ST.MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

ASSESSMENT OF CREDIT RISK MANAGEMENT PRACTICE IN COMMERCIAL BANK OF ETHIOPIA (CBE'S).

BY GEBREWAHD TESFAY BRHANE

JANUARY 2016

ADDIS ABABA ETHIOPIA

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A THESIS SUBMITTED TO THE SCHOOL OF GRADUATE STUDIES, ST.MARY'SUNIVERSITY, INPARTIALFULFILLMNTOF THE REQUIREMENT FOR THE AWARD OF MASTERS DEGREE IN BUSINESS ADMINISTRATION.

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APPROVED BY BOARD OF EXAMINERS

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External Examiner	Signature & Date

Declaration

I, undersigned, declare that this work entitled "**Assessment of the credit risk management practice of CBE's ''** is out come of my own effort study that all sources materials used for the study have been duly acknowledged. I have produced it independently except for the guidance and suggestion of the research Advisor.

Name -------------------------

Signature……………………….

Date of Submission……………………….

Endorsement

This thesis has been submitted to St. Mary's Universty, school of graduated Studies for examination with my approval as university advisor.

______________________________ ____________________

Advisor **Signature**

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ACKNOWLEDGEMENTS

First, I thank the Almighty God for everything that is given to me to go through this task.

My sincere gratitude goes to my Advisor ALEM HAGOS (PHD) For his intellectual support and constructive comments throughout this paper. I thank the management decision of CBE's for giving me the opportunity to conduct detail analysis and understanding of the banking operation particularly related to my project subject matter.

Special thanks to credit process staffs for giving me the opportunity and sparing their time for the interviews and filling the questionnaires. I finally appreciate the moral support from friends, and work colleagues.

Thank you all.

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Acronyms and abbreviations

CBE - Commercial Bank of Ethiopia

CRM - Credit Risk Management

CSA – Central statics Agency

ISO - International Standard organization

MOFED – ministry of finance and economic development

NBE - National bank of Ethiopia

RM – Relationship manager

FIS - Financial institutions

Abstract

Taking risks is an integral and unavoidable part of banking business, indeed, embedded with reward for taking it. Therefore, risk management is the major component of strategic management system. Banks like CBE's which has an objective of benefiting the wider society rather then simply profit making, through active participation in financing economic development programs and long term project of the country, will inevitably require risk management strategy including credit risk management. This is because it is believed that there is a close relationship between company's vision, mission, and general strategic direction on the one hand, and its willingness and ability to take risk (risk appetite, risk tolerance),risk policy and risk strategy on the other hand. Therefore, the main purpose of this paper is to asses CBE's credit risk management practice against NBE and Basel parameters of credit risk management principles. The study used exploratory research approach. The objective is to generate more information about the situation before launching a formal study and to define clearly the research question in the form of investigative questions. Structured set of interviews and questionnaires were used to collect the primary source of data from samples in order to attain research objectives. Simple analysis fact against these standards indicated that there are deviation on role and responsibilities of board of director with respect to credit risk management process, lack of accurate, reliable and consistent information/data base system, lack of variety of risk controlling techniques, and poor integration among departments are some of the challenges in credit risk management practice in CBE's. The reason behind for simple descriptive analysis is so as to make simple and easy respondents feed back on credit risk management practice and put in a precise way the finding that were found from them.

Key words: Credit risk Management practice, NBE and Basel credit risk management standards.

Chapter One

Introduction

1.1. Background of the Study

Banking business today is quite complex than ever and the future will undoubtedly rest on risk management dynamics that banks exercise. Risk in banking is commonly defined as the possibility that the outcome of an action being taken/not taken or an event that could bring an adverse impact on the bank's capital, earnings or its viability and survival. It is true that banking services & operations involve various kinds of risks, for example, credit risk, liquidity risk, operational risk and market risk are some of them. Unfortunately taking risks is an integral and unavoidable part of the baking business, indeed, embedded with reward for taking it.

This shows that there exists relationship between risk and reward/return, which in turn, leads to the implication that the higher the rate of return, is the greater the risk and risk tolerance one must take. Conversely, it tells that organizations especially banks should know how to cope with or control risks profitably and strategically in sustainable way aligned with their goals and visions. For this reason, risk management becomes an important functions of a business these days unlike those periods where the significance of risk management was ignored. According to ISO (2004), "Risk management is a central part of any organization's strategic management. It is the process whereby organizations methodologically address the risks attaching to their activities with the goal of achieving sustained profits and benefits within each activity and across the portfolio of all activities". From the above sentence, one can understand that risk management's primary goals are to bring benefits to the companies, risk management is heart of firm's strategy and it also covers all areas of business process. Moreover, failing to risk management practice in banking will lead to banking inefficiency ranging from not knowing what to take during crises subject to allegations of variety of compliance and regulations requirements, living in non directional decisions, no clue in what to take next if the first action going wrong, creating uncertainties and value deteriorations, unwise investment and costly decision on scares resources and lack of accountability and responsibility at the end of the day, to high loss and finally speedy failure of institutions. However, risk management is not guarantee for success it has been evidenced that for most, it is only those banks that have efficient risk management system will survive in the market and achieve their objectives in the long run.

Consequently it is clear that credit being among the products that banks provide for customers to generate income, involves risk. **"Credit risk is defined as** the risk of default or it is the case that a borrower fails to services its debt as agreed terms and conditions, Duffie and Singleton (2003).**"**Supportive statement to the above fact is that according to Broll, Pausch and Welezel (2002), credit risk is one of the oldest and biggest risks that face banks by virtue of its very nature of business inherit. As a result for banking institution having strategic visions, objectives and goals it is very likely to have risk management strategy and practice. Commonly, credit risk management is part and parcel of compressive risk management process in banks. it is the process, that require establishment of frame work that defines corporate priorities, loan approval process, credit risk rating system, risk-adjusted pricing system, loan-review mechanism and comprehensive reporting system. Farther components of effective credit risk management comprise active board and senior management oversight, sufficient policies, procedure and limit, adequate risk measurement, monitoring and management information systems; and comprehensive internal controls. As credit constitutes the largest single income-earning asset in the portfolio of most banks, it is reasonable for banks to commit efforts on the management of credit quality and credits risks. A bank with high credit risk has high potential to insolvency risk that puts mainly depositors and other stakeholder in jeopardy. This is because credit risk is the risk that can easily and most likely prompts other risks and finally bank failure.

Therefore, in this paper, the aim is to assess CBE's overall credit risk management practice and further probe and unfold what CBE's credit risk management practice seems in the year of 2011/12 and 2012/13 but to show the trends (flow) of loan disbursement to loan collection it is important to see some years back starting from the year of 2007/08 in order to simple to understand whether loans disbursement to loan collections shows increasing or decreasing trend.

1.2. Back Ground of the organization

The agreement that was reached in 1905 between Emperor Minilik II and Mr.Ma Gillivray, representative of the British owned National Bank of Egypt marked the introduction of modern banking in Ethiopia. Following the agreement, the first bank called Bank of Abyssinia was inaugurated in February 16,1906 by the Emperor. The bank was totally managed by the Egyptian National Bank operate until its liquidation in 1931.

Thus by 1931 Bank of Abyssinia was legally replaced by the Bank of Ethiopia shortly after Emperor Haile Selassie came to power. The new Bank, Bank of Ethiopia, was a purely Ethiopian institution and was the first indigenous Bank in Africa and established by an official decree on August 29,1931with capital of Ureao 750,000. Bank of Ethiopia took over the commercial activities of the Bank of Abyssinia and was authorized to issue notes and coins. During the invasion, the Italian established branches of their main Banks namely Banca d'Italia, Banco di Roma, Banco di Napoli and Banca Nazionale del lavoro and started operation in the main town of Ethiopia. However, they all ceased operation soon after liberation except Banco di Roma and Banco di Napoli which remained in Asmera. In 1941 another foreign bank, Barclays Bank, came to Ethiopia with the British troops and organized Banking services in Addis Ababa until its withdrawal in 1943. In April 1943, the state Bank of Ethiopia commenced full operation and acted as central Bank of Ethiopia and had a power to issue Bank notes and coins as the agent of the Ministry of finance. The bank also functioned as the principal commercial bank in the country and engaged in all commercial banking activities.

The Ethiopian Monetary and banking law that came in to force in 1963 separated the function of commercial and central banking creating National Bank of Ethiopia and give birth to commercial Bank of Ethiopia. Moreover it allowed foreign banks to operate in Ethiopia limiting their maximum ownership to be 49 percent while the remaining balance should be owned by Ethiopians.

