ST. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

ASSESSMENT OF CREDIT RISK MANAGEMENT PRACTICE IN BERHAN INTERNATIONAL BANK SHARE COMPANY

BY

BELSTI ABATIHUN

JANUARY, 2016

ADDIS ABABA, ETHIOPIA

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A THESIS SUBMITTED TO ST. MARY'S UNIVERSITY, SCHOOL OF GRAUDATE STUDIES IN PARTIAL FULFILMENT OF THE REQUIRMENTS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION

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List of Acronyms

BrIB	Berhan International Bank S.C
KYC	Knowing Your Customer
NBE	National Bank of Ethiopia
NPL	Non-performing Loan
RM	Risk Management
SPSS	Statistical Package for Social Science

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Abstract

Credit risk management has become an important topic for financial institutes, especially since the business sector of financial services is related to conditions of uncertainty. The turmoil of the financial industry emphasizes the importance of effective risk management procedures. The purpose of this research is to assess the credit risk management practice of Berhan International Bank S.C through examining the policies or guidelines, the tools of credit risk management, the factors of credit granting process, performed activities of credit risk management, risk management reporting system and credit risk management process. The researcher applied purposive (judgmental) sampling technique. Qualitative and quantitative (mixed) research method was used. The type of data used for the study includes qualitative and quantitative data. Primary and secondary sources of data were used for the study. The main primary source of data is through the use of questionnaires. In the case of the secondary source of data, annual and quarterly reports of the bank were analyzed. These reports contain financial performance of the bank. Besides, as reference material NBE directives, journals working paper as well as different thesis were used in the study. Data collected from 58 employees who are involved in the lending decision and risk management. The researcher used descriptive tools of data analysis such as frequency and percentage. The major findings were the bank had credit risk management policy; the bank used credit risk management tools and techniques to reduce the amount of loan default which is a principal cause of bank failure and collateral is used as a primary technique of credit risk management. The study concluded that Berhan International Bank S.C management problem in non-performing Loans (NPL), credit portfolio concentration & monitoring and controlling. Thus, it was recommended BrIB needs to strength applying the tools of credit risk management, portfolio management, training of customers on loan usage, credit administration, monitoring & controlling and managing problem loans and control.

Key words: *Risk management, Credit risk management*

CHAPTER ONE
1. INTRODUCTION

1.1. Background of the Study

Any profit-maximizing business, including banks, needs to deal with risks, and in fact, bankers are in the business of managing risks (Heffernan, 2009:101.).Therefore, risk and the banking business are inseparable. Although risk is the uncertainty that can cause damage for business, it is the phenomenon accompanying business activities in the market mechanism and in competition.

Credit risk is a popular type of risk that both non-financial and financial institutions must deal with. Credit risk occurs when a debtor/borrower fails to fulfill his obligations to pay back the loans to the principal/lender. In banking business, it happens when "payments can either be delayed or not made at all, which can cause cash flow problems and affect a bank's liquidity (Greuning & Bratanovic, 2009:161). Hence, credit risk management in a bank basically involves its practices to 'manage', or in other words, to minimize the risk exposure and occurrence. For a commercial bank, lending activities form a critical part of its products and services.

Credit risk is the most obvious risk in the banking and possibly the most important in terms of potential losses. The default of a small number of key customers could generate very large losses and in an extreme case could lead to a bank becoming insolvent. This risk relates to the possibility that loans will not be paid or that investments will deteriorate in quality or go in to default with consequent loss to the bank. Credit risk is not confined to the risk that borrowers are unable to pay; it also includes the risk of payments being delayed, which can also cause problems for the bank (Tibebu, 2011:1).

Credit Risk Management can be treated as the heart of any Commercial Banks. It plays the vital role in the performance of a financial institution as it analyzes credit-worth-ability of borrowers. If there is any loophole in credit risk assessment, then recovery of the provided loans and advances is challenged greatly. As a whole, profitability falls in a great uncertainty.

A bad loan often arises from different factors or combination of factors, but the most important reason is the absence of proper loan classification system. It can identify problem loans immediately and take necessary steps to minimize potential defaults and consequent losses. Poor Credit Risk Management is the main consideration in case of Banks' unsatisfactory performance and often the reason of bankruptcy (Md. Moeid, 2014:1).

Credit risk management is a structured approach to managing uncertainties through risk assessment, developing strategies to manage it and mitigation of risk using managerial resources. The strategies include transferring to another party, avoiding the risk, reducing the negative effects of the risk, and accepting some or all of the consequences of a particular risk (Girma, 2011:12).

Amongst the many factors that can lead to bank problems, poor credit risk management has always been pointed out by different writers as being the cause of bank problems and failures. This is basically because since banks make their profits from interest gotten after lending money to customer, a poor credit risk management during the lending process will also have negative results on the bank at the end and vice versa. Directors should be aware that, as accountants already know, non-payment is one of the most critical risks a company faces and all practical steps should be taken to mitigate this risk (Roberts, 2010: 32). The failure has a chain effect to influence payment systems and thus affect the whole economy in the long run. Despite the consequences of credit risk, it cannot be avoided because it is associated with the core activities of the bank. Banks like any other business entity makes their profits through loan granting so; a collapse is assured with the least mistake in the course of the process. The root cause of this problem has always been poor and unreliable information that lenders get from borrowers even though other factors including poor risk management can be associated.

Likewise, Berhan International Bank S.C (BrIB) as part of the Ethiopian banking industry is also engaged in the provision of credit service to its customers. Therefore; the purpose of this study would the assessment of credit risk management practice of Berhan International Bank S.C. BrIB is one of newly established private owned financial institutions in Ethiopia. It was established on June 01, 2009 under License No. LBB/14/2009 in accordance with the commercial code of Ethiopia and proclamation code of the Licensing and Supervision of Banking Business No. 592/2008 with a paid up capital of 76.5million and authorized capital of birr 300 million. As at June 30, 2014 the bank had 37 branches of which 20 were in Addis Ababa and 17 branches in regional towns. According to its 2013/14 annual report the total capital of the bank reached birr 554.4 million, its total deposit reached birr 2 billion while its loan and advance accounted birr 1.17 billion. The level of annual gross profit was Birr 121.7 million. The total number of staff of the Bank as at June 30, 2014 reached 693, of which 501(72.3%) are male and 192(27.7%) are female.

1.2. Statement of the Problem

Risk management is very important and forms a main part of any organization's activities because its main aim is to help all other management activities to reach the organization's aims directly and efficiently since it is a continuous process that depends directly on the changes of the internal and external environment of the organization (Tchankova, 2002: 290).

Banks consciously take risk as they perform their role of financial intermediation in the economy. Consequently, they assume various risks, which include credit risk, interest rate risk, liquidity risk, foreign exchange risk and operational risk. Managing these risks is essential for their survival & prosperity (National Bank of Ethiopia, 2010:42).

Most importantly, Banks are exposed to credit risk since their principal profit making activity is making loan, to their customers. Lending represents the heart of the industry. Loans are the dominant asset at banks; they generate the largest share of operating income and represent the banks greater risk exposure (Mac Donald and Koch, 2006).

Credit risk occurs when a debtor/borrower fails to fulfill his obligations to pay back the loans to the principal/lender. In banking business, it happens when "payments can either be delayed or not made at all, which can cause cash flow problems and affect a bank's liquidity" (Greuning & Bratanovic, 2009:161). Hence, credit risk management in a bank basically involves its practices to 'manage', or in other words, to minimize the risk exposure and occurrence.

Although the effects of all risks types can cause negative consequences to the bank, credit risk has been pinpointed or identified as the key risk associated with negative consequences in terms of its influences on bank performance (Sinkey, 1992: 279). This means if credit risk is not well managed, it can lead to failure. Thus, for any bank to succeed, its credit risk management must be handled with a lot of seriousness. This is because should a loss occur, the bank will have to "extend its hands" to get funds from other means to meet up or cover the losses. A clear reason why a correct management of credit risk is very important is because banks have a limited capacity to absorb loan losses and this loses can be covered only by using income generated by other profitable loans or by bank capital (Boffey& Robson, 1995:66) . If the income is used from these two sources to meet up for a loan that has not been paid, this action will go a long way to affect the capital adequacy of the bank, its liquidity and even its profitability. Looking at the consequences or effects of credit risk, it is important that before a bank gives out a loan, it should try as much as possible to have a concrete view of the borrower.

Most previous studies indicated the importance of effective credit risk management for a better performance of Ethiopian commercial banks. A study by Tibebu (2011) with the objective of assessing the impact of credit risk management practice on performance of seven commercial banks for periods covering 2001 to 2010 indicated that there is poor credit risk management practice in the sampled banks which was identified as one of the causes for their poor performance. Other studies also proofed that there is a significant relationship between credit risk management and bank performance for Ethiopian commercial banks (Girma, 2011 and Wondimagegn, 2012).

Unlike previous studies, investigating factors affecting loan recovery and assessing determinants of nonperforming loans, this study would rather attempt to capture the credit risk management practice. Therefore, the research would be focused on active review of the credit risk management techniques and practice of Berhan International Bank S.C which previously was not considered.

1.3. Research Questions

This study up on completion would attempt to answer the following research questions:-

1. Does BrIB use appropriate policies towards credit risk management?
2. Does BrIB use appropriate tools/techniques for its credit risk management?
3. Have Berhan International Bank S.C undertaken credit granting process?

1.4. Objectives of the Study

1.4.1. General Objective

The general objective of the study was to assess the credit risk management practice of Berhan International Bank S.C (BrIB).

1.4.2. Specific Objectives

The specific objectives of the study include:

- ✓ To assess the policies of BrIB towards credit risk management
- ✓ To evaluate the implemented tools/techniques in managing credit risk used by the Bank
- ✓ To assess the credit granting process of Berhan International Bank

1.5. Significance of the Study

This research would be significant to diagnose the existing credit risk management practice of the bank. Thus, the bank might reconsider and improve the existing credit risk management practice based on the recommendations given to the problems. It could also have practical relevance to the Ethiopian banks by providing data to a policy environment for the credit risk management operation of banks in the economy. Thus, it would also a valuable lesson for the banking sector of Ethiopia.

Finally, the study could also contribute to the existing body of knowledge regarding the credit risk management and can serve as an insight or input for further research on the area more specifically on macroeconomic aspect of credit risk management which is not studied under the research.

1.6. Scope of the Study

The objective of the research paper was focused on assessing the credit risk management practice in banking industry with a special focus on Berhan International Bank S.C (BrIB) and it would cover the period 2010-2014.The study would incorporate credit, risk and compliance management of the bank along with 37 of its Addis Ababa and outlaying branches as at June 30, 2014.

1.7. Organization of the study

The research project was organized into five chapters: Chapter one has contained the introduction part dealing with research problems, research questions, objectives, definition of terms, significance of the study and scope. The second chapter discussed the review of related literatures about the subject matter. In chapter three was focused on the research design and methodology. Chapter four was focused on analysis of the subject matter to investigate and evaluate the problems. Finally, chapter five has covered the conclusions of the findings and forwards recommendations.

1.8. Definition of Terms

National Bank of Ethiopia (NBE):- It is the reserve or central bank of Ethiopia. Besides licensing and supervising banks, insurers and other financial institutions, NBE fosters a healthy financial system and undertakes other related activities that are conducive to rapid economic development of Ethiopia (Proclamation No.592/2008, FDRE, 2008).

Loans and Advances: means any financial assets of a bank arising from a direct or indirect advance or commitment to advance funds by a bank to a person that are conditioned on the obligation of the person to repay the funds, either on a specified date or on demand, usually with interest (NBE Directive, SSB/43/008).

Non-performing loans (NPL): loans or advances 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 advances are in question; or when principal and/ or interest is due adnoun collected for 90 (ninety) consecutive days or more beyond the scheduled payment date or maturity (NBE Directive, SSB/43/008).

Risk: Risk is the possibility that something unpleasant or dangerous might happen (Macmillan Dictionary, 2002).

Risk management: is the prediction and assessment of risks alongside with the recognition of procedures to nullify or minimize their consequences (Oxford University Press 1997, 122).

Credit: It is responsibility formed by banks for one who demands from it that he be permitted to use particular asset on account of the confidence reposed in him with respect to it (Nazik H. 2014: 17).

Credit risk: The possibility of opposite party which not succeed to meet its liability according to their contract. It can also be described as credit or opponent party risk is the probability that debtor of a financial tool, whether individual, an organization or a state will not pay back primary and other investment associated cash flows according to the particular provisions in a credit accord. Credit risk can be defined as the chances that a corresponding person of a contract will fail to fulfill its actions, either as a one-off or completely (Nazik H. 2014: 17).

CHAPTER TWO

2. LITERATURE REVIEW

2.1. Theoretical Review

Risk is the fundamental element that drives financial behavior. Without risk, the financial system would be vastly simplified. However, risk is being everywhere (simultaneously) in the real world. Financial Institutions, therefore, should manage the risk efficiently to survive in this highly uncertain world. The future of banking will undoubtedly rest on risk management dynamics.

Credit risks appear in banking institution because of the uncertainties plagued the financial system. The uncertainties remain a major challenge in country. Still, the major approaches applied by the banks are the continuing efforts on research and close monitoring. Banks believe that the research and monitoring are the key sources of uncertainties like data generating institutions and the treasury (Uchendu, 2009:95). The market structure is important in banking for it influences the competitiveness of the banking system and companies to access to funding or credit investment. The economic growth affects the structure and development of the banking system. In addition, the vast knowledge in risk assessment and managerial approach is recognized as part of the development. Moreover, because the banks and the processes are highly regulated, it became very useful in assessing the effects or impact of the credit risk management in the banks and even in other financial sources (Gonzalez, 2009:8).

