of the Bank
   - ☐ Improper documentation of collateral items such as mortgage agreements, landholding certificates and deeds of vehicles that enables the Bank liquidates collaterals legally in case of loan default.
   - ☐ Overestimation of the value of fixed assets pledged as collateral security by the Bank.
   - ☐ Any other (please specify)____
7. What do you say about NPLs ratio of DBE as compared to other banks working in the Ethiopian banking industry since the issue of separate Directive for development finance institutions on Asset Classification and Provisioning
   - ☐ Best of all the banks
   - ☐ Better than majority of the banks
   - ☐ Better than some of the banks
   - ☐ Better than none of the banks
   - ☐ I have no idea
8. Does the Bank have preventative systems and procedures that are aimed at reducing the creation of new NPLs?
   - ☐ Yes, it does have
   - ☐ No, it doesn't have
   - ☐ I have no idea
9. Do you think that the Bank does have an effective early warning system?
   - ☐ Yes, it does have
   - ☐ No, it doesn't have
   - ☐ I have no idea

10. If your answer for question 8 is yes, what are the key elements of an effective early warning system?

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11. Does the Bank have a checklist for warning signs of borrower and loan distress?
    - ☐ Yes, it does have
    - ☐ No, it doesn't have
    - ☐ I don't know
12. If your answer for question 9 is yes, please list the key warning signs.

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13. Which work unit(s) of the Bank is (are) responsible for early identification of problem loans or NPLs?
    - ☐ Credit Process & main branches
    - ☐ Project Rehabilitation & Loan Recovery (PRLR) Sub-process & regional PRLR teams
    - ☐ Risk Management Process
    - ☐ Other (Please Specify) ________________________________
14. As per Asset Classification and Provisioning Directive of NBE
    - ☐ All loans are properly classified periodically
    - ☐ Majority of loans are properly classified periodically
    - ☐ Some are properly classified periodically

☐ None are properly classified periodically

15. As per Asset Classification and Provisioning Directive of NBE
    - ☐ All NPLs are properly and timely identified, and classified
    - ☐ Majority of NPLs are properly and timely identified, and classified
    - ☐ Some of NPLs are properly and timely identified, and classified
    - ☐ None of NPLs are properly and timely identified, and classified
16. Does the Bank have a well-thought-out and well-understood set of NPLs transfer criteria and procedures?
    - ☐ Yes, it does have
    - ☐ No, it doesn't have
17. What do you say about the existing paractice of the Bank with regard to transfer of NPLs from the units where the loans originated to the workout or recovery units?
    - ☐ The transfer is made quickly to all NPLs
    - ☐ The transfer is made quickly to majority of NPLs
    - ☐ The transfer is made quickly to some of NPLs
    - ☐ The transfer is not made quickly to all NPLs
18. Identify the parties that are involved in the process of negotiating NPLs at DBE
    - ☐ The Bank itself
    - ☐ Management of the borrower business
    - ☐ Shareholders of the borrower business
    - ☐ Other creditors
    - ☐ Employee representative or trade union
    - ☐ Any other (please specify) ___________________________________
19. Which unit of the Bank is responsible to perform the prevention of a flow of new NPLs being created?
    - ☐ Credit Process & main branches
    - ☐ Project Rehabilitation & Loan Recovery (PRLR) Sub-process & regional PRLR teams
    - ☐ Risk Management Process
    - ☐ Any Other (Please Specify) ______________________________________
20. What do you say about DBE's use of NBE's Directive in categorizing renegotiated non-performing loans as a substandared in the past recent three financial years?
    - ☐ Perfect