The National Bank of Ethiopia with more power and duties started its operation in January 1964.Following the incorporation as a hare company on December 16, 1963 as per proclamation no.207/1995 of October 1963, Commercial bank of Ethiopia took over the commercial banking activities of the former state bank of Ethiopia. It started operation January 1, 1964 with a capital of Eth. Birr 20 million. In the new commercial Bank of Ethiopia, in contrast with former state Bank of Ethiopia, all employees were Ethiopians.

The first privately owned bank, Addis Ababa Bank share Company, was established on Ethiopian initiatives and started operation in 1964 with a capital of 2 million. There were two other bank in operation namely Banco di Roma S.C and Banco di Napoli S.C. that later reaplied for license according to the new proclamation each having a paid - up capital of Eth Birr of 2 million.

Following the declaration of socialism the government extended its control over the whole economy and nationalized all large corporations. Organizational setups were taken in order to create stronger institutions by merging those that perform similar functions. Accordingly, the three private owned banks, Addis Ababa Bank,Banco di Roma, and Banco di Naploi merged in 1976 to form the second largest Bank in Ethiopia called Addis Bank. Consequently Addis Bank and Commercial Bank of Ethiopia S.C. were merged by proclamation No.184 of August 2,1980 to form the sole commercial bank in the country till the establishment of private commercial banks in 1994.

There were other financial institutions operating in the country like the Imperial saving and Home ownership public association (ISHOPA) specialized in providing loans for the construction of residential houses and to individual under the guarantee of their savings. There was the saving and mortgage corporation of Ethiopia whose aims and duties were to accept savings and trust deposits account and provide loans for the construction, repair and improvement of residential houses, commercial and industrial buildings and carry out all activities related to the mortgage operations, until its changed to its current name, Construction and business Bank. on the other hand, there was a bank called Agricultural Bank that provides loan for the agricultural and other relevant projects established in 1945 and operated until it was replaced by its successor Ethiopian Agriculture and commerce bank in 1950.

In 1979, Ethiopian Agriculture and commerce bank was replaced by Agriculture and industry development bank, which was then renamed to the present, Development Bank of Ethiopia with the new objectives enacted as per proclamation number 25/1991 and council of ministries regulation no. 83/2oo2.

Subsequent to the demise of the Dergue regime in 1991, EPRDF declared a liberal economy system. In line with this, Monetary and Banking proclamation of 1994 laid down the legal basis for investment in the banking sector. Consequently, the first private bank ,Awash International bank was established in 1994. On December 31, 2013, there were 16 private and 3 governments – owned banks operating in Ethiopia.

CBE's profile

- ✓ It has more than 965 branches stretched across the country as of August 26, 2015.
- ✓ A bank with asset of birr 241.7 billion as of August 26, 2015.
- ✓ Plays a catalytic role in the economic progress & development of the country.
- ✓ The first bank in Ethiopia to introduce ATM service for local users.
- ✓ CBE has more than 10.7 million Account holders as at August 26, 2015.
- ✓ It has strong correspondent relationship with more than 50 renowned foreign banks and a SWIFT bilateral arrangement with financial institution.
- ✓ CBE combines a wide human capital base with more than 23,000 skilled and committed employees.
- ✓ Pioneer to work with Western Union Money Transfer Service in Ethiopia.
- ✓ The authorized capital of the Bank is birr 4billion (Councils of Ministries regulation no.137/2007).

Vision

To become a world class commercial bank by the year 2025.

Mission

We are committed to best realize stakeholders' needs through enhanced financial intermediation globally and supporting national development priorities, by deploying highly motivated, skilled and disciplined employees as well as state-of the art technology. We strongly believe that winning the public confidence is the base of our success.

1.3. Statement of the Problem

Risk is the major component of strategic management system and this has got an increasing special attention of the top management of banks these days than ever. As discussed in the earlier part, risk management is not an end by itself, but a key instrument in supporting the management in achieving corporate objectives and visions. This applies to the management of credit risks too. It is believe that there is a close relationship b/n company's vision, mission and general strategic orientation on the one hand, and its willingness and ability to take risks (risk appetite, risk tolerance),risk policy and risk strategy on the other hand (Keith, 1998).

While the basic components of risk management system are similar, banks often significantly differ in their visions and objectives to attain, risk culture, whose interest they maximize, what compliance requirement they are obliged by, and what risk management structure and risk infrastructure they established. For instance for banks like CBE, which has an objective of benefiting the wider society rather than simply profit making, through active participation in financing economic development programs and long term projects of the country, will inevitably require proactive risk management strategy particularly in credit risk as project financing needs long term commitment of loans. This means that the bank's risk exposure is likely to increase due to, the uncertainty involved in long time to get back its loans, the volume of loans and advances that developmental projects require by their nature and the associated requirement for the bank to keep substantial amount of capital or reserve to protect its solvency and to maintain its economic stability. Thus credit, apart from its risk, may result in risk of liquidity problem for the bank, if loans are not repaid as per the agreed period. Therefore for CBE in order to minimize such risk must perform a lot on its credit management both before and after credit disbursement. For this to happen in addition to other requirements it has to work on its human resource skill variety and level who appraise project and long term loans. Although CBE's in order to minimize such risk must perform a lot on its credit management both before and after credit disbursement. For this to happen in addition to other requirements it has to work on its human resource skill variety and level who appraise project and long term loans. Although CBE's total non-performing loans or credit default level has shown a favorable decrease ranging from 1% to 0.86% in the bank history in the last few years, it does not mean that CBE will remain with no problem of credit risk, particularly while it is intensively engaged in a long term development program financing. Because, one thing this percentage seems low but with the increasing volume of loans and advances still this it is not something to be considered as low, another is that the trend of loans and advances is still showing increasing pattern. For instance, CBE's overall outstanding loans and advances at the end of the year 2012/13 was 38.8 billion excluding bonds showing an increase of 89.3% over the preceding year balance of 20.5 billion (Annual report 2011/12). This figure has continued to show an increasing pattern in the year 2014 too, that is the total outstanding loans and advances of the bank rose to 46.7% reaching 74.6 billion including bounds (Annual report 2013/14). Hence the issue of credit risk management merits a lot for CBE more than simply risk management.

Accordingly the main focus of this paper is to asses to what extent CBE is exercising credit risk management, what tools or techniques are being practice and visional zed as the bank is aspiring to become world commercial bank by the year 2025.

Table below shows loans Disbursement trend:

Table 1 Trends in loans Disbursement, by Sector (in millions Birr)

Particular	2011/12	2012/13	Percentage change
Loans and bonds disbursement	55,441	56,506.64	1.9
Loans	31,940	34,631.64	8.42
Bonds	23,501	23,670	7.2
Pres-shipment(net increase)	2,170	2,184	6.4
Receivables	3,263	-	
Total Disbursement	60,874	66,506.64	92.5

Sources Annual report CBE's 2011/12, 2012/13.

The amount of fresh loans Disbursed to the various economic sectors during the reporting year 2011/12, 2012/13 was Birr 60.9 billion and 66.5 billion. This constituted an increase of 61.4% when compared with level in the preceding year.

Table below shows Loans collection trend:

Table 1.1.Trends in loans collection (Mn. Birr)

Particular	2010/11	2011/12	Percentage change
Term loan collection	10,156	14,643	44.2
Bonds collection	7,424	4,822	-35
DBE and Housing		2,855	
EEPCO		1,682	
Government Bonds		285	
Sub-total	17,580	19,465	10.7
Receivables- EGTE	0	1040	128.2
Total Loans collection	17,580	20,505	16.6

Sources Annual report of 2010/11, 2011/2012

The total loan collection reached Birr 20.5 billion, showing an increase of 16.6% over the preceding fiscal year. This increase was attributed mainly to the large loan collections from disbursements effected during the year under review.

Table 1.2. Trends in loans collection (Mn. Birr)

Particular	2011/12	2012/13		Percentage change
Term loan collection	14,643	27,597.20		88.5
Bonds collection	4,822	8,855.50		83.6
DBE and Housing	2,855	5,165.80		80.9
EEPCO	1,682	3,600.80		114
Government Bonds	285	88.90		(69.0)
Sub-total	19,465	36,452.70		79.2
Receivables- EGTE	1040	2,372.80		128.2
Total Loans collection	20,505	38,825.50		89.3

Source Annual report of CBE'S 2011/12, 2012/13.

The total loan collection reached Birr 38.8 billion, showing an increase of 89.3 percent over the preceding fiscal year. Despite a slight increase compared with the preceding year, the bank managed to contain its NPL level below 5 percent [standard] at 2.2 percent. Knows a day CBE's remarkably managed its NPL below 1 percent this because of good credit granting process, approval, review and loan follow up policies and procedures. Another reason for the decline NPL is maintaining good relationship with borrowers or applying know your customer principle in a good manner with all areas to whom the credit is given.