2.1.1. The concept of Risk management

Management in the simplest understood definition can be defined as the act of planning, directing, controlling, monitoring and testing for desired results to be obtained. Or it is simply the act, manner, or practice of managing; handling, supervision, or control (Stephen P. 2012). Risk on the other hand can be defined as the possibility that something unpleasant or dangerous might happen (Macmillan Dictionary, 2002). When companies spoil in business, it is obvious that they will be exposed to one type of risk or another which in most cases is an uncertainty although at times it can be certain that it will occur. Banks are one of such businesses whose risk is very sure because they don’t function in isolation given the dynamic environment in which they operate, the volatility of the Financial

Markets in which they participate, diversification and the competitive environment in which they find themselves, (Williams et al., 2006:69). Even though it is certain that risk will occur, it is not always possible in most cases to eliminate, reduce or ameliorate it (Keith, 1992: 16). So, the best possibility for companies is to try to manage the risk so as to reduce the possibility of occurrence or to reduce the consequences. These possibilities can range from ‘do nothing at all’ to attempting to nullify the effect of every identified risk (William et al., 2006: 67). But, because of the nature of the banking activity, a bank can’t find itself in a position to do nothing at all or to nullify the risk. So, all it does is to live with it but look for means to manage it. Given the riskiness of its activities, a bank does not wait to introduce risk management at a certain stage of its activities but does so right from the start. This is so because its activities are so correlated in such a way that if not well handled, the effect / consequences can be connected and can even lead to bankruptcy. For this goal to be attained, decision makers need to first of all identify the risk involved, measure its intensity, assess it, monitor it and then look for measures on how to control it. This act of managing the risk is called Risk management (RM). RM is “a course of action planned to reduce the risk of an event occurring and/or to minimize or contain the consequential effects should that event occur” (Keith, 1992:14). This course of action linked, gives rise to a Risk Management process which involved a number of stages. Risk management is very important and forms a main part of any organization’s activities because its main aim is to help all other management activities to reach the organization’s aims directly and efficiently since it is a continuous process that depends directly on the changes of the internal and external environment of the organization (Tchankova, 2002: 290).

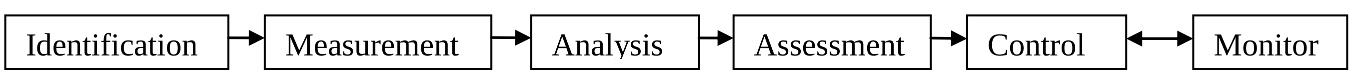

Figure 1: Risk Management Process

Source: Keith, 1992: 15 / General Literature

2.1.2. Risk Identification

Risk Management cannot be implemented when first of all the risk has not been identified. This means if there is no risk identified, there is thus no need for risk management. This identification is done by using different techniques depending on the company in question to ascertain all forms of threats it can be faced with both present and future. So, risk identification is the first stage of the

Risk Management process which develops the basis for the next stages. If success is not attained at this stage, then the risk will be non-manageable. This means that the company will not account for the risk and will not take any action related to it and the consequences could be much unexpected (Tchankova, 2002: 290-291). This way, risks related to gains and losses must be identified. The inability to identify the risks of one is as inappropriate as to identify the other. Risk identification thus involves a comprehensive analysis of all present and future risks in the business operations, asset management and support services (Keith, 1992: 15). During the process of risk identification, the bank is able to study its activities and the places where its resources are exposed to risk. This will help it especially when it has to carry out a future duty, in terms of developing and implementing new programs for risk control. Although all banks may be conscious of being faced with the same type of risks, the risk identification techniques for each of them can be different. It is always important for managers to identify all the possible risks they can be faced with because any neglected risk can have very negative consequences on the whole system.

2.1.3. Risk Analysis or Assessment

The risk assessment task is to understand what is at risk and what events could potentially cause harm or benefits. The risk is being assessed in terms of the severity of the impact, likelihood of occurring and controllability (Gray & Larson, 2006: 215). When this is done, it helps the bank to know the chances that the risk might occur, and if it occurs, the impact it can have on the bank and how they can possibly control it. Risk assessment is done by prioritizing the risk either by using risk analysis or risk evaluation (Williams et al., 2006:70)**.** This risk analysis is based on the likelihood and consequences. Likelihood depends on the probability that the risk will occur and how frequently it will take place. While, consequences on the other hand can be measured by looking at the effects on results or on the enablers of results (Williams et al,. 2006:70). Knowing the frequency of occurrence of the risk and the effect it will have should it occur, gives the bank the base to know how important the risk is. Risk evaluation is then carried out when a good risk analysis has been undertaken. An evaluation is done against an appropriate risk-acceptance criterion to give a ranking (Williams et al., 2006:70).

2.1.4. Risk Control

Risk control involves using physical measures, techniques, tools and /or training staff to avoid, reduce, prevent or eliminate the perceived threat / its financial consequences and other undesirable results of risks (Keith, 1992: 15). Naturally, risk cannot be avoided or eliminated so the only option is to control it. Banks like other organizations have different ways of approaching risks and the amount of risks each is ready to accept differs. Some will decide either to prevent the risk or to allow it happen and then start looking for measures to tackle it, while others will decide whether to transfer or insure it.

There may also be a wide gap between the level of control possible and the level of control practiced. Risk tolerance is another domain in which banks may vary; some may be risk averse while others will be prepared to run calculated risks. This means the amount of risk that one bank may accept to tolerate differs from that of another bank. So, it is very important that all the aforementioned points be considered when assessing risk control (Keith, 1992: 17).

2.1.5. Risk Monitoring

A plan is always made for the activities that are used to manage risk. To be sure that the activities attain the desired goal of the business, monitoring is very important so that the results gotten are in line with the set down goals. If it is noticed that the results are going contrary, readjustment should be done immediately. Risk monitoring is very important and it goes hand in hand with risk control. Risks in banks need to be monitored just like any project in progress. The risk manager needs to constantly do assessment and make updates where there is need so as to be sure to handle any unforeseen risks at the right time before it is too late (Gray & Larson, 2006: 225).

2.1.6. Credit Risk

The risk management process is important to be followed in the management of credit risk because it is an unavoidable risk of the bank based on its activities. The management of this risk is an activity which is indispensable for a bank if really it wants to meet up with competition, create value for itself and create value for the shareholders. Like any other business entity, the aim of any bank is mostly to make profits and thus create value. To attain this goal, they cannot escape from risk whose consequences can be a barrier to this goal attainment. Credit risk is the most important of these risks because it comes about as a result of failure of the borrowers to pay their debts or delayance to meet up with their obligations in time. Credit risk has been pointed out or identified as the key risk in terms of its influences on bank performance (Sinkey, 1992: 279).

2.1.7. Credit Risk Management in Banks

Although the effects of all risks types can cause negative consequences to the bank, credit risk has been pinpointed or identified as the key risk associated with negative consequences in terms of its influences on bank performance (Sinkey, 1992: 279). This means if credit risk is not well managed, it can lead to failure. Thus, for any bank to succeed, its Credit Risk Management (CRM) must be handled with a lot of seriousness. This is because should a loss occur, the bank will have to “extend its hands” to get funds from other means to meet up or cover the losses. A clear reason why a correct management of credit risk is very important is because banks have a limited capacity to absorb loan losses and this loses can be covered only by using income generated by other profitable loans or by bank capital (Boffey& Robson, 1995:66) . If the income is used from these two sources to meet up for a loan that has not been paid, this action will go a long way to affect the capital adequacy of the bank, its liquidity and even its profitability. Looking at the consequences or effects of credit risk, it is important that before a bank gives out a loan, it should try as much as possible to have a concrete view of the borrower. (Greuning & Bratanovic, 2003: 136) says “Because of the potentially dire effects of credit risk, it is important to perform a comprehensive evaluation of a bank’s capacity to assess, administer, supervise, enforce and recover loans, advances, guarantees, and other credit instruments”.

This monitoring is very important because with the uncertainty in the future, any potential event that can cause a borrower to default payment can be fast identified or, a mechanism can be put in place on time to reduce the frequency and /or intensity of a loss should it occur. Early identification of borrowers at risk is good because it enables servicers to adequately staff collections departments, determine the most cost-effective type of customer outreach, and initiate repayment plans before a borrower’s financial situation worsens to the point at which foreclosure is unavoidable (Focardi, 2009: 73).

2.1.8. Credit Risk Management Policy

Banks like any other firm or corporation have formal laid down policies and principles that have been put in places by the board of directors on how to manage credits and this have to be carefully implemented by management. This restricts supervisors or managers on how to take action. They must do so by looking at the policies laid down to know if they are doing the right thing at the right time. Maness &Zietlow, 2005: 139 specifies that a credit policy has four major components which include; credit standards, credit terms, credit limits and collection procedures.

- *Credit standards*- This is the profile of the minimally acceptable creditworthy customer
- *Credit terms*- This is the credit period stipulating how long from the invoice the customer has to pay, and the cash discount (if any) .
- *Credit limit*- This is the dollar amount that cumulative credit purchases can reach for a customer if credit is extended.
- *Collection procedures*- These are detailed statements regarding when and how the company will carry out collection of past-due accounts.

2.1.9. Credit Risk Management Practice

As banks have different credit risk management policies /philosophies, same do the risk management practices differ from one financial institution to another despite the fact that they can be open to the same risk types. The practices differ according to their previously laid down policies and philosophies. Some or all of the banks may decide to use hedging strategies or insurance to influence their profits and / or to avoid the costs of variations but, the way they put it in practice or their way of going about this will be different. Another difference can also be seen in the level of risk tolerance. Each and every bank has their individual level of risk that they can decide to let go based on how it is outlined in their risk management policy. To summarize this, it is clear that the same theory can exit for firms in the same industry, but, the implementation in practice differs. Practice is not consistent with theory. In most cases because of data limitation for most industries, it is difficult to describe which firms manage more risk than others or whether firms engage in dynamic risk management strategies and more importantly it cannot be reliably tested whether a firm's risk management practices conform to existing theories (Tufano, 1996: 1097-1098).

2.1.10. Credit Risk Management Strategy

The Macmillan English Dictionary defines a strategy as a plan (method) for achieving something, or the skill of planning how to achieve something. A strategy thus simply means a way to go about an activity. This thus goes that as banks have different credit risk policies /philosophies and different management practices, their strategies to attain their desired goals in the same way may differ. The idea to go about a particular activity can exist to the knowledge of the bankers but the strategy of how to implement so that desired goals can be attained and / or to make a difference will be different for each bank or company. Given the competitive environment in which banks operate, it is always good to have a strategy position of how to manage its credit risk that will make or show its difference from its competitors. A strategy positioning means performing different activities from rivals or performing similar activities in different ways- a company can outperform its rivals only if it can establish a difference that it can preserve by choosing to perform activities differently than rivals do (Porter, 1996: 62). When a bank carries out its operational activities which are the same activities carried out by other banks, they should try to make a difference from their rivals by not only trying to be more efficient but by trying to make a difference. This can be done by performing different activities from the rivals or performing the same activities in a different way. For example: although specific risk management practices may differ among banks depending on the nature or complexities of their credit activities, a bank which will want to show a difference will use a comprehensive credit risk management strategy like the others by addressing area like; establishing appropriate credit risk environment, operating under a sound credit granting process, maintaining an appropriate credit administration, measurement and monitoring process and, ensuring adequate controls over credit. But, will go ahead to apply these practices in conjunction with sound practices related to the assessment of assets quality, adequacy of provision and reserves and the disclosure of credit risk (Basel, 1999: 4).

2.1.11. Credit Culture

A bank as an entity can be likened to a community and thus has its own culture which acts as a mirror on how it carries out its own activities. Actions or behaviors out of this culture will be going against the roles or norms of the bank. A bank’s credit culture is the policies, practices, philosophy and management style that are being put in place to act as a guide for the lending manager or personnel to carry out their credit management function. This spells out the lending environment and points out the lending behavior that is acceptable to the bank. In a study made by Mckinley, (1990, cited in Boffey& Robson, 1995: 67), Credit culture is defined as “a combination of factors that establish a lending environment that encourages certain lending behavior. It should include such things as management’s communication of values and priorities, the indoctrination of lenders during training, and the bank’s lending philosophy and policy.” Credit culture is thus good because it acts as a guideline for a good bank credit management, performance and maybe failure. Even if there is a wrong move in the credit risk management resulting to losses, the manager personally cannot be blamed if the decisions were taken based on its credit culture. The blame will go to the entire management or decision makers and adjustments can then be made.

2.1.12. Credit Risk Management Process

The same way that banks have different credit culture, they also have different credit risk management processes. Credit risk management process is a set of outlined activities aimed at managing credit risk. These activities are just like the ones outlined above for the risk management process and will cover the range from credit granting to credit collection. They are risk identification, measurement, assessment, control and monitor. The first step is to identify the risk involved in the credit process. After identification, the risk is measured by evaluating the consequence if it is not well managed. After the evaluation phase, the risk is then assessed to know the impact, the likelihood of occurrence, and the possibility for it to be controlled. The control and monitoring phase then comes in. These phases are not distinct like the other three. In the control phase, measures which can be used to avoid, reduce, prevent or eliminate the risk are put in place. The monitoring phase is used to make a constant check so that all processes or activities which have been put in place for the risk management process are well implemented for desired results to be gotten and in case of any distortions, corrections are then made. All this is done because credit risk is a very important and delicate risk that banks face and needs to be managed with great care / precaution because its consequences are always very detrimental to the bank. Despite the changes in the financial service sector, credit risk remains the major single cause of bank failure (Greuning & Bratanovic, 2003:135).

2.2. Tools of Credit Risk Management

As Thirupathi Kanchu and M. Manoj kumar (2013) stated, the instruments and tools, through which credit risk management is carried out, are detailed below:

A). Exposure Ceilings: Prudential Limit is linked to Capital Funds – say 15% for individual borrower entity, 40% for a group with additional 10% for infrastructure projects undertaken by the group, Threshold limit is fixed at a level lower than Prudential Exposure; Substantial Exposure, which is the sum total of the exposures beyond threshold limit should not exceed 600% to 800% of the Capital Funds of the bank (i.e. six to eight times).

B). Review/Renewal: Multi-tier Credit Approving Authority, constitution wise delegation of powers, Higher delegated powers for better-rated customers; discriminatory time schedule for review/renewal, Hurdle rates and Bench marks for fresh exposures and periodicity for renewal based on risk rating, etc are formulated.

C). Risk Rating Model: Set up comprehensive risk scoring system on a six to nine point scale. Clearly define rating thresholds and review the ratings periodically preferably at half yearly intervals. Rating migration is to be mapped to estimate the expected loss.