- [ ] Imperfect
- [ ] I have no idea

21. How many times the Bank in actual fact reschedule, restructure or renegotiate a short-term loan to a borrower?
    - [ ] Less than three times
    - [ ] Just three times
    - [ ] More than three times
22. What the Bank does in reality before rescheduling, restructuring or renegotiating a short-term loan?
    - [ ] It collects the entire amount of interest in arrears in cash
    - [ ] It collects a portion of the amount of interest in arrears in cash
    - [ ] It does not collect the entire amount of interest in arrears in cash at all
    - [ ] I have no idea
23. In the past recent three financial years
    - [ ] DBE has properly used NBE's Directive in categorizing renegotiated nonperforming loans as substandared
    - [ ] DBE has never properly used NBE's Directive in categorizing renegotiated nonperforming loans as substandared
24. What do you say about taking over management of a defaulting company?
    - [ ] It has helped DBE significantly to solve its NPLs problem
    - [ ] It has helped DBE to some extent to solve its NPLs problem
    - [ ] It has not helped DBE to solve its NPLs problem at all
    - [ ] Any different idea (please specify) ________________________________
25. Has DBE been succesful in disposing NPLs for the last recent three financial years in general?
    - [ ] Yes, it has been.
    - [ ] No, it hasn't been.
    - [ ] I don't know
26. What do you say about taking possession of the mortgaged assets of loan defaulters largely without the intervention of the courts?
    - [ ] It has helped DBE considerably to solve its NPLs problem
    - [ ] It has helped DBE a little to solve its NPLs problem
    - [ ] It has not helped DBE to solve its NPLs problem at all
    - [ ] Any different idea (please specify) ____________________________

27. How do you categorize the process of writing-off NPLs at DBE?
- [ ] Lengthy
- [ ] Fair
- [ ] Short

28. What do you say about the workout units (PRLR sub-process & regional PRLR teams) performance in general in reducing NPLs of the Bank?
- [ ] Their performance is above expectation
- [ ] Their performance as expected
- [ ] Their performance is below expectation
- [ ] I have no idea

29. Provisions held by the Bank for NPLs in the past recent three financial years
- [ ] Has been adequate to absorb potential losses
- [ ] Has not been adequate to absorb potential losses
- [ ] I have no idea

30. In the past recent three financial years
- [ ] It has been made to accurately reflect earnings by assuring that all loans categorized as non-performing are placed on non-accrual status
- [ ] It has not been made to accurately reflect earnings by assuring that all loans categorized as non-performing are placed on non-accrual status
- [ ] I have no idea

31. In restoring non-performing loans placed on non-accrual status to accrual status, the Bank
- [ ] Has always properly implemented NBE's Directive
- [ ] Has sometimes deviated from NBE's Directive
- [ ] Has always deviated from NBE's Directive

32. What do you say about the profit and capital reported in an Audited Annual Reports of the Bank?
- [ ] They are the reflections of true level of provisions held on NPLs
- [ ] They aren't the reflections of true level of provisions held on NPLs
- [ ] I have no idea

Appendix D Questionnaire to Obtain Views of Non-management Staff

Dear Colleague,

MANAGEMENT OF NON-PERFORMING LOANS AT DEVELOPMENT

BANK OF ETHIOPIA

This questionnaire is designed to obtain your view on the management of non-performing loans of Development Bank of Ethiopia (DBE) for a research report to be presented to the Coordinator (Projects) School of Management Studies, IGNOU in partial fulfillment of the requirement for the Degree of Master of Business Administration in Financial Management.

You as a senior staff have been nominated to fill the attached questionnaire taking into account the knowledge and experience you have acquired through a long time service in the various operational areas of the Bank particularly credit operations and/or operations which have connections with the credit operations and/or non-performing loans.

Please take a few minutes to complete the questionnaire as accurately and honestly as possible. The questionnaire has two sections. The first section is about your experience. In the second section you are required to give your response with regard to each question by placing a tick (√) mark in the boxes of your choice from the possible answers listed under each question. Your response will be kept *strictly confidential*.

Please return the material to me at your earliest convenience.

I appreciate your willingness to fill this questionnaire.

Sincerely,

Hunegnaw Zegeye

SECTION ONE

Please *tick the items* representing the most appropriate responses for you.

1. Overall experience you have at DBE

- ☐ Less than 5 years
- ☐ 5-10 years
- ☐ 11-20 years
- ☐ Over 20 years

2. Work experience at senior positions in DBE

- ☐ Less than 5 years
- ☐ 5-10 years
- ☐ 11-20 years
- ☐ Over 20 years

3. Operational areas you have acquired work experience (you can tick more than one)

- ☐ Loan processing
- ☐ Project appraising
- ☐ Loan workout
- ☐ Loan approving
- ☐ Loan reviewing
- ☐ Internal auditing