Generally from the above tables 1, table 1.1, table1.2 the ratio of total loans-collection- to- loans disbursement slightly increased as shown in the summarized table and charts below as follows:

Particular years	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Total loans Disbursement	13,575	11,902	20,225	37,710	60,874	66,506.64
Total loan collection(Mn.Birr)	7,135	9,366	10,233	17,580	20,505	38,825

Total loan collection-to loans disbursement shows an increment from year to year which is from amount 7,135 to 38,825, & 13,575 to 66,506.64 and years 2007/08 to 2012/13.

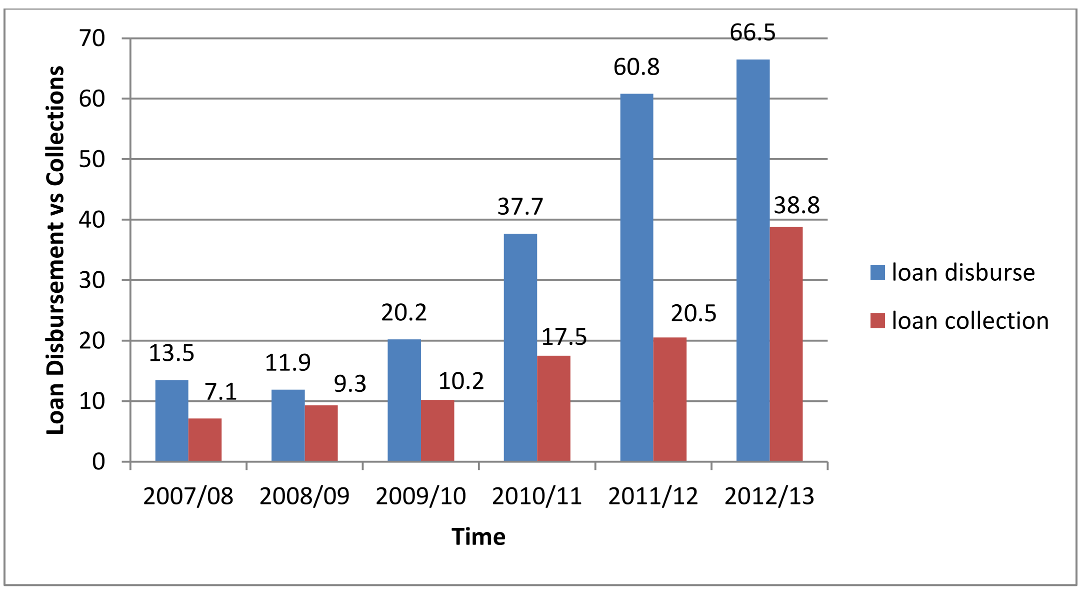


Figure 1 loans Disburse vs. loans collection, Sources Annual report of CBE's 2007/08 to 2012/13.The chart represents loans disbursement versus to loan collection shows an increasing trend and this would be support the statement that non performance loan are decreasing.

1.4. Basic Research Question

As explain in the statement of problem above, the paper try to address issues related to credit risk management practice in commercial bank of Ethiopia (CBE). That is specifically it questions:

- What is the extent and level of strategic attention and consideration given for credit risk management practice in CBE's?
- What specific techniques and tools are employed by CBE in order to mitigate credit risk?
- What gaps or deviations exist among the credit risk management techniques of CBE practice against NBE directives and international standards of credit risk management, and impact of the gap, if there is any?

1.5. Objectives of the Study

1.5.1. General Objectives

The main objective of the study is assessment of credit risk management practice in commercial bank of Ethiopia (CBE's) and to have a bigger picture of how CBE's manages its credit risk.

1.5.2. Specific Objectives

- ✓ To describe the existing credit risk taking and managing culture of CBE's.
- ✓ To Asses and evaluate the existing credit risk monitoring and controlling techniques of CBE'S.
- ✓ To evaluate the internal and external source of credit risk in CBE's.
- ✓ To Address Reporting and management information system practice of CBE's to contain credit risk.
- ✓ To evaluate the gaps in CBE's methodologies of credit risk management practice against standard of NBE and other international credit risk management conventions.
- ✓ Recommend possible solutions and remedies, if any.

1.6. Definition of Terms

Liquidity is the availability of cash or the capacity to obtain it on demand, or the quality being readily converted to cash.

Solvency shows the company's after tax income and how likely it will continue to meet up with its debt obligations.

Market risk – portion of security's stand-alone risk that can not be eliminated through diversification.

Capital inadequacy (insolvency) capital adequacy means the financial capability of the bank to meet up with its financial obligations or uncertainties that may arise and thus will reduce the risk that it may face to some extent. "An acceptable adequacy position is equivalent to saying that a bank is not over exposed to risks" (Garderner, 2007).

"Credit risk is defined as the risk of default or it is the case that a borrower fails to services its debt as agreed terms and conditions, (Duffie and Singleton,2003).**"**

1.7. Significance of the Study

Primarily the study is significant for bank to identify the focus area in the course of its credit risk management and stakeholders to know in detail a bout the bank healthy credit risk management practice because potential of the bank in maintaining its credit risk will give them loyalty and confidence to work with the bank with a different commitment. It is significant for the researcher in that, it gives me a detail understanding about the structure and management of credit, credit risk management strategy of the bank as the bank is visioning to become world class commercial bank by the year 2025 secondly, the study is significant in identifying possible gaps in CBE's credit risk management practice and tools and suggests possible remedies. Thirdly it is also important that the study may be used a source of initiating other reaches to conduct comprehensive research in the area for further.

1.8. Delimitation/Scope of the Study

The study covers contextual on the credit risk management practice of commercial bank of Ethiopia. Therefore, it has dealt only with the credit assessment, measurement and management practice, culture of credit risk management in CBE, policies and procedures that are being employed by the bank to manage such risk.

1.9. Organization of the Paper

This paper has five chapters. The first chapter addresses background of the study, statement of the problem, basic research questions, objectives of the study,) definition of terms, significance of the study, and delimitation/scope of the study. While, second chapter presents theoretical and empirical review of the related literature. The third chapter: involve Methods of the Study required to describe the type and design of the research; the subjects/participant of the study; the sources of data; the data collection tools/instruments employed; the procedures of data collection; and the methods of data analysis used. Chapter Four: Results and Discussion against the literature facts, finding of analysis and identification of possible gaps. Finally the fifth chapter comes up with conclusion and recommendation.

Chapter two

Literature review

This chapter covers the explanation of the theoretical framework/literature review and developed in a manner so as to give an insight and deep understanding of credit risk management practice in banking business. It starts with a review of the risk management (RM) concept. Then the RM concepts or practices are analyzed, tried to indicate how risk and value/return are moving together. After that, the literature focuses on credit risk and its variables which affects or influence credit risk management. It also helps the reader to identify/gain an understanding about existing ideas about the subject, concepts and theories which are relevant and above all if there are any consistencies or implications on the research area that is Commercial Bank of Ethiopia's practice.

2.1. 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 (answer com, 2010). Risk on the other hand can be defined as the possibility that something unpleasant or dangerous might happen (Macmillan Dictionary, 2002). Furthermore according to the International Organization for Standardization (ISO) "risk management is a central part of any organization's strategic management it is the process whereby organizations methodically address the risks attaching to their activities with the goal of achieving sustained benefit within each activity and across the portfolio of all actives (IRM, 2002). The key phrases in the sentences above are in bold. That is risk management is also a process and its primary mission is to bring benefits to the companies and makes them sustainable. And it is also at the heart of any firm's strategy. When companies indulge in business, it is obvious that they will be exposed to one type of risk or another which in most case 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 increasing regulations requirement they operate, diversification and the competitive environment in which they find themselves (Williams et al 2006).

Even though it is certain that risk will occur, it is not always possible in most cases to eliminate, reduce or ameliorate it (Keith, 1998). 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 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). 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 managing the risk is call 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, 1998). This course of action linked, gives rise to a RM process which involved a number of stages. RM is very important and forms a main part of any organization's activities because its efficiently since it is a continuous process that depends directly on the changes of the internal and external environment of the organization (Tchankova, 2002).

Looking at the process below, it shows that before risk can be managed, it must be identified. Once the risk is identified, measures are taken to measure its intensity or to evaluate the outcome of the risk, and assessment of the consequences is being done, control measures are then put in place to avoid or reduce its intensity and after that good monitoring is being done to see whether the expected outcomes are as desired.