D). Risk based scientific pricing: Link loan pricing to expected loss. High-risk category borrowers are to be priced high. Build historical data on default losses. Allocate capital to absorb the unexpected loss. Adopt the RAROC framework.

E). Portfolio Management: The need for credit portfolio management emanates from the necessity to optimize the benefits associated with diversification and to reduce the potential adverse impact of concentration of exposures to a particular borrower, sector or industry. Stipulate quantitative ceiling on aggregate exposure on specific rating categories, distribution of borrowers in various industry, business group and conduct rapid portfolio reviews.

F). Loan Review Mechanism: this should be done independent of credit operations. It is also referred as Credit Audit covering review of sanction process, compliance status, and review of risk rating, pickup of warning signals and recommendation of corrective action with the objective of improving credit quality. It should target all loans above certain cut-off limit ensuring that at least 30% to 40% of the portfolio is subjected to LRM in a year so as to ensure that all major credit risks embedded in the balance sheet have been tracked.

2.3. What Type of Risk Considered?

Commercial banks are in the risk business. In the process of providing financial services, they assume various kinds of financial risks. Over the last decade our understanding of the place of commercial banks within the financial sector has improved substantially. Over this time, much has been written on the role of commercial banks in the financial sector, both in the academic literature and in the financial press. These arguments will be neither reviewed nor enumerated here. Suffice it to say that market participants seek the services of these financial institutions because of their ability to provide market knowledge, transaction efficiency and funding capability. In performing these roles they generally act as a principal in the transaction. As such, they use their own balance sheet to facilitate the transaction and to absorb the risks associated with it (Saunders and Cornett, 2007).

2.4. The ‘five C’s’ of Credit

Each bank has its analytical tools which it uses to minimize losses of money when giving out loans to customers. The bank always find itself in a situation where they can give a loan to a customer who will not be able to pay back or refuses to give to a customer who is good and has the potentials of meeting up with the repayment. To go about a good analysis of potential customers, the five C’s of credit have been introduced as a guide for bankers of what criteria to use. This includes the gathering of both quantitative and qualitative information to assist the bankers in their screening process of bad and potential creditors. This information is gotten using the five Cs of credit as the standards tools. The five Cs include; character, capacity, capital, conditions and collateral (Dev, 2009: 34). The *character* of a company refers to the distinct capabilities about the company which the lenders see that inspires them with confidence that the loan will be repaid. This includes things like the business plan, cash flow, history, management, etc. The *capacity* of the company incorporates words like sufficiency, adequacy and perseverance. This means what the company as a customer has as assets and the value of those assets which shows that it can be able to repay its loans. *Capital* of the company means how much adequate funds she has to make her business operate efficiently in generating cash flow and efficiently within its competitive business environment. The *condition* of the company describes the economic and environmental influences on the company’s financial condition and performance. Lastly, *collateral* refers to what the company is able to present to the lender which serves as the final source of repayment and protection against loan loss. The bank incorporates the ‘five C´s (character, capacity, capital, conditions and collateral) in their loan granting process of screening bad from potential creditors. When the loan officers receive the information (quantitative and qualitative) about the customer, they do their analysis not in isolation of each element but in relationship amongst the categories. The bank incorporates the ‘five C´s (character, capacity, capital, conditions and collateral) in their loan granting process of screening bad from potential creditors. When the loan officers receive the information (quantitative and qualitative) about the customer, they do their analysis not in isolation of each element but in relationship amongst the categories with the customers character being the center because it is the character that shows them the distinct capabilities about the customer whether they can pay the loan back or not. This is because a customer could as well show a good capacity, have enough capital, have a good economic / environmental influences on its financial condition and performance and have a good collateral but, if it has a bad character, it will not still act as an inspiration for the bank to grant the loan. On the other hand, if the character (business plan, cash flow, history, management, etc) showed by the customer in question is good, it will go ahead to assure them of the customer's repayment capability more. This will thus help the bank whether to grant the loan or not or it will determine the credit limit. This is because a customer's character shows how their previous loan transactions were handled. If after the decision has been taken, whatever may arise in the future, the bank will always recall the decisions taken in the past given the structure they used for their analysis to see if they took the right decision or not.

2.5. Framework for Credit Risk Analysis

The framework for analysis was guided by specific principles including Basel Committee submission on Banking Supervision, (Basel, 1999). The observation is that an effective credit approval process is the first step against excessive counter party credit risk which should begin with comprehensive financial and non-financial information which provides a clear picture of the counterparty's risk profile and risk management standards. In addition, the credit assessment process should identify the purpose, structure of the transaction for which approval is requested while providing a forward looking analysis of the repayment capacity from various scenarios. Some of the processes one might follow to identify and analyses the components of credit risk include non-financial issues such as knowledge of customer, credit referencing bureau and financial factors namely awareness of the purpose for credit, identification and assessment of sources of repayment, financial gearing, security analysis and assessing the business risk of the borrower.

An issue that cannot be overemphasized is a bank's knowledge of their customers; it implies that a bank should be familiar with the counter party and be confident that it is dealing with an entity of sound repute and credit worthiness (Basel, 1999). This can be achieved in a number of ways such as asking for references from known parties, accessing credit register, evaluating legal status and becoming knowledgeable about the individual responsibility for managing counter party. This could enhance the integrity of the banking system by reducing the likelihood of banks becoming a vehicle for money laundering and so on. Also, knowing your customer (KYC) could be facilitated by a credit referencing bureau. A credit referencing bureau, are positron of credit information is an entity that collates customer credit information by soliciting creditors such as banks, insurance company and lending institutions to contribute and share the credit information of their customers. It helps lending institutions with an easy means of carrying out their KYCs and enables banks to better manage their risk exposures.

The purpose of the credit facility is important to the lending institutions as it enables them to assess the legality of the transaction it is contracting with customers, relative to laws of the country in which they operate. Again, identification and assessment of sources of repayment is also a major tool for analyzing credit risk of customers of bank. A borrower’s repayment capacity is measured by identifying the source of repayment, and carefully reviewing future cash income from that source to ensure that it is enough to meet borrower’s needs and help generate enough cash flows from the core business to repay debt, pay a competitive return to shareholders or owners and replace long term operating assets.

Assessing the business risk is another way of analyzing the credit risk in banking. Business risk is the variability in operating cash flows or profit before interest (Pike et al., 2006). A firm’s business risk depends on the underlying economic environment within which it operates. This is a factor exogenous to the bank business variability in operating cash flows can be heavily affected by the cost structure of the business and hence the operating gearing.

Financial gearing is a way banks analyses the risk of the borrower. It is the risk over and above the business risk from the use of debt capital (Pike et al., 2006). It seeks to assess the impact of the credit on the capital structure of the counter party. By financial analysis, lending institutions are able to assess the borrowing needs, capital structure and borrower’s ability to meet their obligation as per terms of contract. Financial risk analysis gives an indication of the proportion of both external and internal funding used to finance the assets of the business. Another important factor in the process is security analysis. Because business risk is always present; most financial institutions rely heavily on the security of their portfolio as a means to offset the impact of credit risk on their loan portfolio (Rose et al., 2008). The security analysis in credit risk management involves the evaluation of the marketability of the security, security control and price stability of security being offered.

2.6. Banking credit risk management in Ethiopia

NBE (2010) reviewed the credit risk management guideline implementation in Ethiopia banks. Thus, the guideline is detailed below:

2.6.1. Introduction``

Experiences elsewhere in the world suggest that the key risk in a bank has been credit risk. Indeed, failure to collect loans granted to customers has been the major factor behind the collapse of many banks around the world. Banks need to manage credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Additionally, banks should be aware that credit risk does not exist in isolation from other risks, but is closely intertwined with those risks. Effective credit risk management is the process of managing an institution‘s activities which create credit risk exposures, in a manner that significantly reduces the likelihood that such activities will impact negatively on a bank‘s earnings and capital. Credit risk is not confined to a bank‘s loan portfolio, but can also exist in its other assets and activities. Likewise, such risk can exist in both a bank‘s on-balance sheet and its off-balance sheet accounts.

2.6.2. Board Responsibilities

The board of directors is responsible for reviewing and approving a bank‘s credit risk strategy and policies. Each bank should develop a strategy that sets the objectives of its credit-granting activities and adopts the necessary policies and procedures for conducting such activities.

2.6.3. Management Responsibilities

Senior management has the responsibility for implementing the credit risk strategy approved by the board of directors and for developing policies and procedures for identifying, measuring, monitoring and controlling credit risk. Such policies and procedures should address credit risk in all of the bank‘s activities at both the individual credit and portfolio levels. Senior management must ensure that there is a periodic independent internal or external assessment of the bank‘s credit management functions.

2.6.4. Policies, Procedures and Limits

2.6.4.1. Credit Policies

The foundation for effective credit risk management is the identification of existing and potential risks in the bank‘s credit products and credit activities. This creates the need for development and implementation of clearly defined policies, formally established in writing, which set out the credit risk philosophy of the bank and the parameters under which credit risk is to be controlled. Measuring the risks attached to each credit activity permits a platform against which the bank can make critical decisions about the nature and scope of the credit activity it is willing to undertake. A cornerstone of safe and sound banking is the design and implementation of written policies and procedures related to identifying, measuring, monitoring and controlling credit risk. Credit policies establish the framework for lending and guide the credit-granting activities of the bank. The policies should be designed and implemented with consideration for internal and external factors such as the bank‘s market position, trade area, staff capabilities and technology; and should particularly establish targets for portfolio mix and exposure limits to single counterparties, groups of connected counterparties, industries or economic sectors, geographic regions and specific products. Effective policies and procedures enable a bank to: maintain sound credit-granting standards; monitor and control credit risk; properly evaluate new business opportunities; and identify and administer problem credits. Credit policies need to contain, at a minimum:

1. A credit risk philosophy governing the extent to which the bank is willing to assume credit risk;

2. A general areas of credit in which the bank is prepared to engage or is restricted from engaging;

3. Clearly defined and appropriate levels of delegation of approval, and provision or write off authorities; and

4. Sound and prudent portfolio concentration limits.

The basis for an effective credit risk management process is the identification and analysis of existing and potential risks inherent in any product or activity. Consequently, it is important that banks identify the credit risk inherent in all the products they offer and the activities in which they engage. This is particularly true for those products and activities that are new to the bank where risk may be less obvious and which may require more analysis than traditional credit-granting activities. Although such activities may require tailored procedures and controls, the basic principles of credit risk management will still apply. All new products and activities should receive board approval before being offered by the bank.

2.6.4.2. Credit Analysis and Approval Process

Prior to entering into any new credit relationship, consideration shall be given to the integrity and reputation of the party as well as their legal capacity to assume the liability. Banks need to understand to whom they are granting credit. Therefore, prior to entering into any new credit relationship, a bank shall become familiar with the borrower or counterparty and be confident that they are dealing with an individual or organization of sound repute and creditworthiness. In particular, strict policies shall be in place to avoid association with individuals involved in criminal activities.

Establishing sound, well-defined credit-granting criteria is essential to approving credit in a safe and sound manner. In order to conduct an effective credit-granting program, banks shall receive sufficient information to enable a comprehensive assessment of the risk profile of the counterparty. Depending on the type of credit exposure and the nature of the credit relationship with the counterparty, the factors to be considered and documented in credit granting include:

1. Purpose of the credit and sources of repayment;

2. Borrower‘s repayment history and current capacity to repay, based on historical financial trends and future cash flow projections under various scenarios;

3. Terms and conditions of the credit including covenants designed to limit changes in the future risk profile of the borrower;

4. Adequacy and enforceability of collateral or guarantees under various scenarios;

5. Current risk profile of the counterparty (including the nature and aggregate amounts of risk), and sensitivity to economic and market developments, especially for major exposures; and

6. Borrower‘s business expertise and management capability.

Occasionally, banks may participate in loan syndications or other such loan consortia. In such cases, undue reliance should not be placed on the risk analysis performed by the lead underwriter or external credit assessors. Rather, syndicate participants should perform their own risk analysis prior to committing to the syndication. Such analysis should be conducted in the same manner as directly sourced loans.

In order to maintain a sound credit portfolio, a bank must have a clearly established process in place for approving new credits as well as extensions or renewal and refinancing of existing credits. Approvals should be made in accordance with the bank‘s written guidelines and granted by the appropriate level of management. There should be a clear audit trail documenting the approval process and identifying the individual(s) and/or committee(s) making the credit decision.

Each credit proposal should be subject to careful analysis by a qualified credit analyst with expertise commensurate with the size and complexity of the transaction. An effective evaluation process establishes minimum requirements for the information on which the analysis is to be based as listed above. The information received will be the basis for any internal evaluation or rating assigned to the credit and its accuracy and adequacy is critical to management making appropriate judgments about the acceptability of the credit.

2.6.4.3. Authority for Loan Approval

Banks must develop a corps of credit analysts who have the experience, knowledge and background to exercise prudent judgment in assessing, approving and managing credit. A bank‘s credit approval process should establish accountability for decisions taken and designate the individuals who have authority to approve credits or changes in credit terms. Depending upon its size and nature, credit may be approved through individual authority, joint authorities or through a committee.

2.6.5. Lending to Connected Parties

Banks should have credit granting procedures in place that identify connected counterparties as a single obligor which means aggregating exposures to groups of counterparties (corporate or non-corporate) that exhibit financial interdependence by way of common ownership, common control, or other connecting links (for example, common Management, familiar ties). Identification of connected counterparties requires a careful analysis of the impact of the above factors (e.g. common ownership and control) on the financial interdependence of the parties involved.

2.6.6. Credit Limits and Credit Concentration

To ensure diversification, exposure limits are needed in all areas of the bank's activities that involve credit risk. Banks should establish credit limits for individual counterparties and groups of connected counterparties that aggregate different types of on and off balance sheet exposures. Such limits are frequently based on internal risk ratings that allow higher exposure limits for counterparties with higher ratings. Under no circumstance can limits established by banks be higher than regulatory limits set by NBE. Limits should also be established for particular industries or economic sectors, geographic regions specific products, a class of security, and group of associated borrowers.