4. Operational areas you have worked as a senior staff (you can tick more than one)

- ☐ Loan processing
- ☐ Project appraising
- ☐ Loan workout
- ☐ Loan approving
- ☐ Loan reviewing
- ☐ Internal auditing

SECTION TWO

1. How do you rate the level of non-performing loans at DBE in the past recent three financial years in general?
   - ☐ Above the NPL ratio set by NBE
   - ☐ Close to the NPL ratio set by NBE
   - ☐ Below the NPL ratio set by NBE
2. What do you say about the trend of NPLs at DBE since a separate Directive issued by NBE for development finance institutions on Asset Classification and Provisioning
   - ☐ Continuous decrease in the ratio of NPLs has been observed
   - ☐ Rise and fall in the ratio of NPLs has been observed
   - ☐ Continuous increase in the ratio of NPLs has been observed
   - ☐ A constant trend in the ratio of NPLs has been observed
3. Which factors are responsible for NPLs problem at DBE?
   - ☐ External factors
   - ☐ Internal factors
   - ☐ Both external & internal factors
4. What are the internal factors responsible for causing nonperforming loans at DBE?
   - ☐ Inadequate screening process of potential borrowers
   - ☐ Unable to appraise adequately the various aspects of projects submitted by prospective clients to the Bank due to capacity limitations
   - ☐ Lack of proper supervision and reporting of projects under implementation and taking corrective actions timely
   - ☐ Insufficient efforts made to collect loans as per the repayment schedules after the financed projects have started commercial production.
   - ☐ Delay in releasing approved loans after the necessary requirements are fulfilled by the borrower.
   - ☐ Failure to hold adequate collateral as per the Collateral Policy of the Bank
   - ☐ Improper documentation of collateral items such as mortgage agreements, landholding certificates and deeds of vehicles that enables the Bank liquidates collaterals legally in case of loan default.
   - ☐ Overestimation of the value of fixed assets pledged as collateral security by the Bank.
   - ☐ Any other (please specify)____
5. Does the Bank have preventative systems and procedures that are aimed at reducing the creation of new NPLs?
   - ☐ Yes, it does have

- [ ] No, it doesn't have
- [ ] I have no idea

6. Does the Bank have a checklist for warning signs of borrower and loan distress?
   - [ ] Yes, it does have
   - [ ] No, it doesn't have
   - [ ] I don't know
7. If your answer for question 9 is yes, please list the key warning signs.

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8. As per Asset Classification and Provisioning Directive of NBE
   - [ ] All loans are properly classified periodically
   - [ ] Majority of loans are properly classified periodically
   - [ ] Some are properly classified periodically
   - [ ] None are properly classified periodically
9. As per Asset Classification and Provisioning Directive of NBE
   - [ ] All NPLs are properly and timely identified, and classified
   - [ ] Majority of NPLs are properly and timely identified, and classified
   - [ ] Some of NPLs are properly and timely identified, and classified
   - [ ] None of NPLs are properly and timely identified, and classified
10. When principal and/or interest is due and uncollected for 90 (ninety) consecutive days or more beyond the scheduled payment date
    - [ ] All short-term loans are classified as NPLs
    - [ ] Majority of short-term loans are classified as NPLs
    - [ ] Some short-term loans are classified as NPLs
    - [ ] All short-term loans are not classified as NPLs
11. When principal and/or interest is due and uncollected for 180 (one hundred and eighty) consecutive days or more beyond the scheduled payment date
    - [ ] All medium and long-term loans are classified as NPLs
    - [ ] Majority of medium and long-term loans are classified as NPLs
    - [ ] Some medium and long-term loans are classified as NPLs
    - [ ] All medium and long-term loans are not classified as NPLs