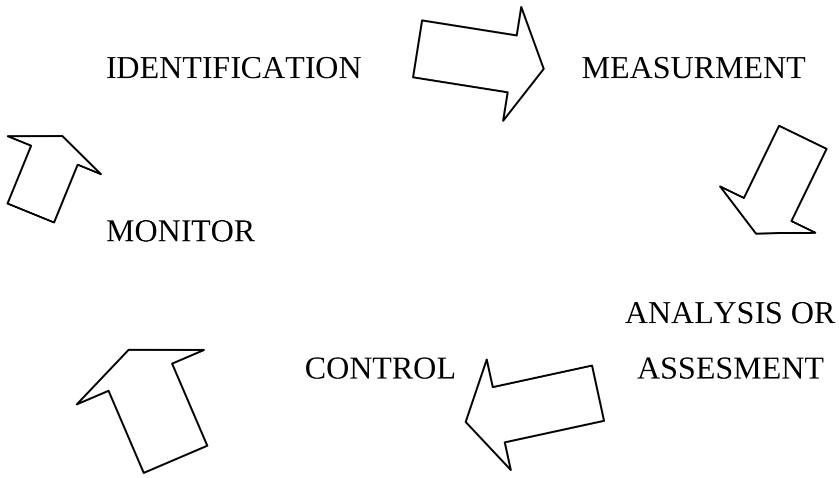


Figure 2 : Risk management process

Source: Keith (1992,1998).Finance and Financial Markets

2.1.1. Risk Identification

RM 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 I 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 RM 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 (Techankova 2002). That is why risks related to gains and losses must be identified. The inability to identify the risks of one is as in the bank is appropriate 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, 1998). During the process of risk identification, the bank 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. Given the importance of risk identification in the risk management process, managers don't have to focus their attention on what can be insured or mitigated but should start with the following questions as put forward by (Tchankova, 2002). How can the organizational resources be threatened, what adverse effect can prevent the organization from achieving its goals, and what favorable possibility can be revealed? Starting the identification at this point will give a good kick-off for implementation and no barriers to the type of risks that will be identified.

2.1.2. Risk Measurement

Risk measurement comes in after the identification phase to give an understanding of the nature and level/extent of the risk so that it can be managed in an appropriate manner. This is because without risk measurement the intensity of effect or consequences which can result from the identified risk if neglected cannot really be analyzed. A good risk measurement will determine the risk management techniques that have to be put in place to manage the said risk. This will go along to bring out the extent and cost associated with the risk should it occur and the company in question then uses the known results to see how much value is at stake or cost is associated.

A good risk measurement and understanding is thus vital for the bank so that it will not only settle on the risk considerably but will also improve on her performance drastically so as to improve safely and profitably. This will also help to determine how much effort has to be put in place or the degree of seriousness on how to manage the risk. For competitive and regulatory reasons, it is necessary for all banks to have a sound risk measurement framework. Risk measurement simply put, is the evaluation of the outcome of risk using a set of risk factors which can be observed and measured. A risk factor is something that is likely to increase the chances that a particular event will occur. To measure the different types of risks, different techniques ranging from traditional simple to sophisticated ones are being used. Some include, Value at Risk (VAR), duration analysis, sensitivity analysis, stress testing and scenario analysis. Even though all banks may be faced with the same type of risk each may use different risk measurement techniques depending on their individual choices.

2.1.3. Risk Analysis 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).** 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).** 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).** 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). For example, low (tolerable), Medium (low as reasonably practical) and High (intolerable) this ranking then determines the decision or stand point of the bank but what should be noted it that a decision depends on each bank independently.

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 or its financial consequences and other undesirable results of risks (Keith, 1998). 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 form that of another bank. So, it is very important that all the aforementioned points be considered when assessing risk control (Keith, 1998).

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).** This is because any neglected or minimized risk can have very long term big and negative consequences since the banking activities are so interrelated.

2.2. Banking business, Credit Risk and Return

The banking business, compared to other types of business, is substantially exposed to risks, especially in this ever-changing competitive environment. Banks no longer simply receive deposits and make loans. Instead, they are operating in a rapidly innovative industry with a lot of profit pressure that urges them to create more and more value-added services to offer to and better satisfy the customers. Risk are much more complex now since one single activity can involve several risks. For example, according to **Greuning & Bratanovic (2009)** different types of banking risks are classified into major three categories as follows;

Table1.3: showing classification of risk.

Financial risks	Operational risks	Environmental risks
Balance sheet structure	Internal fraud	Country and political risks
Earnings and income statement structure	External fraud	Macroeconomic policy
Capital adequacy	Employment practices and workplace safety	Financial infrastructure
Credit	Clients, products, and business services	Legal infrastructure
Liquidity	Damage to physical assets	Banking crisis and contagion
Market	Business disruption and system failures (technology risks)	
Interest rate	Execution delivery and process management	

Source Keith Pilbeam. (1998).Finance and financial Markets

While financial and operation risks can occur due to the organization subjective reasons environmental risks mainly deal with objective factors in the bank's business environment that somehow are out of its control. On the other hand 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 delaine 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).**when this risk arises, It leads to less capital adequacy because the bank will look for other sources of finance to cover up the loss. It will also to less liquidity to meet up with other customers demand and thus less Profitability because of a slowdown in business or even bankruptcy. this goes to show the credit risk and returns are so intertwined, the more credit risk, the less returns and vice versa. But there is also a tradeoff between the two riskier securities (higher yield loans) pay risk premium (higher average return) because there is greater uncertainty of payment so, average revenue and thus value/ returns can be increased only by increasing risk.

2.3. Credit risk management in the 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) this means if credit risk is not well managed it can lead to failure. Thus for any bank to succeed, its 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 correct management of credit risk is very important is because banks have limited capacity to absorb loan losses and this looses can be covered only by using income is used generated by other profitable loans or by bank capital (Boffey and Robson) if the income generated by other profitable loans or by bank capital (Boffey & Robson, 1995).if the income is used from these two sources to meet up for loan that has not been paid this action will go a long way to affect the capital adequacy of the bank, its liquidity and 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 bank gives out a loan, it should try as much as possible to have a concrete view of the borrower (Greuning and Bratanovic 2003) says" because of the potentially dire effects of credit risk it is important to perform a compressive evaluation of a bank's capacity to assess administer supervise enforce and recover loans advances, Guarantees and other credit instruments''.

The bank has to possess its capability of how to recover a loan from a customer while reviewing its credit risk management policies and practices as outlined by the board. This means that the credit risk management process has to be followed in order to ensure that granted loans can be recovered in time if not, a good collateral can be got in replacement of the loan. Each bank obviously has to develop its own strategies so as to fight competitors in the same industry by being successful.

The bank has to assess the credit worthiness of the borrower and even after the loan is granted, interim monitoring is required until when the borrower has finished repaying the loan. 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)** .

2.3.1. Credit Risk Management policy/philosophy

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 mange 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 known if they are doing the right thing at the right time. **Maness & Zietlow(2005)** 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 each discount (if any)
- Cruet limit- This is the dollar amount that cumulative credit purchases can reach for a customer if credit is extended.
- Collection procedures – there is detail statement regarding when and how the company will carry out collection of past due accounts. Despite the rule ,it does not mean that the credit policies are stereotyped. A good lending policy is not overly restrictive , but allows for the presentation of loan to the board that officer believe are worthy of consideration but which do not fall with in parameter of written guidelines''.(Greuning &Bratanovic, 2003).
  - ✓ Polices aimed to limit or reduce credit risk (concentration and large exposures, adequate diversification lending to connected parties or over exposures)

- ✓ Policies of assets classification (mandate periodic evaluation of collectability of the portfolio of loans and other credit instruments, including any accrued and unpaid interest, which exposé a bank to credit risk).
- ✓ Policies of loss positioning (making of allowances at level adequate to absorb anticipated loss).

2.3.2. Credit Risk management practices.

As banks have different credit risk management polices /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 type. 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 of risk tolerance. Each and every bank has their individual level of risk that they can decide to let go based on how it outlined in their risk management policy. To summarize this it is clear that the same industry, but the implementation in practice differs. practices is not consistent with theory. In most cases because of data limitation for most industries, it is difficult to describe which firms mange 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).**

2.3.3 credit risk management strategies

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 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 difference will be different for each bank or company. Given the competitive environment in which banks operate, it is always good to have 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 activates differently than rivals do (porter 1996). When a bank carries out its operational activities which are same activities carried out by other banks, they should try to a make difference from their rivals by not only trying to be more efficient but by trying to make difference in effective way. 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 risk 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 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 consultative paper 1999).