2.6.7. Credit Concentration

Credit concentration can occur when a bank's portfolio contains a high level of direct or indirect credits to:

1. A single counterparty;

2. A group of related counter parties;

3. An industry;

4. A geographical region;

5. A type of credit facility (i.e. overdrafts); and

6. A class of collateral.

Excessive concentration renders a bank vulnerable to adverse changes in the area in which the credit is concentrated and to violations of statutory and regulatory limits. Sound and prudent risk management involves the minimization of concentration risk by diversifying the credit portfolio. At a minimum, credit diversification policies should:

1. Be stated clearly

2. Include goals for portfolio mix;

3. Place exposure limits on single counter parties and groups of associated counter parties, key industries or economic sectors, geographical regions and new or existing products; and

4. Be in compliance with NBE statutory and regulatory limits on large exposures.

In considering potential credits, banks must recognize the necessity of establishing provisions for identified and expected losses in line with the NBE directives on provisions and holding adequate capital to absorb unexpected losses. These considerations should factor into credit-granting decisions as well as the overall portfolio risk management process.

2.6.8. Credit Risk Mitigation

A number of techniques are available to banks to assist in the mitigation of credit risk. Collateral and guarantees are the most commonly used. Notwithstanding the use of various mitigation techniques individual credits transactions should be entered into primarily on the strength of the borrower‘s repayment capacity. Banks should also be mindful that the value of collateral might well be impaired by the same factors that have led to the diminished recoverability of the credit.

Banks should have policies covering the acceptability of various forms of collateral, procedures for the ongoing valuation of such collateral, and a process to ensure that collateral is, and continues to be, enforceable and realizable.

2.6.9. Measurement, Monitoring and Control

Failure to establish adequate procedures to effectively monitor and control the credit function within established guidelines has resulted in credit problems for many banks around the world. Compromising credit policies and procedures has been another major cause of credit problems. Accordingly, each bank needs to develop and implement comprehensive procedures and information systems to effectively monitor and control the risks inherent in its credit portfolio.

2.6.10. Administration Policies

Credit administration is a critical element in maintaining the safety and soundness of a bank. Once a credit is granted, it is the responsibility of the bank to ensure that the credit is properly maintained. This includes keeping the credit file up to date, obtaining current financial information, sending out renewal notices and preparing various documents such as loan agreements. In larger banks, the responsibility for credit administration may be split among different departments, but in smaller banks these responsibilities may be assigned to individuals.

2.6.11. Credit Files

The credit files of a bank should include all the information necessary to ascertain the current financial condition of counterparties as well as sufficient information to track the decisions made and credit history of borrowers.

2.6.12. Credit Monitoring Procedures

Banks need to develop and implement comprehensive procedures and information systems for monitoring the condition of individual counterparties across the bank's various portfolios. These procedures should define the criteria for identifying and reporting potential problem credits and other transactions to ensure that they are subject to more frequent monitoring, corrective action, and proper classification/provisioning.

Specific individuals should be responsible for monitoring credit quality; including ensuring that relevant information is passed to those responsible for assigning internal risk ratings to the credit. In addition, individuals should be made responsible for monitoring on an ongoing basis any underlying collateral and guarantees. Such monitoring will assist the bank in making necessary changes to contractual arrangements as well as maintaining adequate reserves for credit losses.

Banks should develop an adequate framework for managing their exposure in off-balance sheet products as a part of overall credit to an individual customer and subject them to the same credit appraisal, limits and monitoring procedures. Banks should classify their off balance sheet exposures into three broad categories:

1. Full risk (credit substitutes) – e.g. standby letters of credit or money guarantees;

2. Medium risk (not direct credit substitutes) – e.g. bid bonds, indemnities and warranties; and

3. Low risk – e.g. cash against document (CAD).

2.6.13. Internal Risk Rating

An important tool in monitoring the quality of individual credits, as well as the total portfolio, is the use of an internal risk rating system. A well-structured internal risk rating system is a good means of differentiating the degree of credit risk in the different credit exposures of a bank. This will allow more accurate determination of the overall characteristics of the credit portfolio, problem credits, and the adequacy of loan loss reserves. Detailed and sophisticated internal risk rating systems can also be used to determine internal capital allocation, pricing of credits, and profitability of transactions and relationships.

2.7. Bank performance

In banking performance refers the ability of banks in provision of quality banking services to customers. The performance of bank will be measured by using different measuring variables which are the core performance indicators in the banking industry. Such as:

1. Profitability: - is the efficiency of banks at generating earnings which will be measured by Profitability ratios which focus on profit of the bank. The ratio includes: Return on Asset & Return on Equity.

2. Bank Liquidity: - is the ability to meet its financial obligations as they come due. Bank lending finances investments in relatively illiquid assets, but it fund its loans with mostly short term liabilities.

3. Bank Solvency: - is the banks long run ability to meet all financial obligations. A solvent business has a positive net worth. Solvency indicators include the debt-to-asset ratio and debt-to-equity ratio.

4. Loan Portfolio: - is total of all loans held by a bank or finance company on any given day.The loans that a lender (or a buyer of loans) is owed. The value of a loan portfolio depends on both the principal and interest owed and the average creditworthiness of the loans (Caouette, Altman, Narayanan and Nimmo, 2008).

2.8. Relationship between credit risk management and bank performance

As per different researchers and authors, Credit risk is the most significant of all risks in terms of size of potential losses. As the extension of credit has always been at the core of banking operation, the focus of banks risk management has been credit risk management. When banks manage their risk better, they will get advantage to increase their performance (return). Better risk management indicates that banks operate their activities at lower relative risk and at lower conflict of interests between parties (Anthony M. Santomero, 1997).

The major assets of a bank are its loans to individuals, businesses, and other organizations and the securities that it holds, while its major liabilities are its deposits and the money that it borrows, either from other banks or by selling commercial paper in the money market. And profitability of any business area can be measured through return on assets (ROA) and return on equity (ROE). Profitability is the dependent variable of this study. The researcher tries to evaluate the profitability of commercial banks in Ethiopia.

The advantages of implementing better risk management lead to better banks performance.Better bank performance increases their reputation and image from public or market point of view. The banks also get more opportunities to increase the productive assets, leading to higher bank profitability, liquidity, and solvency (Tandelilin, Kaaro, Mahadwartha, Supriyatna, 2007). Therefore, Effective credit risk management should be a critical component of a bank‘s overall risk management strategy and is essential to the long-term success of any banking organization. It becomes more and more significant in order to ensure sustainable profits in banks.

2.9. Empirical Review

Credit risk is a serious threat of banks; therefore various researchers have examined the impact of credit risk on banks in varying dimensions.

Kargi (2011) evaluated the impact of credit risk on the profitability of Nigerian banks. Financial ratios as measures of bank performance and credit risk were collected from the annual reports and accounts of sampled banks from 2004-2008 and analyzed using descriptive, correlation and regression techniques. The findings revealed that credit risk management has a significant impact on the profitability of Nigerian banks. It concluded that banks' profitability is inversely influenced by the levels of loans and advances, non-performing loans and deposits thereby exposing them to great risk of illiquidity and distress. Epure and Lafuente (2012) examined bank performance in the presence of risk for Costa-Rican banking industry during 1998-2007. The results showed that performance improvements follow regulatory changes and that risk explains differences in banks and non-performing loans negatively affect efficiency and return on assets while the capital adequacy ratio has a positive impact on the net interest margin.

Felix and Claudine (2008) investigated the relationship between bank performance and credit risk management. It could be inferred from their findings that return on equity (ROE) and return on assets (ROA) both measuring profitability were inversely related to the ratio of non-performing loan to total loan of financial institutions thereby leading to a decline in profitability. Ahmad and Ariff (2007) examined the key determinants of credit risk of commercial banks on emerging economy banking systems compared with the developed economies. The study found that regulation is important for banking systems that offer multi-products and services; management quality is critical in the cases of loan-dominant banks in emerging economies. An increase in loan loss provision is also considered to be a significant determinant of potential credit risk. The study further highlighted that credit risk in emerging economy banks is higher than that in developed economies.

Ahmed, Takeda and Shawn (1998) in their study found that loan loss provision has a significant positive influence on non-performing loans. Therefore, an increase in loan loss provision indicates an increase in credit risk and deterioration in the quality of loans consequently affecting bank performance adversely.

David H., (1997) Bank Risk Management: Theory .This paper is conducted to discuss why risk management is needed. It outlines some of the theoretical underpinnings of contemporary bank risk management, with an emphasis on market and credit risk. This paper merely focuses on theory it doesn‘t get in to the practical aspects of the title.

According to Basel committee (1999) on the management of credit risk, the following was observed: Many credit problems reveal basic weaknesses in the credit granting and monitoring processes. While shortcomings in underwriting and management of market-related credit exposures represent important sources of losses at banks, many credit problems would have been avoided or mitigated by a strong internal credit process. They noted too that many banks find carrying out a thorough credit assessment (or basic due diligence) a substantial challenge. For traditional bank lending, competitive pressures and the growth of loan syndication techniques create time constraints that interfere with basic due diligence. Globalization of credit markets increases the need for financial information based on sound accounting standards and timely macroeconomic and flow of funds data. When this information is not available or reliable, banks may dispense with financial and economic analysis and support credit decisions with simple indicators of credit quality, especially if they perceive a need to gain a competitive foothold in a rapidly growing foreign market. Finally, banks may need new types of information, such as risk measurements, and more frequent financial information, to assess relatively newer counterparties, such as institutional investors and highly leveraged institutions.

It was also noted from Basel's research that some credit problems arise from subjective decision making by senior management of the bank. This includes extending credits to companies they own or with which they are affiliated, to personal friends, to persons with a reputation for financial acumen or to meet a personal agenda, such as cultivating special relationships with celebrities (Nikhade et al., 2004). Many banks that experienced asset quality problems in the 1990s lacked an effective credit review process (and indeed, many banks had no credit review function). Credit review at larger banks usually is a department made up of analysts, independent of the lending officers, who make an independent assessment of the quality of a credit or a credit relationship based on documentation such as financial statements, credit analysis provided by the account officer and collateral appraisals. At smaller banks, this function may be more limited and performed by internal or external auditors (WOCCU, 2011). The purpose of credit review is to provide appropriate checks and balances to ensure that credits are made in accordance with bank policy and to provide an independent judgment of asset quality, uninfluenced by relationships with the borrower.

Effective credit review not only helps to detect poorly underwritten credits, it also helps prevent weak credits from being granted, since credit officers are likely to be more diligent if they know their work will be subject to review. A common and very important problem among troubled banks in the early 1990s was their failure to monitor borrowers or collateral values. Many banks neglected to obtain periodic financial information from borrowers or real estate appraisals in order to evaluate the quality of loans on their books and the adequacy of collateral. As a result, many banks failed to recognize early signs that asset quality was deteriorating and missed opportunities to work with borrowers to stem their financial deterioration and to protect the banks position. This lack of monitoring led to a costly process by senior management to determine the dimension and severity of the problem loans and resulted in large losses.

In some cases, the failure to perform adequate due diligence and financial analysis and to monitor the borrower can result in a breakdown of controls to detect credit-related challenges. For example, banks experiencing fraud-related losses have neglected to inspect collateral, such as goods in a warehouse or on a showroom floor, have not authenticated or valued financial assets presented as collateral, or have not required audited financial statements and carefully analyzed them. An effective credit review department and independent collateral appraisals are important protective measures, especially to ensure that credit officers and other insiders are not colluding with borrowers (Njoku, 1997). In addition to shortcomings in due diligence and credit analysis, bank credit problems reflect other recurring problems in credit-granting decisions. Some banks analyze credits and decide on appropriate non-price credit terms, but do not use risk-sensitive pricing. Banks that lack a sound pricing methodology and the discipline to follow consistently such a methodology will tend to attract a disproportionate share of under-priced risks. These banks will be increasingly disadvantaged relative to banks that have superior pricing skills.

According to the same report by Basel, Many banks have experienced credit losses because of the failure to use sufficient caution with certain leveraged credit arrangements. As noted above, credit extended to highly leveraged borrowers is likely to have large losses in default. Similarly, leveraged structures such as some buyout or debt restructuring strategies, or structures involving customer-written options, generally introduce concentrated credit risks into the bank's credit portfolio and should only be used with financially strong customers. Often, however, such structures are most appealing to weaker borrowers because the financing enables a substantial upside gain if all goes well, while the borrowers losses are limited to its net worth.

The team also noted that many banks credit activities involve lending against real collateral. In lending against real assets, many banks have failed to make an adequate assessment of the correlation between the financial condition of the borrower and the price changes and liquidity of the market for the collateral assets. Much asset-based business lending (i.e. commercial finance, equipment leasing, and factoring) and commercial real estate lending appear to involve a relatively high correlation between borrower creditworthiness and asset values. Since the borrower's income, the principal source of repayment, is generally tied to the assets in question, deterioration in the borrower's income stream, if due to industry or regional economic problems, is likely to be accompanied by declines in asset values for the collateral.

Some asset based consumer lending (i.e. home equity loans, auto financing) exhibits a similar, if weaker, relationship between the financial health of consumers and the markets for consumer assets. A related problem is that many banks do not take sufficient account of business cycle effects in lending. As income prospects and asset values rise in the ascending portion of the product business cycle, credit analysis may incorporate overly optimistic assumptions. Sometimes the cycle is less related to general business conditions than the product cycle in a relatively new, rapidly growing sector, such as health care and telecommunications. Effective stress testing which takes account of business cycle effects is one approach to incorporating into credit decisions a fuller understanding of a borrower's credit risk. They concluded that, many underwriting problems reflect the absence of a thoughtful consideration of downside scenarios. In addition to the business cycle, borrowers may be vulnerable to changes in risk factors such as specific commodity prices, shifts in the competitive landscape and the uncertainty of success in business strategy or management direction. However many lenders fail to 'stress test' or analyze the credit using sufficiently adverse assumptions and thus fail to detect vulnerabilities.

NBE conducted the first survey on risk management practices of Ethiopian commercial banks by taking sample of nine members of bank's board of directors in 2009. It was specially aimed to identify the status of risk management practice of Commercial bank and to improve its strength further through providing fruitful recommendation on weakness. Inadequate risk management training , inefficient allocation of Risk management budget, lack of up to date and relevant economic and business data for decision making, lack of documented risk management strategy and program, lack of reviewing risk management document regularly, and poor internal communication and lack of comprehensive risk limits system were identified as weakness of Risk management

system and practice of some Ethiopian Commercial banks while having qualified Risk management staffs, existence of policy and procedure of Risk management, having committed BOD, awareness of risk in banking operation, contingence plan for Operational and Credit risk were the major strength of the banks. Generally, the dominance of all those weaknesses over the strength witnesses the existence of poor Risk management system and practice in Ethiopian Commercial banking industry.