12. Does the Bank have a well-thought-out and well-understood set of NPLs transfer criteria and procedures?
    - [ ] Yes, it does have
    - [ ] No, it doesn't have
    - [ ] I don't know
13. What do you say about the existing paractice of the Bank with regard to transfer of NPLs from the units where the loans originated to the workout or recovery units?
    - [ ] The transfer is made quickly to all NPLs
    - [ ] The transfer is made quickly to majority of NPLs
    - [ ] The transfer is made quickly to some of NPLs
    - [ ] The transfer is not made quickly to all NPLs
14. What the Bank does in reality before rescheduling, restructuring or renegotiating a short-term loan for the first time?
    - [ ] It collects the entire amount of interest in arrears in cash
    - [ ] It collects a portion of the amount of interest in arrears in cash
    - [ ] It does not collect the entire amount of interest in arrears in cash at all
    - [ ] I have no idea
15. Does the Bank in reality collect the entire amount of interest in arrears in cash plus a minimum of 25% of outstanding principal balance before rescheduling, restructuring or renegotiating a short-term loan for the second time?
    - [ ] Yes, it does
    - [ ] No, it doesn't
    - [ ] I have no idea
16. Does the Bank in reality collect the entire amount of interest in arrears in cash plus a minimum of 50% of outstanding principal balance before rescheduling, restructuring or renegotiating a short-term loan for the third time?
    - [ ] Yes, it does
    - [ ] No, it doesn't
    - [ ] I have no idea
17. What do you say in general about the effecting of NBE's Directive by DBE in categorizing renegotiated nonperforming loans as substandared
    - [ ] DBE has properly implemented the Directive
    - [ ] DBE has never properly implemented the Directive
    - [ ] I have no idea

18. Which method *is principally applied* by the Bank's workout units (PRLR sub-process & regional PRLR teams) to rehabilitate sick projects and thereby reduce NPLs?
   - [ ] Loan repayment scheduling
   - [ ] Provision of additional loan
   - [ ] Loan transfer to third party
   - [ ] Reorganization
   - [ ] Management intervention
   - [ ] Debt restructuring
   - [ ] Any combination of the above mechanisms
   - [ ] Any other (please specify) ______________________________________
19. Which mechanism of project rehabilitation *has been most effective* in reducing NPLs?
   - [ ] Loan repayment scheduling
   - [ ] Provision of additional loan
   - [ ] Loan transfer to third party
   - [ ] Reorganization
   - [ ] Management intervention
   - [ ] Debt restructuring
   - [ ] Any combination of the above mechanisms
   - [ ] Any other (please specify) ______________________________________
20. What do you say about rescheduled loans?
   - [ ] None of them required more than one rescheduling
   - [ ] Majority of them required one more rescheduling
   - [ ] Just few of them required one more rescheduling
   - [ ] Majority of them required three or more rescheduling
   - [ ] Just few of them required three or more rescheduling
21. What do you say about taking over management of a defaulting company?
   - [ ] It has helped DBE considerably to solve its NPLs problem
   - [ ] It has helped DBE a little to solve its NPLs problem
   - [ ] It has not helped DBE to solve its NPLs problem at all
   - [ ] Any different idea (please specify) ______________________________
22. Does the Bank bring back non-performing loans to performing loans mostly?
   - [ ] Yes
   - [ ] No
   - [ ] I have no idea
23. In restoring nonperforming loans, the Bank
   - [ ] Has always properly implemented NBE's Directive
   - [ ] Has sometimes deviated from NBE's Directive
   - [ ] Has always deviated from NBE's Directive

24. What do you say about taking possession of the mortgaged assets of loan defaulters largely without the intervention of the courts?
- [ ] It has helped DBE considerably to solve its NPLs problem
- [ ] It has helped DBE a little to solve its NPLs problem
- [ ] It has not helped DBE to solve its NPLs problem at all
- [ ] Any different idea (please specify) ______________________________

25. Has DBE been succesful in disposing NPLs for the last recent three financial years in general?
- [ ] Yes, it has been.
- [ ] No, it hasn't been.
- [ ] I don't know

26. How do you categorize the process of writing-off NPLs at DBE?
- [ ] Lengthy
- [ ] Fair
- [ ] Short

27. Does the Bank in actual fact maintain the minimum provision percentages against the outstanding principal amount of each loan or advance classified as pass (1%), special mention (3%), substandard (20%), doubtful (65%) or loss (100%)?
- [ ] Yes, it does
- [ ] No, it doesn't
- [ ] I have no idea

28. In the last recent three financial years DBE
- [ ] Has never considered uncollectable accruals as income
- [ ] Has considered uncollectable accruals as income
- [ ] I have no idea.

29. What do you say about the profit and capital reported in an Audited Annual Reports of the Bank?
- [ ] They are the reflections of true level of provisions held on NPLs
- [ ] They aren't the reflections of true level of provisions held on NPLs
- [ ] I have no idea