2.3.4. Credit culture

A lending organization credit risk management framework is designed under and umbrella guideline called - credit culture. covers the ''attitudes, perceptions, behaviors, styles, and beliefs that are conducted and practiced throughout the credit organization as result of management attitudes to wards credit risk''. it is usually presented in the "mission, objectives, and lending strategies to legitimatize the values placed on credit quality and safe sound lending practices'' (Colquitt 2007).

credit culture supplies general frame work to guide day - to -day credit decision. further 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 polices, practices, philosophy and management style that are being put in place to act as 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 and Robson, 1995), credit culture is defined as a combination of factors

that establish a lending environment's 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 guideline for a good bank credit management, performance and may be failure. Even if there is 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

2.3.5. 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. 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 its 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 activists 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 done because credit risk aver important and delicate risk banked face and needs to be managed with great care/ precaution because it 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 and Bratanovic 2003).**

2.4.Principles Formulated By the Basel Committee

As a direction for the achievement of the required level of loan status and healthyfinancial institutions the Basel Committee on Banking Supervision in September 2000also formulated the following Principles

A) Establishing an appropriate credit risk environment

Principle 1: The board of directors should have responsibility for approving and periodically (at least annually) reviewing the credit risk strategy and significant credit risk policies of the bank. The strategy should reflect the bank's tolerance for risk and the level of profitability the bank expects to achieve for incurring various credit risks.

Principle 2: Senior management should have 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 and at both the individual credit and portfolio levels.

Principle 3: Banks should identify and manage credit risk inherent in all products and activities. Banks should ensure that the risks of products and activities new to them are subject to adequate risk management procedures and controls before being introduced or undertaken, and approved in advance by the board of directors or its appropriate committee.

B) Operating under a sound credit granting process

Principle 4: Banks must operate within sound, well-defined credit-granting criteria.

These criteria should include a clear indication of the bank's target market and a thorough understanding of the borrower or counterparty, as well as the purpose and structure of the credit, and its source of repayment.

Principle 5: Banks should establish overall credit limits at the level of individual borrowers and counterparties, and groups of connected counterparties that aggregate incomparable and meaningful manner different types of exposures, both in the banking and trading book and on and off the balance sheet.

Principle 6: Banks should have a clearly-established process in place for approving new credits as well as the amendment, renewal and re-financing of existing credits.

Principle 7: All extensions of credit must be made on an arm's-length basis. In particular, credits to related companies and individuals must be authorized on an exception basis, monitored with particular care and other appropriate steps taken to control or mitigate the risks of non-arm's length lending.

C) Maintaining an appropriate credit administration, measurement and monitoring Process

Principle 8: Banks should have in place a system for the ongoing administration of their various credit risk-bearing portfolios.

Principle 9: Banks must have in place a system for monitoring the condition of individual credits, including determining the adequacy of provisions and reserves.

Principle 10: Banks are encouraged to develop and utilize an internal risk rating system in managing credit risk. The rating system should be consistent with the nature, size and complexity of a bank's activities.

Principle 11: Banks must have information systems and analytical techniques that enable management to measure the credit risk inherent in all on- and off-balance sheet activities. The management information system should provide adequate information on the composition of the credit portfolio, including identification of any concentrations of risk.

Principle 12: Banks must have in place a system for monitoring the overall composition and quality of the credit portfolio.

Principle 13: Banks should take into consideration potential future changes in economic conditions when assessing individual credits and their credit portfolios, and should assess their credit risk exposures under stressful conditions.

D) Ensuring adequate controls over credit risk

Principle 14: Banks must establish a system of independent, ongoing assessment of the bank's credit risk management processes and the results of such reviews should be communicated directly to the board of directors and senior management.

Principle 15: Banks must ensure that the credit-granting function is being properly managed and that credit exposures are within levels consistent with prudential standards and internal limits. Banks should establish and enforce internal controls and other practices to ensure that exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.

Principle 16: Banks must have a system in place for early remedial action on deteriorating credits, managing problem credits and similar workout situations.

2.4.1.Common Sources of Major Credit Problems

1. Most major banking problems have been either explicitly or indirectly caused by weaknesses in credit management. In supervisors' experience, certain key problems tend to persist. Severe credit losses in a banking system usually reflect simultaneous problems in several areas, such as concentrations, failures of due diligence and inadequate monitoring.

2. Concentrations are probably the single most important cause of major credit problems. Credit concentrations are viewed as any exposure where the potential losses are large relative to the bank's capital, its total assets or, where adequate measures exist, the bank's overall risk level.

3. Banking supervisors should have specific regulations limiting concentrations to one borrower or set of related borrowers, and, in fact, should also expect banks to set much lower limits on single-obligor exposure. Most credit managers in banks also monitor industry concentrations. Many banks are exploring techniques to identify concentrations based on common risk factors or correlations among factors. While small banks may find it difficult not to be at or near limits on concentrations, very large banking organizations must recognize that, because of their large capital base, their exposures to single obligors can reach imprudent levels while remaining within regulatory limits.

4. 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.

5. 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.

6. 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 celebrity.

7. 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. 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.

8. 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 bank's 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.

9. 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 fraud. 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.

10. 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.

11. 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 borrower's losses are limited to its net worth.

12. Many banks' credit activities involve lending against non-financial assets. In such lending, 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 may 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.

13. 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 business cycle, credit analysis may incorporate overly optimistic assumptions. Effective stress testing which takes account of business or product cycle effects is one approach to incorporating into credit decisions a fuller understanding of a borrower's credit risk.

14. More generally, 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. Many lenders fail to "stress test" or analyze the credit using sufficiently adverse assumptions and thus fail to detect vulnerabilities.

Credit Analysis

Credit analysis is the primary method in reducing the credit risk on a loan request. This includes determining the financial strength of the borrowers, estimating the probability of default and reducing the risk of non repayment to an acceptable level. In general, credit evaluations are based on the loan officer's subjective assessment (or judgmental assessment technique).

Once a customer requests a loan, bank officers analyze all available information to determine whether the loan meets the bank's risk-return objectives. Credit analysis is essentially default risk analysis, in which a loan officer attempts to evaluate a borrower's ability and willingness to repay.

Credit Information

Adequate and timely information that enables a satisfactory assessment of the credit worthiness of borrowers applying for a bank loan is crucial for making prudent lending decisions. Prudent lending decisions made on the basis of adequate information on the creditworthiness of borrowers are one of the principal factors in ensuring the financial soundness of banks. But, there has been serious difficulty in Ethiopia of getting accurate and timely information on prospective borrowers that facilitates the making of such prudent lending decisions. One of the means for alleviating this difficulty of getting accurate and timely information on prospective borrowers is the establishment of a Credit Information Center (CIC) where relevant information on borrowers is assumed to be pooled and made available to lending banks.

According to article 36 of the Licensing and Supervision of Banking Business Proclamation No. 84/1994, the National Bank Ethiopia (NBE) has issued these directives to establish such a Credit Information Center (CIC). Though there is still serious limitations in the accuracy of the credit information extracted the summary of the directive is as follows:

- Banks shall provide, alter and update credit information on each and every one of their borrowers using online system.

- Upon written request by banks, the Supervision Department of the NBE shall provide to the requesting bank, in writing, all credit information available in the Central Database on a prospective borrower within three working days from the date of receipt of the request;
- Access to the Central Database shall be restricted to the user group;
- The role of the NBE shall be restricted to administering the Credit Information Sharing system, providing in writing credit information on borrowers available at Credit Information Center to banks, ensuring that access to online system to update or alter credit information is given only to authorized persons and ensuring that the system is operating smoothly and reliably;
- The NBE shall not be responsible for any damages, claims or liabilities that may arise as a result of inaccurate, misleading or incomplete credit information on borrowers supplied

to the Credit Information Center by individual banks and shared, through the NBE, with other banks.

- Each bank shall provide, electronically, the initial credit and other related information to the Credit Information Center on each and every one of its borrower;
- Each bank shall be fully responsible for providing accurate, complete and timely credit information to the Credit Information Center. In cases where errors have been made, such errors shall be corrected promptly by the concerned bank;
- Each bank shall be fully responsible for any damages, claims or liabilities that may arise as a result of providing inaccurate, misleading or incomplete credit information to the Credit Information Center or failure to provide, inadvertently or otherwise, information to the Center that should have been provided in line with these directives;
- Each bank shall use the credit information on borrowers obtained from the Central Database of the Credit Information Center only and only for making a lending decision. Such information shall be treated with utmost confidentiality and shall not be disclosed to any third party or used for any other purpose;
- Each bank shall be fully responsible for any damages, claims or liabilities that may arise as a result of disclosure of credit information on borrowers obtained from the Credit Information Center to third parties or use of that information for purposes other than for making a lending decision.

2.5.Credit risk and financial distress

One of the bank's main reasons of fighting for a good credit risk management is to avoid financial distress. The financial viability of a bank is very important for its success. Managers are more and more being obliged to meet up with the financial obligation and expectations, manage risk and increase share holders values. This is very important because given the function carried out by banks of being an intermediary between lenders and borrower's, a lack or shortage in liquidity can lead to adverse effects on it not being able to meet up with the demand of its customers. This can lead to an effect called financial distress. Financial distress is when the obligations to creditors are not meet or are meet with difficulty(Arnold,2008). Financial distress arises when a bank starts experiencing financial problems that may force it to close, merge with another banks, declare bankruptcy, eliminate services, or take actions that have adverse effects on the financial services delivery system of a region(Trussel & Patrick,2009).