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further through providing fruitful recommendation on weakness. Inadequate risk management training , inefficient allocation of Risk management budget, lack of up to date and relevant economic and business data for decision making, lack of documented risk management strategy and program, lack of reviewing risk management document regularly, and poor internal communication and lack of comprehensive risk limits system were identified as weakness of Risk management system and practice of some Ethiopian Commercial banks while having qualified Risk management staffs, existence of policy and procedure of Risk management, having committed BOD, awareness of risk in banking operation, contingence plan for Operational and Credit risk were the major strength of the banks. Generally, the dominance of all those weaknesses over the strength witnesses the existence of poor Risk management system and practice in Ethiopian Commercial banking industry.

The study of NBE (2009) identified and ranked three important types of risks in which Credit risk was ranked firstly and then followed by operational and liquidity risk

Richard E. et al., (2008) conduct research on the Credit risk management system of Tanzanian commercial banks and found that checklist with the help of 5C (Character, Capacity, Condition, Credit history, and Collaterals) was used to assess borrowers Creditworthiness. Researcher also found that the quantitative Credit scoring model was not used as a result of poor record keeping and lack of effective data base system in different sectors with in the country. Researcher further noted the difficulty of using modern Credit risk management model due to lack of information and other financial infrastructure in under developed country.

Wondimagegnehu (2012), conducted a study with a purpose of identifying the determinants of non-performing loans the case of Ethiopian banks. The study covered the period between 2005 up to 2010. The researcher identified deposit loans and total asset variables as affecting NPL of Ethiopian banks. Accordingly, the researcher found that there were no statistically significant relationship between all independent variables and NPL.

Solomon (2013), a study conducted on assessment of credit risk management practice of Nib International bank S.C. The study focuses on entire review of the credit risk management techniques & practices. The study used stratified random sampling to select the number of participants. The result of the study shows that collateral used a number one technique of credit risk management and risk pricing by the bank.

The findings and analysis reveal that credit risk management has effect on profitability in all 4 banks. Among the two credit risk management indicators, NPLR has a significant effect than CAR on profitability (ROE). The analysis on each bank level shows that the impact of credit risk management on profitability is not the same.

CHAPTER THREE

3 RESEARCH DESIGN AND METHODOLOGY

In this section the researcher wants to demonstrate the methodology which was used in the research work. It consists of research design, sample, population & sampling techniques, types of data and instruments of data collection, procedure of data collection and methods of data analysis.

3.1. Research Design

To meet the objective of the study and answer the research questions, descriptive research design was used. The attempt of the study was to describe the present state of affairs of the bank (BrIB) as it exists without having any control over the variables, that is, the extent of the application of the credit risk management tools and measurement techniques of the bank.

The relevant information required to answer the research questions includes data obtained from respondents through structured questionnaire, and review of relevant policy procedures, annual reports, National Bank of Ethiopia (NBE) directives and other related publications. Hence both primary and secondary data were used. Respondents were branch managers, risk and compliance staffs and credit analysts, loan officers from credit management department.

3.2. Populations and Sampling Techniques

As at June 30, 2014 the bank had 37 branches of which 20 are in Addis Ababa and 17 branches in regional towns. Thus, the researcher took 37 branch managers. In head office 29 employees directly involved in risk, compliance and credit management department. Therefore, the total sample size was 66 employees incorporated in the study by using purposive sampling technique.

3.3. Types of Data and Instruments of Data Collection

The type of data used for the study includes qualitative and quantitative data (mixed). Primary and secondary sources of data were used for the study. The main primary source of data is through the use of questionnaires. The questionnaire was open and close-ended. The open-ended question offered the respondents the opportunity to freely express themselves on the issues under consideration while the close-ended questions restricted the respondents on the options provided.

In the case of the secondary source of data, annual and quarterly reports of the bank were analyzed. These reports contain financial performance of the bank. Besides, as reference material NBE directives, journals working paper as well as different thesis were used in the study.

Structured questionnaires were used for the collection of data. As earlier these questions were both open and close-ended questionnaire.

3.4. Procedures of Data Collection

To collect the required data from respondents structured questionnaire was employed. The primary data was collect from selected personnel from credit and risk management area of the bank using questioner and the secondary data was collected from different documents. The researcher gathered the opinion of various personnel working at credit and risk area at branch level and head office department.

3.5. Methods of Data Analysis

The data collected was summarized and presented by means of tables. This offered a pictorial presentation to enhance the understanding of the data. The data presentation was also analyzed using descriptive tools such as frequency and percentage. The findings would present in a tables. The data collected from the close-ended questions was analyzed using Statistical package for social science (SPSS) version 20 while the open-ended questions were presented in a narrative way.

3.6. Ethical Consideration

Before the research was conducted, the researcher informed the participants of the study about the objectives of the study, and was consciously consider ethical issues in seeking consent, avoiding deception, maintaining confidentiality, respecting the privacy, and protecting the anonymity of all respondents. A researcher must consider these points because the law of ethics on research condemns conducting a research without the consensus of the respondents for the above listed reasons.

CHAPTER FOUR
4. DATA ANALYSIS AND DISCUSSION

This study was, as described in the aforementioned chapter, aimed at assessing the credit risk management practice of Berhan International Bank S.C. The data were collected from the credit management department director, the senior manager, branch managers, credit management experts and loan officers of the bank. To gather relevant data for the purpose of the study, questionnaire means of data instruments were employed. Therefore, the data collected from the target population of the study through these instruments were presented and discussed in this chapter. In doing so, the data gathered through the questionnaire were presented in tables.

4.1. Overview of the Research

In conducting this research used both the primary and secondary source. The primary source is conducted through the use of questionnaire. A total of 66 questionnaires were distributed to those individuals who are working in the credit and risk area of Berhan International Bank S.C. Out of the total 66 questionnaires distributed 58 questionnaires have been fully completed and returned to the researcher. Thus, the researcher believes that the returned questionnaire i.e. 87.88% of the total will be representative for the study under consideration.

Questionnaires were prepared in English. Accordingly, the respondents gave their responses about the extent of assessment of credit risk management of Berhan International Bank S.C. Therefore: the data found from the respondents were analyzed and discussed in line with the research questions as follows.

Generally speaking, the analysis was done in primary and secondary data sources. The primary data were analyzed using frequency distribution tables, while the secondary data were analyzed using ratios.

4.1.1 Reliability Test

Cronbach's alpha is used in this study to assess the internal consistency of the research instrument, which is developed questionnaire. Cronbach's α (alpha) is a coefficient of reliability used to measure the internal consistency of a test or scale; it resulted as a number between 0 and 1. As the result approaches to 1 the more is the internal consistency of the items, which means all the items measure the same variable. The result of the coefficient alpha for this study's instrument was found to be

0.986 (table 1). The alpha coefficient is .986, suggesting that the items have high internal consistency. A reliability coefficient of .70 or higher is considered "acceptable". Therefore, this study's instrument was acceptable.

Table 1: Scale Reliability (Cronbach's alphas) – for credit risk management dimensions

Cronbach's Alpha	No. of Items
0.986	30

Source: Own computation

4.2. General Information

Table 2: Characteristics of the Respondents

Variables	Variable categories	Frequency	Percentage
Gender	Male	45	77.6
	Female	13	22.4
	Total	**58**	**100**
Age	20-29 years	2	3.4
	30.39 years	46	79.3
	40.49 years	7	12.1
	Above 50 years	3	5.2
	Total	**58**	**100**
Educational Background	Diploma	3	5.2
	Degree	49	84.5
	Master and above	6	10.3
	Total	**58**	**100**
Current Position	Clerical	-	-
	Professional	18	31
	Managerial	40	69.0
	Total	**58**	**100**
Experience	0-5 years	7	12.1
	6.10 years	38	65.5
	11.20 years	8	13.8
	Above 20 years	5	8.6
	Total	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

It can be observed in the above table that from the total 58 respondents, 45(77.6%) respondents were male and 13(22.4%) respondents were female. Thus, we can say that in the studied area (credit and risk) major respondents were male. It can be observed from table the above that 3.4%, 79.3%, 12.1 and 5.2% of the respondents were between 20 to 29, 30 to 39, 40 to 49 and 50 or older respectively. The above table shows that 55(94.8%) of the respondents own degree and above which is a good indication that the Bank is staffed by educated people. The remaining 3(5.2) of the respondents own diploma. It can be seen from the frequency distribution of the respondents current position (Table 4) that the most respondents were managerial (69%) followed by professional level (31%) but not clerical staffs in the respondents. This implies this study addresses the supervisory level of employees. Thus, the response given was highly relevant. The table above shows the percentage of the years of experience the respondents had working within the bank. The researcher asked this question because the researcher wanted to know how experienced the respondents were in terms of banking sector. In the results, the researcher notices that 65.5% have experience working with in the bank 6-10 years, followed by 13.8 % have experience working with in the bank 11-20 years. Whereas, the respondents who have working experience in banking sector more than 20 years was 8.6% and less than 5 years was 12.1%. This implies that most of the respondents were experienced in banking sector. This helped the researcher to reach in a correct conclusion.

4.3 Research Related Questions

Table 3: Expectation from Effective Credit Risk Management

Response	Frequency	Percentage
Reduce financial loss	25	43.1
Improve communication with the stakeholders	5	8.6
Improve decision making	13	22.4
Improve resource allocation	15	25.9
Total	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

This question was asked the respondents to indicate their expectations of credit risk management in the organization. The researcher asked this in order to find out how important the respondents think credit risk management. The results show that most of the respondents expect risk management to reduce financial losses (43.1%). As a result, effective credit risk management helps to reduce the financial loss.

Additionally, 22.9% of the respondents expect effective credit risk management to improve resource allocation, 22.4% expect effective credit risk management to improve decision making and 8.6 % improve communication with customers (stakeholders). As a result, effective credit risk management is essential to reduce financial loss, improve communication with the stakeholders, improve decision making and improve resource allocation. Managing the credit risk effectively create credit risk exposures, in a manner that significantly reduces the likelihood that such activities will impact negatively on a bank‘s earnings and capital.

Table 4: The Authority to Establish Credit Risk Management Policy

Response	Frequency	Percentage
Chief executive officer(CEO)	-	-
Chief financial officer (CFO)	-	-
Board/Committee	55	94.8
Executive management committee (EMC)	3	5.2
Internal auditor	-	-
Staff	-	-
Total	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

In the table, the respondents asked to identify who has the authority to establish credit risk management policy in their organization. The results of this question were closely expected because it assumed the top-level managers should have the authority to establish risk management. As it can see in the table, the majority of the respondents (94.8%) specify that the board or committee have the authority to establish risk management. Next was the executive management team (5.2%). As shown in the above (table 4), top level management support risk management policy.

Banks like any other firm or corporation have formal laid down policies and principles that have been put in places by the board of directors on how to manage credits and this have to be carefully implemented by management. This restricts supervisors or managers on how to take action. They must do so by looking at the policies lay down to know if they are doing the right thing at the right time (Maness & Zietlow, 2005: 139). Accordingly, Board/Committee has the authority to establish credit risk management policy in the bank. Because, the board of directors is responsible for reviewing and approving a bank‘s credit risk strategy and policies. Each bank should develop a strategy that sets the objectives of its credit-granting activities and adopts the necessary policies and procedures for conducting such activities.

Table 5: The Organization has Documented Credit Risk Guideline or Policy.

Response	Frequency	Percentage
Yes	58	100
No	-	-
Total	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

In table 5, the percentage of the Yes/No question that was asked regarding if the respondent's organization has a documented credit risk management guideline or policy. 100% of respondent replied 'Yes'. This helps the organization to manage their credit risk. This implies that the employees of the organization works under the guideline or policy developed by the organization. Effective policies and procedures enable a bank to: maintain sound credit-granting standards; monitor and control credit risk; properly evaluate new business opportunities; and identify and administer problem credits (Basel, 1999).

Table 6: Guidelines Support Goals and Objectives of Credit Risk Management

Response	Frequency	Percentage
Yes	56	96.6
No	2	3.4
Total	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

Tables 6, shown 96.6% of respondents assure that the risk management guideline supports the goals and objectives of credit risk management. But, 3.4% assure that the risk management guideline or policy didn't support the goals and objectives. This implies that the workers of credit, risk, compliance departments and branch managers assured that the guidelines support the goals and objectives of credit risk management; this enables the banks guidelines, goals and policies not contradict and flows smoothly.

Table 7: The Understanding of Credit Risk Management Guideline

Response	Frequency	Percentage
Yes	55	94.8
No	3	5.2
Total	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

In table 7, showed 94.8% of respondents understood the risk management guideline or policy. But, 5.2% did not understand the risk management guideline or policy. This implies that almost all the employees of credit risk management know/understand the guidelines that developed by the organization, this enables them to manage the credit that arise in the organization.

Table 8: The Change of Guidelines or Policies to Manage Risk

Activity	Frequency	Percentage
once per year	39	67.2
one per two years	14	24.1
once for more than two years	5	8.6
Never	-	-
Total	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

In table 8, most of the respondents (67.2%) replied that the organization revise guidelines or policies to manage credit risks once per year. 24.1% of the respondents replied that their organization revised the guidelines or policies one every 2 years and revising once in more than 2 years had 8.6%. As a result the organization revises the guidelines or policies to manage credit risks once per year. Grabowski and Roberts (1999) suggest that risk management is primarily associated with the variability of organizational structures. It is a flexible approach to respond in different ways and respond quickly in the face of changing conditions. Because, financial world fluctuating from time to time.

Table 9: Plan to Support the Development of Credit Risk Management

Activity	Frequency	Percentage
Yes	54	93.1
No	4	6.9
Total	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

In table 9, the researcher used a yes/no question to ask the respondents about future credit risk management policy. The results show that the amount of respondents who choose yes was 93.1% and the rest 6.9% choose no. This implies that top management is willing to support the development of risk management policy.