2.6. Credit scoring

A credit granting process comes in place when a company which needs a loan from a bank or lending institution hands in an application demanding for a loan. This application then goes through some procedures or processing in the bank evaluates the application using their individual evaluation method to determine the credit worthiness of the company. some banks does the evaluation using number (credit scoring) while other does so using subjective evaluation like personal identification of the company or the owner. Credit scoring is a statistical technology that quantifies the credit risk posed by a prospective or current borrower and seeks to rank them. So that those with poorer score are expected to perform worse on their credit obligations than those with better scores (Aveny, Brevoort & Canner, 2009). credit scoring has an advantage in that it saves time, cost and believe to increase access to credit, promote competition and improve market efficiency. credit scoring reduces subjective judgment and possible biases during the credit assessment process (Kraft, 2002). This is to say no matter when or who is doing the evaluation, the result is always same because it is computerized. This shows that if a good credit scoring is taken by a bank before granting loans to customers, it can determine the ability of the customers to pay back the loans although in some cases it may not really be a guarantee since the future is uncertain. The way things or situations can be seen today may change tomorrow and obviously affect already taken decisions.

2.7. 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 customer who will not be able to pay back or refuse to give to a customer who is good and has the potential of meeting up with the repayment. To go about a good analysis of potential creditors, the five Cs of a credit have been introduced as a guide for a 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). 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 business plan, Cash flow, history management, etc.

The capacity of the company incorporated 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 serve as the final source of repayment and protection against loan loss.

2.8. Credit granting

When a customer demands for a credit the bank can't just grant the loan because the demand has been made. The bank does so while looking at its policies on credit granting. This is important because the bank has to know the credit worthiness of the customer and its capability of repaying the loan. A credit granting decision is very important and delicate issue to be handled by the bank. This is because banks need to examine and measure any activity which affects their risk profile and must closely monitor accompanying conditions. Loans are the main areas where banks make profits but are also the biggest areas of risk. Thus for the bank to effectively carry out its risk management, it is always good to evaluate the credit profile of the transaction in Question. This is to say the bank has to look at the purpose of the loan, how it is to be repaid, the repayment history of the borrower of previous loans, its capacity and even the collateral in order to be sure that it is equivalent to cover the loan in a case of default.

Given the importance and implications of credit granting decisions, many research papers have been written based on it because a mistake in it can be very disastrous to the bank. The written works have almost the same elements that have to be considered before granting a loan to a customer. This is because when good decision are taken, it is as if the loan is almost paid. for example Maness & Zietlow(2005) said any decision on whether to grant a loan and how much credit to give is taken based on four steps; developing credit standards, gathering necessary Information about the customer, applying credit standards, and setting limits. Developing credit standards refers to the minimum standards a customer has to fulfill before he or she can be extended credits. These standards should be set while looking at the customers character (i.e. morals, integrity, trustworthiness and management quality, capital, capacity (i.e. its ability to repay debts when due), conditions (the general economy, the borrower's environment and the reasons for the loan request), and collateral (the asset which is given as a security to back up the loan).

Gathering necessary information about the borrower is done so as to help the bank to evaluate the possibilities of the borrower repaying the loan or its credit worthiness. Applying credit standards is done after the necessary information has been gathered. From the information, it is analyzed if the customer has to be granted the loan. If so, how much is to be granted. In setting the limits of how a borrower can be approved of the loan the bank can be use credit scoring to choose those to whom the loan can be granted. This is done because it is often difficult for the bank as a lender to observe borrowers probability of default. Credit scoring is a model used by lending institutions to rank potential customers according to their default risk which can improve the allocation of resources from a better to a best position (Jacobson & Roszbach 2003). Thus, it is important that each bank has a procedure or guideline on how to make its credit decision.

2.9. Asymmetric Information

Although it is known that bank has to have information about the borrower before taking its credit granting decisions, there is no guarantee that the borrower will give all the information about itself. Some, Borrowers may have some vital information which could have helped the bank when taking the credit granting decisions but refused to give them because they think that in will act as a barrier of the loan being granted to them or may reduce their credit limit. This type of information which is known only to the borrower and hidden from the bank about a customer it has already financed is called asymmetric information (Shibata & Tian, 2010).The theory of asymmetric information is a new development in the Economics of uncertainty brought forward by Kenneth Arrow, Gerard Debreu and may others in the first decades of the postwar period (Sandmo, 1999). Their emphasis was on exogenous uncertainty, the source of which were found outside the economic system itself. They talked of uncertainty in the case were individuals had different types of information, with the typical situation being they has private information about their own characteristics that not directly available to other people, Like those responsible for the design of public polices. To make this clearer, they used two examples firstly, they talked of a situation between employers and his or her employees, where the employees have information about their own preference and skills that are not observable by the employer.

Another example is where buyers and sellers have different information about the good to be traded. The provider of a good for example a public good, will always like to have information about the willingness to pay of the consumers who will benefit from it, but of which the consumers are the ones who possess this information for themselves.

FIs (in this case banks), can also face this problem because of the positive role they play of channeling funds from savers to borrowers. Lack of enough information about these people (especially the borrowers) can be very detrimental. Asymmetric information between the bank and borrower exist when either the borrower or the bank has better information about the financial circumstance and prospects of a project or firm than their counterpart (Bruns, 2004). if the bank fails to have enough information about a borrower's potentials to repay the loan, and goes ahead to grant loans (without a good collateral security), it will lead to problems on the banks which can even go as far as affecting the savers should they turn up for cash withdrawals or even bankruptcy.

It should be noted that information asymmetry does only imply when a borrower refuses to give information about itself to the bank. It also refers to a case where the bank can hide certain information about itself or its management forecast from the borrower just they want the deal to be favorable but to them. Information problem can also arise from information differences and conflicting incentives between the banks, the savers and borrowers (Healy & Palepu, 2001). So, for good credit risk management to take place, it is always good for both parties to have adequate information about each other.

2.10. Credit collection

There is no guarantee that when a bank has a good credit policy, its credit activity cannot encounter problem. There are probable some borrowers who will pass the due date and some may be delinquent. credit collection procedures have to be implemented on how to collect the Loans. It will become a problem if the credit collection procedures were not well formulated, or if the implementation is not well carried out, or if the credit policy was not followed. This is because if the borrower repays late or defaults payment, the bank will obviously look for other means to meet up with this financial loophole. This can result to increased debts, which can lead to higher interest payments, reduced profits, reduced borrowing capacity, increased equity, reduced shareholders value, reduced future capital investments, limiting the bank's long term business performance, or an increase in the length (thus amount) of trade credit taken from suppliers (Maness & Zietlow, 2005). So it is a very important duty of the bank to accelerate its loan collection so as to avoid the above mentioned consequences.

Even though the bank has to collect it loans, while collecting or using efforts to collect them, it has to make sure that it collects the amount owed as close to the credit terms as possible but must always try to preserve customers goodwill when doing so (Maness & Zietlow,2005) This is because some customers may fail to pay back their loans as a result of the fact that they may be experiencing temporary problems. If the bank's personal efforts to collect these loans fail, they can then introduce a collection agency.

2.11. Bank and Customers relationship effect on loan risk

The relationship between a bank and its customers is very vital for its success. This is because it is very similar to a parent and child relationship. When a parent has a cordial relationship with the child, it is always very possible to know in advance from the child's behavior (without he or she telling them) that something is not moving on well with the. This is always done because the parent has developed a dialoguing attitude with the child making him or her to always feel free to inform them of any problem and will give them advice on how to handle certain issues in life even before they encounter them.

Building a good customer relationship with the borrower is also good for the bank because this will help the borrower to develop loyalty and trust and they will know that if they present the bank with a difficulty, they are not going to get a black stare. It will also help the borrower to bring to the notice of the bank in advance of any problem they might be facing thus giving the bank greater chance and possibility of handling the problem in advance. In the case of a good relationship, the bank can also give the customer advice on how to handle a problem in advance before it dawns on them. This will go a long way to profit the bank because the customer will be able to pay back their credits in time. When the bank also has a good relationship with the customer, it will be possible to call them at any point in time to ask how their business is moving. This can lead to better advice in time before things go off hand. But if the relationship is not good, it will lead to totally negative consequence from the ones mentioned above and even in a situation of difficulty the bank will only come to realize when the customer is not able to pay back the credits or bankrupt and this will go a long way to affect the bank negatively as well.

Empirical works like that of (Dahiya, Saunders& Srinivasan, 2003) says banks are likely to be better informed about the financial status of their borrowers and thus will be able to take steps to reduce their loan exposures before the news of a borrower's distress becomes public information if they had maintained a good relationship.

2.12.Selecting the credit Risk management standards

Althoughit is very difficult to select a single set of universal standards for credit risk management principles as they operate in different circumstances, for the purpose of this study, it is very essential to a look at some of the national standards developed by the national bank (NBE) country experiences and international standards like those which are indentified by Basel committee of Banking supervision.

2.12.1. National standards on credit risk Management set by National Bank of Ethiopia (NBE)

For example ,the national bank of Ethiopia (NBE), (May, 2010) in its revised Bank Risk Management Guide line has emphasized for the most common and interrelated risks facing banks in the country namely credit, liquidity, market and operational risks, and the need on strong risk management practices in all banks operating in the country, further this document indicates that consistent with international standards and best practices, is expected to provide indicates that consistent with international standards and best practices is expected to provide minimum risk management in the banks. More specifically in section two of same document National Bank of Ethiopia has put the credit Risk Management Guide line in detail, as 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 and its off-balance sheet accounts.

Therefore, according to NBE Guide line Banks need to have separate and responsible body of credit risk management to be developed and implemented by. The credit risk management practice of banks should address in detail the following issues.

1. **Board and senior Management Oversight of Credits**
    - ✓ Segregated Board and Management Responsibilities

2.**Establishment of Credit policies, Procedure and Limits like;**

- ✓ Detail Credit Analysis and Approval process
- ✓ Delegation of Authority for Loan Approval
- ✓ Related party Transactions
- ✓ Lending to connected parties
- ✓ Issues of Credit Limits and credit concentration
- ✓ Credit Risk Mitigation strategies

3. Measurement Monitoring and control

- ✓ Availability of Credit administration policies
- ✓ Maintaining effective credit filing system
- ✓ Credit Monitoring procedures
- ✓ Internal Risk Rating
- ✓ Stress Testing (test that indicate future changes in economic conditions that could have unfavorable effects on a bank's credit exposures and assessing the bank's ability to withstand such changes)
- ✓ Managing problem Loans/ Non performing Loans
- ✓ Management Information system and Measuring Credit Risk

4. Internal controls and Reporting

Generally, the goal of credit risk management, according to the NBE is to maintain a bank's credit risk exposure within parameters set by the board of directors and senior management. The establishment and enforcement of internal controls, operating limits and other practices will help to ensure that credit risk exposure do not exceed levels acceptable to the individual banks.

2.12.2. Experience of other countries Tanzania Bank of Tanzania (BOT)

Bank of Tanzania (BOT), which is playing role of monitoring in the country just like NBE of Ethiopia, in the year 2010, has also developed Risk Management Guidelines for Banks and Financial institutions to enhance risk management practices among banking institutions in Tanzania. According all banks are therefore required to observe these guidelines in the course of conducting their businesses.

The guideline covers six most common risks in banking i.e. credit, liquidity, market, operational, strategic and compliance risks. Thus, credit risk management guide line is one of which this guide line has given strong attention by putting remark that most common credit problems are coming from credit concentrations and credit process issues. Moreover BOT has indentified same standards as NBE with some additional elements like.

- ✓ **Formulating credit strategy**
- ✓ **Organizational structure and**
- ✓ **Development of Information system**

Here one can understand that national standards are more or less similar at the center of the national monitoring institutions as in NBE and BOT; however the difference may lay on the practical implementation of individual banks in each state.

2.12.3. International standards of credit Risk Management

Credit risk remains the most important risk that banks have to manage in the world today. Experience all over 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. While financial institutions have faced difficulties over the years for a multitude of reasons, the major cause of serious banking problem continues to be directly related to lack of credit standard for a borrowers and counter parties, poor portfolio risk management, or a lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of a bank's counterparties. Thus, banks need to establish and manage credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions.

Consequently, one of the international organization that works on banking regulation, Basel committee in September (2000) has issued a document in order to encourage banking supervisors globally to promote sound practice for managing credit risk. In this document, the committee has identified that what a sound practices of credit risk should address. These are

- ✓ **Establishing an 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 risk**.

Although specific credit risk management practices may differ among banks depending upon the nature and complexity of their activates, a comprehensive credit risk management program should address these four (4) areas. More over these four areas contain seventeen (17) separate individual and detail principle that explain what specific activities should the banks undertake in order to manage credit risk, that are more or less similar to the standards of NBE of Ethiopia.

Therefore, for this paper the main standards, principles and measurements to assess credit risk management practice incorporate all these concepts.

2.13. Variables which affect or influence credit risk management

2.13.1. Sources of Credit Risk

There are two main sources of credit risk factors. These are external and internal risk factors. The External risk factors are discussed below as follows:

2.13.2. Economic Conditions

Change in national income and unemployment will have impact on credit risk through change in business cycle, exchange rate, interest rate, credit availability and credit quality. Liquidity crunch or financial problems has the ability to impact borrowers' ability to fulfill their obligation. In addition legal and regulatory change could cause financial institutions to change how they oversee a transaction, as well as the quality and ability of debt collection.

2.13.3. Competition

Competition among financial institutions in terms of growth, profitability and the desire to be a market leader have the ability to cause financial institutions to lower their standards or improperly price their loan products. This could result in higher cost of increasing non- performing loans.

The internal risk factors of credit risk include;

2.13.4. Underwriting standards

This is a process to determine what type of, to whom, for what purpose and when credit should be granted. Proper credit approval process should comprise proper guidelines on both form and methodology in evaluating borrowers' credit worthiness, setting up of credit line and interest rate appropriate to borrowers' risk and credits. Lenient credit underwriting can incur losses to financial institutions especially when debt repayment cannot be demanded or collateral cannot be seized in time. Many credit risks arise from deficiency in underwriting standards and credit monitoring.

2.13.5. Credit Culture & Risk Profile

Understanding the credit culture and risk profile of a bank is central to successful loan portfolio management. Because of the significance of a bank's lending activities, the influence of the credit culture frequently extends to other banking activities. It is important that staff members throughout the bank should understand the bank's credit culture and risk profile.

A bank's credit culture is the sum of its credit values, beliefs and behaviours. It is what is being done and how it is accomplished. The credit culture exerts a strong influence on a bank's lending and credit risk management.

2.13.6.Risk Tolerance

In additionto establishing strategic objectives for the loan portfolio, senior management and the Board of Directors are responsible to set the risk limits on the bank's lending activities.

Risk limits should take into account, the bank's historic loss experience, its ability to absorb future losses, and the bank's desired rate of return.

Limits may be set in various ways, individually and in combination. (*e.g. applied to a characteristic of loans, volume of a particular segment of the portfolio, and the composition of the entire loan portfolio).*

Loan Size Limits (Rationing) prevents the institution from being vulnerable to nonperformance on a few large loans.

Limits on loans to certain industries or on certain segment should be set in line with its impact on the whole portfolio.

2.13.7.Credit Risk Mitigation policy

Credit risk can be moderated by the loan structure. Parties to a loan can arrange for mitigants such as collateral, guarantees, letters of credit, credit derivatives, and insurance during and after the loan is underwritten. Credit derivatives are also been used to efficiently transfer risk while preserving customer relationships.

Although these mitigant have similar effect, there are important distinctions, including the amount of loss protection that must be considered when assigning risk ratings. For example, a letter of creditmay affect a loan's risk rating differently than a credit derivative.

Credit mitigants primarily affect loss when a loan default and, except for certain guarantees, generally do not lessen the risk of default. Therefore, their impact on a rating should be negligible until the loan is classified. Examiners should be alert for ratings that that overstate how much of a loan's credit risk is mitigated. Account officers at time assign less severe ratings based on the existence of collateral or other mitigants rather than undertaking a realistic assessment of the value the bank can recover.

2.13.8.Employees major filed of specialization in their study, experience, competency and educational qualification.

From credit risk management point of view, it is believed that retaining highly qualified ,competent and experienced employees in the credit would benefit in managing credit risk .

Competence of staff:

Credit officers without the necessary expertise in the activities they are responsible for, be it credits, investment, management of problem assets or new products, can lead to poor lending practice, ineffective administration, and eventually, loss to financial institutions.

2.13.9.Credit polices ,procedure and limits in managing credit risk

The importance of credit risk can never be undermined when carrying our lending decision because the bank has to be sure to recover the money it is giving out especially as its continuous functioning depends on it. So that having credit policies, procedure and limits are more significant and helpful to contain a good credit risk.

2.13.10.Employee's contribution in managing credit risk.

For any activity to achieve success, human resource is always at the heart because activities are exercised by the human. Employees at the organization would be considered as important factors for healthy credit risk management. In addition to this job related training (credit related training) given to employees determines whether or not credit risk is going healthy or bad.

2.13.11.Reporting and management of information system (MIS)

There should be ongoing reporting of information system embedded in business process that should be performed by all employees with in the frame work of their tasks in institution. Existence of poor horizontal integration and flows information among departments, and with management information system increases credit risk. So here technology is one factor that plays great role in managing credit risk by improving reporting structure and quality of management information system.