Table 10: The Effective Communication to Reduce Credit Risk

Activities	Frequency	Percentage
Creating clear and trustworthy information	12	20.7
Develop understanding between management team and employee	15	25.9
Fast and sharp communication between management team and stakeholders	10	17.2
Regularly communicating among management and staff	13	22.4
Creating and maintaining a clear communication	8	13.8
Total	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

In table 10, the researcher would like to know how the organization effectively communicates in order to reduce credit risk. The results show that the most common way of communicating effectively to reduce risk is developing understanding between management team and employee, with 25.9% of the respondents. It means that most of the respondents think that developing this understanding is a first priority for the bank. The next results were regularly communicating among management and staff with 22.4%. Creating clear and trustworthy information and fast communication between management team and customers followed with 20.7% and 17.2% respectively. The lowest ranking was creating and maintaining a clear communication, with 13.8%. This means that Creating and maintaining a clear communication is not a common way of communicating to reduce risk. The responses believed that developing understanding between management team and employee, regularly communication between management and staff, create information clear and trustworthy, maintaining clear to communication and fast and sharp communication in organization all is support effective communication in risk management procedures. This implies that develop understanding between management team and employee took the first step to reduce credit risk relative to other ways of communication in the bank.

Table 11: Offering Credit Risk Management Training Courses

Activities	Frequency	Percentage
One time per year	40	69.0
Two times per year	8	13.8
More than two times per year	10	17.2
Never	-	-
Total	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

In table 11, the researcher would like to know the frequency of credit risk management training in the organization. The results show that most of the respondents (69.0%) had a risk management training course once time per year. 17.2% have a risk management training course two times per year and, more than 2 times per year percentages, 13.8%.

Training improves knowledge, skill and attitudes to job satisfaction it is better to know how frequent the organization provide training for employees. According to table 11, it can be concluded that the organizations give training to employees' once time per year. This is short being period and enables employees to understand the credit risk management practices and to do better effort in the behalf of the organization benefit.

Table 12: The Techniques/Instruments of Credit Risk Management

Description	Intractably applied		Highly applied		Applied		Less applied		Not used		Total		Descriptive	
	F	%	F	%	F	%	F	%	F	%	F	%	Mean	SD
Credit Approval Authority	15	25.9	28	48.3	12	20.7	3	5.2	-	-	**58**	**100**	2.05	.826
Risk Ratings/Scoring	-	-	20	34.5	29	50.0	9	15.5	-	-	**58**	**100**	2.81	.687
Portfolio Management	4	6.9	15	25.9	25	43.1	10	17.2	4	6.9	**58**	**100**	2.91	.996
Loan Review Policy	5	8.6	12	20.7	20	34.5	15	25.9	6	10.3	**58**	**100**	3.09	1.113
Collateral	17	29.3	30	51.7	11	19.0	-	-	-	-	**58**	**100**	1.90	.693
Diversification	3	5.2	17	29.3	27	46.6	11	19.0	-	-	**58**	**100**	2.79	.811
Other tools like credit audit and problem loan management	-	-	5	8.6	10	17.2	23	39.7	20	34.5	**58**	**100**	4	.937

Source: SPSS Output from Survey Data, 2015.

Note: 'F' stands for frequency and '%' stands for valid percentage value

In the table 12, 15(25.9%) of respondents responded that there is credit approval authority used in the bank as one credit management technique. While 28(48.3%) responded as it is highly applied, 12(20.7%) responded as applied and 3(5.2%) respondents responded as less applied in the bank.

In risk rating/scoring 20(34.5%) responded highly applied, 29(50%) responded applied, 9(15.5%) less applied as a credit risk management tool. As per the response of respondents, portfolio management was responded by 4(6.9%) of respondents as intractable applied, 15(25.9%) as highly applied, 25(43.1%) as applied 10(17.2%) as less applied and 4(6.9%) not used at all as a tool of credit risk management. Loan review policy is intractable applied as responded by 5(8.6%) of respondents, highly applied as per the response of 12(20.7%) of the respondents, 20 (34.5%) applied as per the response, less applied 15(25.9%) as per the response and not used at all as per the response of 6(10.3%) respondents as a tool for credit risk management. Collateral as a tool for credit risk management is responded as intractable applied by 17(29.3%) of respondents, highly applied as per response of 30(51.7%) respondents, applied as per the response of 11(19%) of the respondents. As per the response of respondents, diversification was responded by 3(5.2%) of respondents as intractable applied, 17(29.3%) as highly applied, 27(46.6%) as applied and 11(19%) as less applied tool of credit risk management. In the table, other tools like credit audit and problem loan management used as a credit risk management technique as rated by respondents, 5(8.6%) highly applied, 10(17.2%) applied, 23(39.7%) less applied and 20(34.5%) not used at all. Therefore, the researcher concluded that collateral and credit approval authority were highly applied as a techniques of credit risk management relative to other techniques. On the contrary the bank used risk rating (scoring), credit audit and problem loan management as a techniques/ instruments of credit risk management. Others like diversification, loan review policy and portfolio management were not given emphasis as a technique of credit risk management.

Table 13: Factors Considered in Credit Granting Process

Description	Very important		Important		Moderate		Unimportant		Very unimportant		Total	
	F	**%**	**F**	**%**	**F**	**%**	**F**	**%**	**F**	**%**	**F**	**%**
Capacity	33	56.9	21	36.2	3	5.2	1	1.7	-	-	**58**	**100**
Character	36	62.1	20	34.5	2	3.4	-	-	-	-	**58**	**100**
Collateral	38	65.5	20	34.5	-	-	-	-	-	-	**58**	**100**
Condition	27	46.6	22	37.9	9	15.5	-	-	-	-	**58**	**100**
Capital	12	20.7	20	34.5	14	24.1	12	20.7	-	-	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

Note: 'F' stands for frequency and'%' stands for valid percentage value

In the above table, 33(56.9%) of respondents responded that capacity is very important factor for credit granting process. While, 21(36.2%) responded as it is important, 3(5.2%) responded as moderate and 1(1.7%) respondents responded as unimportant. In character 36 (62.1%) responded as very important, 20(34.5%) responded important and 2(3.4%) moderate as a factor of credit granting process. As per the response of respondents, collateral is responded by 38(65.5%) of respondents as very important and the rest 20(34.5%) as important as a factor of credit granting process. Condition is very important as responded by 27(46.6%) of respondents, 22(37.9%) important and as per the response of 9(15.5%) of the respondents as moderate factor of credit granting process. Capital as a factor of credit granting process is responded as very important by 12(20.7%) of respondents, important as per response of 20(34.5%) respondents, moderate as per the response of 14(24.1%) of the respondents and unimportant as per the response of 12(20.7%) respondents.

To go about a good analysis of potential customers, the five C's of credit have been introduced as a guide for bankers of what criteria to use. This includes the gathering of both quantitative and qualitative information to assist the bankers in their screening process of bad and potential creditors. This information is gotten using the five Cs of credit as the standards tools. The five Cs include; character, capacity, capital, conditions and collateral (Dev, 2009: 34). As a result, collateral a major factor in loan granting process in relative to other factors of loan granting process. Emphasizing in all 5c's (capacity, character, collateral, condition and capital) helps the effectiveness of the bank instead of depending on the one (i.e. collateral).

Table 14: Collateral Security before Granting of Loans

Response	**Frequency**	**Percentage**
Yes	54	93.1
No	4	6.9
Total	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

In the table, the researcher want to know whether the bank demand any collateral security before loan to clients, as per the response of the respondents 54 (93.1%) agree on collateral security and the rest 4 (6.9%) disagree on bank demand collateral security before granting loan to clients. Hence, almost all respondents result shows that the bank demanded collaterals before loan is granted.

Table 15: Collateral for all types of loans

Response	Frequency	Percentage
Yes	54	93.1
No	4	6.9
Total	**58**	**100.0**

Source: SPSS Output from Survey Data, 2015.

In table 15, the researcher used a yes/no question to ask the respondents about collateral demanded for all types of loans. The results show that the amount of respondents who choose yes was 54(93.1 %) and 4(6.9%) respondent's response no collateral demanded for all types of loans. As a result, collaterals were demanded for all types of loans.

Table 16: Activities Performed for Credit Risk Management

	Very high		High		Moderate		Low		Very low		Total	
Activities	**F**	**%**	**F**	**%**	**F**	**%**	**F**	**%**	**F**	**%**	**F**	**%**
Industries Studies/Profile	38	65.5	20	34.5	-	-	-	-	-	-	**58**	**100**
Periodic Credit calls	11	19.0	25	43.1	16	27.6	6	10.3	-	-	**58**	**100**
Periodic Visits of Plants	12	20.7	20	34.5	16	27.6	10	17.2	-	-	**58**	**100**
Develop Management Information System (MIS)	8	13.8	29	50.0	19	32.8	2	3.4	-	-	**58**	**100**
Credit Risk Rating/Risk Scoring	-	-	20	34.5	29	50.0	9	15.5	-	-	**58**	**100**
Annual Review of Accounts	10	17.2	27	46.6	18	31.0	3	5.2	-	-	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

Note: 'F' stands for frequency and'%' stands for valid percentage value

In the table above shows the rating activities performed for credit risk management. As answered by the respondents the question was asked because the researcher wants to know how about the bank various activities performed for credit risk management. Thus, 38(65.5%) of respondents responded that Industries Studies/Profile is very high and 20(34.5%) as high activity the bank performs for credit risk management. In periodic credit calls, 11(19%) responded as very high, 25(43.1%) responded as high, 16(27.6%) as moderate and 6(10.3%) low activity that the bank performed for credit risk management. As per the response of respondents, periodic visits of plants is responded by 12(20.7%) of respondents as very high, 20(34.5%) as high, 16(27.6%) as moderate and the rest 10(17.2%) as low activity that the bank performed for credit risk management. Develop management information system (MIS) is very high as responded by 8(13.8%) of respondents, 29(50%) as high, 19(32.8%) as moderate and 2(3.4%) as low activity of credit risk management. Credit rating an activity that the bank performed for credit risk management is responded as moderate by 20(34.5%) of respondents, low as per response of 29(50%) respondents and very low as per the response of 9(15.5%) of the respondents. In annual review of accounts, 10(17.2%) responded as very high, 27(46.6%) responded as high, 18(31%) as moderate and 3(5.2%) low activity that the bank performed for credit risk management. In general, the bank highly performed industry study/profile activity relative to other activities for credit risk management. Periodic credit calls, periodic visits of plants and annual reviews of accounts are also activities performed for credit risk management. But, develop management information system (MIS) and credit risk rating given minimum importance credit risk management.

Table 17: The Ways of Risk Management Reporting

Response	**Frequency**	**Percentage**
on a regular, formal basis	27	46.6
as part of other management reporting	19	32.8
on an ad hoc basis	12	20.7
Total	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

In this question the researcher wants to know how often the risk management is reported in the bank on a regular, formal basis 27(46.6%) respondents responded. While 19(32.8%) responded as part of other management reporting and the rest 12(20.7%) responded on an ad hoc basis. Hence, in the above table we can conclude that the bank risk management reporting is on formal and unclear basis.

Table 18: Credit Processing/Appraisal

Credit processing/appraisal	Strongly agree		Agree		Neutral		Disagree		Strongly disagree		Total	
	F	**%**	**F**	**%**	**F**	**%**	**F**	**%**	**F**	**%**	**F**	**%**
The bank checks the borrower history before granting loans	15	25.9	40	69.0	2	3.4	1	1.7	-	-	**58**	**100**
The bank properly assessed the customer ability to meet obligations	5	8.6	23	39.7	30	51.7	-	-	-	-	**58**	**100**
Credit-granting approval process established accountability for decision taken	37	63.8	19	32.8	1	1.7	1	1.7	-	-	**58**	**100**
There are times credit granting and monitoring process is overridden by directors, senior management influential staffs	33	56.9	20	34.5	5	8.6	-	-	-	-	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

Note: 'F' stands for frequency and'%' stands for valid percentage value

All banks should establish credit policy and guideline to foster the loan delivery system. Credit appraisal is the method of evaluating credit before and after loan has been granted to the customers. As shown in the table respondents were asked whether the bank checks the borrowers history before granting loans, 15(25.9%) respondents strongly agree, 40(69%) respondents agree, 2(3.4) respondents neutral and 1(1.7%) respondents disagree. Thus, from the total respondents 55(94.9%) respondents response shows strongly agree and agree that the bank checks the borrower history before granting loans. On the same table, respondents were asked whether the bank properly assessed the customer ability to meet obligations, 5(8.6%) respondents strongly agree, while 23(39.7%) respondents agree and 30(51.7%) respondents neither agree nor disagree. In this survey brought out that credit granting approval process established accountability for decision taken, 37(63.8%) respondents strongly agree, 19(32.8%) respondents agree, 1(1.7%) respondent neither agreed nor disagreed. So, we can conclude that 56(96.6%) respondents lies on strongly agree and agree response. Hence, almost all respondents ensure that credit granting approval process established accountability for decision taken. The researcher wants to know the level of agreement there are times credit granting and monitoring process is over ridden by directors, senior management and influential staffs. This can be seen from the table 33(56.9%) respondents strongly agree, 20(34.5%) respondents agree and 5(8.6%) respondents neutral which were neither agree nor disagree. This implies that credit granting approval process established accountability for decision take and credit granting & monitoring process is overridden by directors, senior management is highly applied in credit risk management process. On the contrary, the bank didn't give emphasis on assessing the customer's ability to meet obligations.

Table 19: Credit Administration

Credit administration	**Strongly agree**		**Agree**		**Neutral**		**Disagree**		**Strongly disagree**		**Total**	
	F	**%**	**F**	**%**	**F**	**%**	**F**	**%**	**F**	**%**	**F**	**%**
The process of 'credit administration' is performed interdependently of individuals involved in the 'business origination' of credit	9	15.5	23	39.7	13	22.4	8	13.8	5	8.6	**58**	**100**
The bank has well structured documentation tracking system for credit and collateral files	22	37.9	19	32.8	6	10.3	8	13.8	3	5.2	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

Note: 'F' stands for frequency and '%' stands for valid percentage value

Regarding the process of credit administration the result shows that 9(15.5%) of the respondents strongly agree that 'credit administration' is performed interdependently of individuals involved in the 'business origination'. Thus, 23(39.7%) of the respondents agree, 13(22.4%) of the respondents neither agree nor disagree, 8(13.8%) of the respondents disagree and 5(8.6%) of the respondents strongly disagree on the response. This implies that there is no clear or well known process of 'credit administration' performance interdependently of individuals involved in the 'business organizations'. In the same table the researcher want to know whether the bank has well structure documentation tracking system for credit and collateral files, 22(37.9%)of the respondents strongly agree, 19(32.8%) of the respondents agree, 6(10.3%) of the respondents neutral (neither agree nor disagree), 8(13.8%) of the respondents disagree and 3(5.2%) strongly disagree. Therefore, the majority of the respondents 41(70.7%) agree that the bank has well structured documentation tracking system for credit and collateral files and the rest feels on the contrary. Credit administration is a critical element in maintaining the safety and soundness of a bank. Once a credit is granted, it is the responsibility of the bank to ensure that the credit is properly maintained. This includes keeping the credit file up to date, obtaining current financial information, sending out renewal notices and preparing various documents such as loan agreements. In larger banks, the responsibility for credit administration may be split among different departments, but in smaller banks these responsibilities may be assigned to individuals (NBE, 2010). Therefore, it could be generalized that the process of 'credit administration' and 'business origination' were not separated.

Table 20: Monitoring and Control of Credit

Monitoring & control of credit	**Strongly agree**		**Agree**		**Neutral**		**Disagree**		**Strongly disagree**		**Total**	
	F	**%**	**F**	**%**	**F**	**%**	**F**	**%**	**F**	**%**	**F**	**%**
Collateral coverage is regularly assessed and related to the borrower's financial health	22	37.9	24	41.4	6	10.3	6	10.3	-	-	**58**	**100**
The bank regularly undertakes stress testing on the overall credit portfolio	3	5.2	24	41.4	22	37.9	9	15.5	-	-	**58**	**100**
Customers are often given sufficient training on loan usage	2	3.4	5	8.6	20	34.5	20	34.5	11	19	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

Note: 'F' stands for frequency and'%' stands for valid percentage value

Failure to establish adequate procedures to effectively monitor and control the credit function within established guidelines has resulted in credit problems for many banks around the world.

Compromising credit policies and procedures has been another major cause of credit problems. Accordingly, each bank needs to develop and implement comprehensive procedures and information systems to effectively monitor and control the risks inherent in its credit portfolio. In the table above, 22(37.9%) of the respondents strongly agreed that collateral coverage were assessed regularly related to the borrower's financial health. While 24(41.4%) of the respondents agreed, 6(10.3%) of the respondents neutral and 6(10.3%) of the respondents disagreed. Therefore, we can say that the majority of the respondent 46(79.3%) agreed that that collateral coverage were assessed regularly related to the borrower's financial health. In the same table the researcher wants to know that wether the bank regularly undertakes stress testing on the overall credit portfolio. In the above table, 3(5.2%) of the respondents were strongly agreed that the bank regularly undertake stress testing on the overall credit portfolio. While, 24(41.1%) of the respondents agreed, 22(37.9%) of the respondents neutral and 9(15.5%) of the respondents were disagreed.Regarding the customer training on loan usage the result shows that 2(3.4%) of the respondents strongly agreed. While, 5(8.6%) of the respondents agreed, 20(34.5%) of the respondents neither agree nor disagree (neutral), 20(34.5%) of the respondents disagreed and 11(19%) of the respondents strongly disagree on the response. Therefore, the result showed that there were no regular ways of stress testing on the overall credit portfolio in the bank. And the bank used collateral coverage is assessed with related to the financial health for credit monitoring and controlling.

Table 21: Managing Problem Credit/Recovery

Managing problem credits/recovery	Strongly agree		Agree		Neutral		Disagree		Strongly disagree		Total	
	F	**%**	**F**	**%**	**F**	**%**	**F**	**%**	**F**	**%**	**F**	**%**
The bank segregates the workout activity from the area that originated the credit	15	25.9	18	31.0	11	19.0	10	17.2	4	6.9	**58**	**100**
The bank has credit risk policy that clearly set out how problem credits are to be managed	24	41.4	25	43.1	6	10.3	3	5.2	-	-	**58**	**100**
The bank has appropriate criteria for credit classification, provisioning and write off	30	51.7	24	41.4	3	5.2	1	1.7	-	-	**58**	**100**
Adequate measures are put in place to recover non-performing loans	20	34.5	29	50.0	6	10.3	3	5.2	-	-	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

Note: 'F' stands for frequency and'%' stands for valid percentage value

In the table 21, 15(25.9%) of respondents responded with strongly agreed there was a segregation in the credit activity from the area of credit origination. While, 18(31%) responded as agreed, 11(19%) responded as neutral, 10(17.2%) respondents as disagreed and the rest 4(6.9%) respondents responded as strongly disagreed for the credit activities to its origination. The researcher want to know the level of agreement, bank credit risk policy that clearly set and how problem credits were managed, 24(41.4%) responded strongly agreed, 25(43.1%) responded agreed, 6(10.3%) neither agreed nor disagreed and the rest 3(5.2) disagreed. Therefore, the majority of the respondents 49(84.5%) response agreed that the bank had clearly set the credit policy and managed the problem credits (loans). As per the response of respondents, the bank's appropriate criteria for credit classification, provisioning and write-off were responded by 30(51.7%) of respondents as strongly agreed, 24(41.4%) as agreed, 3(5.2%) as neutral and 1(1.7%) disagreed with the question. Thus, almost all respondents 54(93.1%) responded that the bank had appropriate criteria for credit classification, provisioning and write-off. The last question were asked in managing problem credit/recovery section, that is to know the agreement level of the respondents in adequate measures put in place to recover non-performing loans, 20(34.5%) respondents strongly agreed, 29(50%) of the respondents agreed, 6(10.3%) of the respondents neither agreed nor disagree and 3(5.2%) of the respondents disagreed on the question. This implies that the bank put the system of managing problem credit or recovery, but segregation of the workout activity from the area that originated the credit was not effectively implemented. Finlay (2008), states that between thirty and ninety days of delinquency, the debt collection process has failed and the account is transferred to debt recovery. Consequently this debt is written-off and is recorded as a loss in that financial institutions profit and loss sheet (Finlay, 2008).Therefore, stress that this is an occurrence that all financial institutions wish to avoid; thus stringent arrears interventions are indispensable. Thus, problem loans/credits should be managed. As Md. Moeid (2014), stated poor credit risk management is the main consideration in case of Banks' unsatisfactory performance and often the reason of bankruptcy.

Table 22: The Strategies of the Bank so as to Improve the Quality of Loan

Description	Frequency	Percentage
Enforcing strict enforcement of loan repayment obligations	9	15.5
Adapting proper loan appraisal and follow-up	15	25.9
Establishing sound and competent credit risk management unit	13	22.4
Adopting early warning system e.g. daily reports on credit quality	9	15.5
Aligning strategic vision, policy objectives and business process	7	12.1
Enhancing anticipated development e.g. technology	5	8.6
Total	**58**	**100**

Source: SPSS Output from Survey Data, 2015.

The credit risk strategy of a bank is 'the basis for how credit risk is monitored, controlled, and responded to' and emerges from its credit philosophy and credit culture (Colquitt, 2007: 35). The bank‘s risk appetite and the approaches to managing risks are reflected in the credit risk strategy and need to be understood by all levels of the bank in order to ensure proper protection. Depending on the size and lending objectives of the bank, the credit risk strategy will vary. Important for all bank institutions, however, is the consistent application of credit standards. A bank carries out its operational activities which are the same activities carried out by other banks, they should try to make a difference from their rivals by not only trying to be more efficient but by trying to make a difference. This can be done by performing different activities from the rivals or performing the same activities in a different way. For example: although specific risk management practices may differ among banks depending on the nature or complexities of their credit activities, a bank which will want to show a difference will use a comprehensive credit risk management strategy(Porter, 1996: 62). In general the fundamental lending objective of modern banks is to find the proper balance between portfolio growth and credit quality. This assures long-term profitability and increases shareholder‘s value. ‘Transactions that create value and yield adequate returns together with appropriate hedging strategies are the keys to extending business credit and maximizing earnings’ (Colquitt, 2007: 52). Respondents were asked the proposed strategies that the bank used so as to improve the quality of the loans/credit. As shown the table 22, 15(25.9%) of the respondents chose adapting proper loan appraisal and follow-up strategy to improve the quality of credits/loans. 13(22.4%) of the respondents selected the bank should establish sound and competent credit risk management unit to increase credit/loan quality. 9(15.5%) of the respondents agreed on the strategy of adopting early warning system to improve the quality of loan or credit and enhance the overall credit risk management. In the strategy of enforcing strict enforcement of loan repayment obligations also 9(15.5%) of the respondents chose to improve loan quality and enhance the credit risk management of the bank. In the strategies aligning strategic vision, policy objectives & business process and enhancing anticipated development e.g. technology, 7(12.1%) and 5(8.6%) of the respondents responded that the bank should use so as to improve the quality of the loans as high as possible and enhance the overall credit risk management of the bank. Therefore, we concluded that to improve the quality of loans and enhance the overall credit risk management of the bank, greater number of respondents chose/selected adapting proper loan appraisal and follow-up strategy followed by establishing sound and competent credit risk management unit.

The response to the subjective questions shows that credit risk management should be strongly applied before loan approval, the bank should participate in credit referencing bureau by providing relevant borrowers information, training of employees continuously, all staffs should contribute their effort, knowing the customer before loan was granted (KYC), signing a contractual agreement at the time loan approval, establishing risk management teams and collateral registration should be undertake to establish a proper credit risk management environment.

4.4. Secondary Data Analysis

For further assessment in credit risk management practice of the Bank, the total loans and advance, and non-performing loans data’s were used and discussed

4.4.1. Credit Concentration

Credit concentration risk is the risk of loss to the Bank arising from an excessive concentration of exposure to a single borrower, group of borrowers or industry.

4.4.1.1. Borrower Concentration

Diversification is a major line of defense against credit losses. In the Bank, diversification is used to avoid concentration of credit with a particular borrower or group of borrowers. The highest concentration on a single borrower was Birr 54.53 million, which was 10% of the Bank's capital. The Bank maintains a concentration of credit risk that is adequately diversified among individuals.

Table 23: Loan and Advances Portfolio in '000'000 of Birr

Sector	**June 30, 2014**		**June 30,2013**		**June 30,2012**		**June 30, 2011**		**June 30, 2010**	
	Amt	**%**	**Amt**	**%**	**Amt**	**%**	**Amt**	**%**	**Amt**	**%**
Agriculture	1,797	0.2	531	0.1	1,604	0.3	1,607	0.4	1,525	1
Transport	180,307	15.2	86,316	8.8	42,233	8.4	63,955	19.3	14,760	9.6
Manufacturing	56,093	15.2	101,135	10.3	57,712	11.6	33,764	10.2	9,203	6
Domestic Trade Service	361,279	30.5	345,866	35.3	95,723	19.2	59,645	17.8	27,316	17.8
Import & Export	230,608	19.5	149,186	15.2	110,255	22.1	72,347	21.8	55,790	36.4
Construction	248,526	21.0	227,178	23.2	138,336	27.7	59,111	17.8	15,386	10.1
Personal	36,182	3.1	8,252	0.8	1,532	0.3	1,119	0.6	308	0.2
Hotel & Tourism	69,902	5.9	60,438	6.2	52,156	10.4	40,270	12.1	28,906	18.9
Total	**1,184,694**	**100**	**978,902**	**100**	**499,551**	**100**	**331,818**	**100**	**153,194**	**100**

Source: Annual report 2010-2014

Note: 'Amt' stands for amount and '%' stands for valid percentage value

The Bank's outstanding loan net of provision as at June, 2014 was Birr 1.18 billion making a growth rate of 21.02% from the preceding year's performance. Similarly with that of the previous year, this increment has been registered against the allocation of 27 percent of every fresh loan disbursement amount for NBE bills.

DTS loans stood at birr 361,279 or 30% at the end of the year from last year's 35%. The Bank enhanced the concentration risk on the construction sector which has decreased to 21% at the end of the year from the prior year of 23.50%. The other sectors specified contributed 49% to the total loan portfolio. The industry concentration of the Bank is within the internal policy limit.

Table 24: Loan and NPL by Sector in ‘000,000’ birr, Sept 30, 2014

Sector	Total Loan	% age share	NPL	NPL % age
DTS	343.93	29	32.28	9
Construction	245.38	20	29.54	12
Import	129.97	11	10.28	8
Hotel & Tourism	58.91	5	1.24	2
Export	119.54	10	-	-
Manufacturing	108.29	9	5.18	5
Transport	166.08	14	-	-
Agriculture	3.60	0.30	-	-
Others	27.65	2	-	-
Total	**1,203.35**	**100**	**78.52**	**6.50**

Source: Quarterly report

Sector wise, DTS constitutes 29% of the total loan portfolio followed by the construction sector which contributes for about 20% to the total loan portfolio. The remaining sectors contribute 51% to the total loan portfolio.

Out of the total NPL, the DTS took the lion share both in terms of absolute value of about birr 32 million (41%). The Construction sectors follows by contributing about 29 million (38%), followed by import sector that contributes about birr 10 million (11%) to the total NPLs. In terms of NPLs ratios by sector, Construction, DTS, Import sectors has their NPLs ratios more than 5% and are categorized as high-risk categories. More importantly as the DTS and construction sectors have significant share of about 49% of the total loan portfolio, any deterioration in the quality of these sectors will significantly affect the total credit quality of the Bank. Hence, the Bank should exercise stringent follow-up and credit granting mechanisms to them.

Table 25: Loan Classification by Risk Class, in '000,000' birr

Items	June 30,14		Sept 30,14		% age Change
	Amount	% age	Amount	% age	
Performing loans					
Pass	1,038.53	87.69	975.22	81	(6)
Special-mention	95.16	8.03	149.61	12	57
Sub-total	**1,133.69**	**95.72**	**1,124.83**	**93**	**(0.80)**
Non-performing loans					
Sub-standard	21.80	1.84	48.73	4.05	124
Doubtful	27.42	2.32	25.64	2.10	(6.50)
Loss	1.50	0.12	4.16	0.35	177
Sub-total	**50.72**	**4.28**	**78.53**	**6.50**	**55**
Total	**1,184.41**	**100**	**1,203.35**	**100**	**1.60**

Source: Quarterly report

At the end of September 2014, the Bank's non-performing loans totaled about birr 78.53 million representing an increase of about birr 27.81 million (55%) from the previous quarter. The ratio of NPL to total loans increased by 2.22 percentage points to 6.50% compared with the previous quarter. The Bank's outstanding special-mention loans amounted to about birr 149.61 million, an increase by 57% compared with the previous quarter end. The share of loans under pass category dropped to 81% from the prior periods 88%. Most of the time the NPL records of exhibited results below 5%, hence the Bank should consistently manage its credit risk to record results below the regulatory requirement throughout the year.

CHAPTER FIVE

5. SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter deals with conclusions and recommendations respectively. Hence, the major findings of the study were analyzed and discussed in chapter four give a way to draw a conclusion. Finally, possible recommendations for the major problems found from the study are forwarded on the basis of the findings of the study.

5.1. Summary

Credit risk management has a great role because banks have a limited capacity to absorb loan losses and these losses can be covered only by using income generated by other profitable loans or bank capital.

The aim of this study was to assess the credit risk management practice of Berhan International Bank S.C. Thus, the study used both primary and secondary data sources.

Therefore, the study was addressed the research objectives. Thus, the findings were illustrated below:

- As qualified and experienced manpower enhances competence, majority of employees of the bank are degree holders and experienced, this enables the bank to accelerate its service delivery and become competitive in the growing stiff competitive industry, to meet its vision of "To be radiant and trustworthy bank in excellence"
- The most common and frequently occurring risk in Berhan International Bank S.C is credit risk. On the other hand liquidity, operational and market risks also affect the organization.
- The study summarizes that banks used different credit risk management tools and techniques to manage the credit risk, the credit risk management and that they all have one main objective, i.e. to reduce the amount of loan default which is a principal cause of bank failure.
- The surveys show that respondents identified commitment and support from top management as the most important. Most of the respondents believed that it is the responsibility of the board of directors or committee and executive management team to establish credit risk management policy.

- The research shows that collateral is uses as a primary technique of credit risk management. This might lead a wrong conclusion to manage credit risk effectively.
- The entire respondents indicated that the bank has a documented credit risk management guidelines and most of the respondents understand the guideline of credit risk management. The guidelines also help the bank to supports the goals and objectives of credit risk management. Because, the financial world is always in fluctuation, almost more than half of the respondent suggests that organizational structure must be reviewed regularly and adjusted to adapt to changing financial environments and the changes made once per year and at the time when it is believed to have changes.
- The survey shows the respondents credit risk management becomes a part of good business practice and should include training staff appropriately. Since the purpose of training is to improve knowledge, skill and attitudes to job satisfaction the organizations provide training for employees once per year as agreed by most of the respondents.
- The result indicated that develop understanding between management team and employee is a means of communication that used to reduce credit risk.
- Credit analysis is the tool that the bank uses to analyze the customer data in order to make the loan approval decision. The policies and strategies are also aims to provide a risk control techniques for the bank.
- From the activities performed for credit risk management the bank mainly focused on industries studies/profile.
- Credit risk management is the lending guideline. In fact, the lending guideline is a combination of many lending policies that issued by the bank for its staff members when dealing with a loan application.

5.2. Conclusions

The banking industry has come to stay and its activities cannot be undermined given the great role it plays in the economy of every country by receiving savings from the '*haves*' and making it available to the '*haven't'* thus boasting productive investments. While carrying out its activity, the banks are faced with a number of risks with credit risk being cited as the most important since its poor management can lead to a total disaster in the bank.

In the theoretical part, (Boffey & Robson, 1995, p.6) pointed this out by saying that CRM has a great role because banks have a limited capacity to absorb loan losses and this looses can be covered only by using income generated by other profitable loans or bank capital. After my findings I still found out that it really has a great role to play because it makes decisions less risky, it helps the banks to have a secure system thus avoiding loss of trust which financial markets might develop, it helps to match risk to interest rates and profitability since credits will be granted based on these aspects, it helps to guarantee availability of customers money should incase they come for it and reduces losses since the bank will be able to meet up with its financial obligations.

Based on the main objective, three research objectives were developed. To achieve this main objective, the study used to descriptive analysis, to investigate the demographic characteristics of the respondents, and assessing the credit risk management practice of Berhan International Bank S.C. More specifically, the study used closed and open ended questionnaire. The study emphasizes on the assessment of credit risk management practice in Berhan International Bank S.C. Credit Risk Management can be treated as the heart of any Commercial Banks. It plays the vital role in the performance of a financial institution as it analyzes credit-worth-ability of borrowers.

In general from the study, Berhan International Bank S.C has a documented credit risk management policy. The bank used collateral as a primary technique of credit risk management mechanism. The bank used different credit risk management tools and techniques to manage the credit risk, the credit risk management and that they all have one main objective, i.e. to reduce the amount of loan default which is a principal cause of bank failure, Berhan International Bank S.C management problem in non-performing Loans (NPL), credit portfolio concentration & monitoring and controlling.

5.3. Recommendations

Based on the findings the researcher would recommend that the bank could establish a credit risk management team that should be responsible for the following actions that will help in minimizing credit risk;

- Since the bank is at infant stage, providing training on credit risk management for the employees to enhance their capacity and reviewing the adequacy of credit training courses for all employees directly involved in credit and risk jobs.
- The bank should establish activities for credit risk management like periodic credit call, periodic visit of plants, develop management information system (MIS), credit risk rating and annual review of accounts.
- In credit administration aspect, the process of "credit administration" should be separated from the "business origination".
- The bank should regularly undertake stress testing on the overall credit portfolio.
- To improve the quality of the loan and enhance the overall credit risk management, the bank should give attention in aligning strategic vision, policy objectives & business process and enhancing anticipated development.
- The bank should focus on creating and maintaining a clear communication, fast, and sharp communication between management team and stakeholders ways of effective communication to credit risk of the Bank.
- The organization should evaluate how much adequate funds the customer has to make the business operate efficiently (capital) in credit granting process.
- The bank should checks the borrower history before granting loans and properly assessed the customer ability to meet obligations in credit processing or appraisal system and properly assess the customer ability to meet obligations.
- The bank should give sufficient training to the customers on loan usage.
- The bank should emphasis in portfolio management, loan review policy, diversification, and other tools like credit audit and problem loan management as a technique / instrument of credit risk management in addition to collateral.
- Follow up the implementation credit policies and standards that conform to regulatory requirements and the bank's overall objectives and improve the miss implementation of

credit risk management policies or guidelines. Cope up to the changes of credit risk management policies with the regulatory body or organ.

- Practitioners should be obliged to follow their credit management process, policy guidelines and make their customers know them well.
- It is necessary that bank participate actively in operations of the credit referencing bureau by providing the centre with relevant information on the borrowing of customers. This will enable the bank to share information on the recalcitrant borrowers and reduce the risk of default. Also, customers with bad credit history could then be denied credit and improve the loan quality of the bank.
- Since, poor credit risk management is the main consideration in case of banks' unsatisfactory performance and often the reason of bankruptcy, the bank should strength the system of managing problem credit.
- As per the respondent's response, assessing the liquidity risk management practice of the bank is the other area of study in addition to assessing the credit risk management practice.

5.4. Limitation of the Study

It is quite known that any study is not absolutely free from limitations. As a result, this study was conducted with some sort of limitations. The researcher was faced with many problems which, in fact, may affect the quality of the study. The following were among others:

- The reluctance of the employees to fill the questionnaire
- The delay by the respondents in returning back the questionnaire

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St. Mary's University
School of Graduate Studies, MBA Program
Questionnaire

Dear respondents,

This is a Questionnaire designed to gather data on 'Credit Risk Management Practice of Berhan International Bank S.C' which will be used as an input for a thesis in a partial fulfillment of Master of Business Administration (MBA). Your genuine response a solely used for academic purpose and the data will be treated utmost confidentiality. Therefore, your kindly co-operation is appreciated in advance.

For further information and need my assistance while you fill the questionnaire please contact me:

E-mail: ethiopiamengste@gmail.com

Thank you for your cooperation

Yours sincerely

Belsti Abatihun

General Instruction

- Please put a tick (√) on the space provided
- Select the appropriate answer and circle
- For questions that need further explanations please use the space provided under each section.

Part I. Background of the respondents

1. Sex Male ☐ Female ☐
2. Age group 20 – 29 ☐ 30 – 39 ☐ 40 – 49 ☐ above 50 ☐
3. Highest Educational Level Obtained

   Diploma ☐ Degree ☐ Masters and above ☐
4. Current position

   Clerical ☐ Professional ☐ Managerial ☐
5. Bank related work experiance

   0-5 Years ☐ 6-10 Years ☐ 11-20 Years ☐ above 20 Years ☐

Part II. Research related questions

1. What is your expectation from effective credit risk management in your organization?

A). Reduce financial loss

B). Improve communication with the stakeholders

C). Improve decision making

D). Improve resource allocation

E). other (please specify)---

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2. Who has the authority to establish credit risk management policy in your organization?

A). Chief executive officer (CEO)

B). Chief financial officer (CFO)

C). Board/ committee

D). Executive management committee

E). Internal auditor

F). Staff

G). other (please specify) ---

3. Does your organization have a documented credit risk management guideline or policy?

A). Yes B). No

4. Does the guideline support the goals and objectives of credit risk management?

A). Yes B). No

5. Do you understand the credit risk management guideline or policy?

A). Yes B). No

6. How often does your organization revise its guidelines or policies to manage risks?

A). Once per year

B). Once per two years

C). Once in more than two years

D). Never

7. In the future, does your organization have a plan to support the development of credit risk management?

A). Yes B). No

8. How does your organization effectively communicate to reduce credit risk?

A). Creating clear and trustworthy information

B). Developing understanding between management team and employee

C). Fast and sharp communication between management team and stakeholders

D).Regularly communicating among management and staff

E). Creating and maintaining a clear communication

F).Other (please specify) ---

9. How often does your organization provide credit risk management training courses?

A). Never

B). 1 times per year

C). 2 times per year

D). More than 2 times per year

10. Tools of Credit Risk Management

10.1.Which technique/instrument, do use for credit risk management in your bank? (please rate them where, 1= intractable applied, 2=highly applied, 3= applied, 4=less applied, 5=not used)

	1	**2**	**3**	**4**	**5**
Credit Approval Authority					
Risk Ratings/Scoring					
Portfolio Management					
Loan Review Policy					
Collateral					
Diversification					
Other tools like credit audit and problem loan management					

10.2.How important do you consider the following factors in your credit granting process. Please rate in order of importance, where; 1= very important, 2= important, 3= moderate, 4= unimportant, 5= very unimportant

	1	**2**	**3**	**4**	**5**
Capacity/how capable is the customer in repaying the debt/					
Character/customers financial history, but also their personal integrity/					
Collateral/assets provided by customer as the security for the loan/					
Condition/Overall environment that customer is operating in/					
Capital/how much adequate funds the customer has to make the business operate efficiently/					

11. Does the bank demand any collateral security before granting loan to its clients?

Yes ☐ No ☐

12. If yes, is collateral demanded all types of loans?

Yes ☐ No ☐

13. Activities Performed for Credit Risk Management

13.1. Does your bank perform the following activities for Credit Risk Management? (Please rank where, 1=very high, 2 = high, 3 = moderate, 4=low, 5= very low).

	1	**2**	**3**	**4**	**5**
Industries Studies/Profile					
Periodic Credit calls					
Periodic Visits of Plants					
Develop Management Information System (MIS)					
Credit Risk Rating/Risk Scoring					
Annual Review of Accounts					

14. Which of the following best describes the way risk management is reported within your organization? I.e. Risk reporting takes place

On a regular, formal basis ☐

As part of other management reporting ☐

On an ad hoc basis ☐

Not reported at all ☐

15. Credit Risk Management Process

Please provide your level of agreement using the following rates (where1= strongly agree, 2= Agree, 3= Neutral, 4= Disagree and 5=strongly disagree)

15.1. Credit Processing/appraisal	**1**	**2**	**3**	**4**	**5**
The bank checks the borrower history before granting loans					
The bank properly assessed the customer ability to meet obligations					
Credit-granting approval process established accountability for decision taken					
There are times credit granting and monitoring process is overridden by directors, senior management influential staffs					
15.2. Credit Administration	**1**	**2**	**3**	**4**	**5**
The process of 'credit administration' is performed					

interdependently of individuals involved in the 'business origination' of credit					
The bank has well structured documentation tracking system for credit and collateral files					
15.3. Monitoring and control of credit	**1**	**2**	**3**	**4**	**5**
Collateral coverage is regularly assessed and related to the borrower's financial health					
The bank regularly undertakes stress testing on the overall credit portfolio					
Customers are often given sufficient training on loans usage					
15.4. Managing Problem Credits/ Recovery	**1**	**2**	**3**	**4**	**5**
The bank segregates the workout activity from the area that originated the credit					
The bank has credit risk policy that clearly set out how problem credits are to be managed					
The bank has appropriate criteria for credit classification, provisioning and write off					
Adequate measures are put in place to recover non-performing loans					

16. Which of the following strategies do you propose to the bank so as to improve the quality of loans as high as possible and enhance the overall credit risk management of the bank?

    A). Enforcing strict enforcement of loan repayment obligations ☐

    B). Adapting proper loan appraisal and follow-up ☐

    C). Establishing sound and competent credit risk management unit ☐

    D). Adopting early warning system e.g. daily reports on credit quality ☐

    E). Aligning strategic vision, policy objectives and business process ☐

    F). Enhancing anticipated development e.g. technology ☐

    Any other, please specify……………………………………………………………………

17. As expert of credit risk management, what do you recommend to its success?

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DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Tiruneh Legesse (Asst. Prof.). All sources of the materials used for the thesis has been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any higher learning institution for the purpose of earning any degree.

________________________ ________________________

Name Signature

St. Mary's University, Addis Ababa **January, 2016**

ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a University advisor.

Advisor _______________________ **Signature & Date** _______________________