Risk will increase if management does not regularly receive accurate and timely reports on credits. The reports shall comprise important information relating to underwriting process such as economic trends, change in the structure of industry, or market share, commodity prices, exchange rates, including past due credits, credit concentrations, and analysis of problem loans.

What Information Are Required for Credit Risk Analysis?

Sound credit risk analysis would depend on a number of Critical piece of information such as;

- Purpose of the loan/credit,
- Amount required,
- Repayment capacity of the borrower,
- Duration of the loan/credit,
- Borrower’s contribution,
- Security aspects & insurance protection,
- Borrower’s character,
- Business plan & projections,
- Environmental considerations, and Other considerations

2.13.12.Inappropriate assessment of credit quality

This problem may result from competitive pressure and credit growth as they tend to put a time constraint on getting accurate data. Moreover, rapid growth and/or entry into new markets can tempt the management to lend without sufficient financial and economic analysis. To facilitate quicker decision making, management may support credit decisions by using simple indicators of credit quality such as borrowers' characteristics, current and expected value of collateral or support of a parent company or affiliated companies.

2.13.13.Credit Review

Independent and on-going credit review with accurate credit grading, appropriate amount and scope, and reporting to the management comprise good credit review since it allows financial institutions to monitor risk management and solve credit problems in an appropriate and timely manner. Such will prevent loss from failure of borrowers or counterparties to fulfill their obligations.

2.14. Summary of theoretical framework

The theoretical has tried basically to bring out theoretical concepts connected to credit risk management process. The frame work from the inception of the risk what analysis has to be done before deciding whether to give credit to a customer, through when the credit is given and to when it is collected. It might be difficult to bring out a model which incorporation all the concepts but if the theory is well understood and put into practice, good or better results of credit risk management can be attained. It should be noted that the concept are not standard but change with the different banks and also influenced by the dynamic enlivenment in which they operate.

When a customer demands for credit, the bank can't just go into granting the loan without fist of all verifying if it is credit worthy or not. The bank goes through the process by using the criteria of the five c□s or credit scoring. If it finally arrives at a decision to grant the loan, there is no guarantee the company will repay the money as predicted because the bank is operating in a very dynamic and unstable environmental. This means that the banks has to have three options in mind; either the loan is repaid, there is a delayed payment or default. If it is repaid in time, then fine but if otherwise problems start arising especially to meet up with the demand of its customers/other financial obligations or even financial distress. This means risk management has to start from day one. If any risk is identified, continuation of the management process continuous. It should be noted that monitoring takes place at all times to be sure the results are always as intended. This management is being done while following the policies, philosophy, practices, strategies and the credit culture of the bank. The bank is doing all this because its profitability, liquidity and solvency have to be guaranteed. Despite all these efforts by the banks, there are still failures at times or problems which can be attributed to different factors including information asymmetry (vital information which the customer hides from the bank) and soon.

2.15.Empirical Literature

Niinima¨ki (2004) in his paper entitled "The effects of competition on banks' risk taking" found that the magnitude of risk taking depends on the structure and side of the market in which competition takes place. He also concluded that if the bank is a monopoly or banks are competing only in the loan market, deposit insurance has no effect on risk taking. Banks in this situation tend to take risks, although extreme risk taking is avoided. In contrast, introducing deposit insurance increases risk taking if banks are competing for deposits. In this case, deposit rates become excessively high, thereby forcing banks to take extreme risks. Several risk-adjusted performance measures have been proposed (Heffernan, 1996; Kealhofer, 2003). The measures, however, focus on risk-return trade-off, i.e. measuring the risk inherent in each activity or product and charge it accordingly for the capital required to support it. This does not solve the issue of recovering loan able amount.

Effective system that ensures repayment of loans by borrowers is critical in dealing with asymmetric information problems and in reducing the level of loan losses, thus the long-term success of any banking organization (Basel, 1999; IAIS, 2003). **Effective CRM** involves establishing an appropriate **credit risk environment**; **operating under a sound credit granting process**; **maintaining an appropriate credit administration** that involves monitoring process as well as adequate controls over credit risk (Basel, 1999; Greuning and Bratanovic, 2003; IAIS, 2003). It requires top management to ensure that there are proper and clear guidelines in managing credit risk, i.e. all guidelines are properly communicated throughout the organization; and that everybody involved in Credit Risk Management (CRM) understand them.

Considerations that form the basis for sound CRM system include**: policy and strategies (guidelines)** that clearly outline the scope and allocation of a bank credit facilities and the manner in which a credit portfolio is managed, i.e. how loans are originated, appraised, supervised and collected (Basel, 1999; Greuning and Bratanovic, 2003; PriceWaterhouse, 1994). Screening borrowers is an activity that has widely been recommended by, among others, Derban *et al* (2005). The recommendation has been widely put to use in the banking sector in the form of credit assessment. According to the asymmetric information theory, a collection of reliable information from prospective borrowers becomes critical in accomplishing effective screening.

The assessment of borrowers can be performed through the use of qualitative as well as quantitative techniques. One major challenge of using qualitative models is their subjective nature (Bryant, 1999; Chijoriga, 1997). However, borrowers attributes assessed through qualitative models can be assigned numbers with the sum of the values compared to a threshold. This technique is termed as "credit scoring" (Heffernan, 1996; Uyemura and Deventer, 1993). The technique cannot only minimize processing costs but also reduce subjective judgments and possible biases (Kraft, 2000; Bluhm *et al*., 2003; Derban *et al*., 2005). The rating systems if meaningful should signal changes in expected level of loan loss (Santomero, 1997). Chijoriga (1997) concluded that quantitative models make it possible to, among others, numerically establish which factors are important in explaining default risk, evaluate the relative degree of importance of the factors, improve the pricing of default risk, be more able to screen out bad loan applicants and be in a better position to calculate any reserve needed to meet expected future loan losses. Clear established process for approving new credits and extending the existing credits have been observed to be very important while managing CR (Heffernan, 1996).

Further, monitoring of borrowers is very important as current and potential exposures change with both the passage of time and the movements in the underlying variables (Donaldson, 1994; Mwisho, 2001), and also very important in dealing with moral hazard problem (Derban *et al*., 2005). **Monitoring involves**, among others**, frequent contact with borrowers**, **creating an environment** that the bank can be seen as a solver of problems and trusted adviser; **develop the culture** of being supportive to borrowers whenever they are recognized to be in difficulties and are striving to deal with the situation; monitoring **the flow of borrower's business** through the bank's account; regular review of the borrower's reports as well as an on-site visit; updating borrowers credit files and **periodically reviewing the borrowers rating** assigned at the time the credit was granted (Donaldson, 1994; Treacy and Carey, 1998; Tummala and Burchett, 1999; Basel, 1999; Mwisho, 2001).

Tools like covenants, collateral, credit rationing, loan securitization and loan syndication have been used by banks in developing the world in controlling credit losses (Benveniste and Berger, 1987; Greenbaum and Thakor, 1987; Berger and Udell, 1992; Hugh, 2001). It has also been observed that **high-quality CRM staff**s are critical to ensure that the depth of knowledge and judgment needed is always available, thus successfully managing the credit risk in Commercial Banks (Koford and Tschoegl, 1997; Wyman, 1999).

Donaldson (1994) and Jeremy and Stein (1999) observed that computers are useful in credit analysis, monitoring and control, as they make it easy to keep track on trend of credits within the portfolio. Marphatia and Tiwari (2004) argued that risk management is primarily about people how they think and how they interact with one another. **Technology** is just a tool; in the wrong hands it is useless. This stresses further the critical importance of **qualified staff in managing credit risk.**

In addition to this some question were given to credit risk management committee of CBE’s what looks like credit risk management practice some year before in order to use as an input for my study. and they respond by saying there is no regular habit of conducting research on credit risk management in CBE’S but From the annual report credit risk management ofCBE’s was not satisfactory due to the common sources of bad loan give to different sectors. To mention like construction machineries and vehicles, and pre-shipment facility. In addition to this they remarked that considerable amount of loans given to higer bus and condominium houses project categorize as bad loans, in fact, these loans were non – convincing from the beginning of their approval process. Due to these reason loans were lastly go to Non performing loan and becomes hard to achieve effective credit risk management. But knows a day effective amicable and legal procedures are used to collect and partially returned to healthy loan and normal truck.

The relation ship between Credit risk and profitability performance of Ethiopian commercial banks are few though many studies documented that credit risk is among the major challenges of banks in Ethiopia. Of these studies, Tefera (2011) and Mekasha (2011) each studied the effect of credit risk management on the performance of commercial banks in Ethiopia. Both used secondary source from the annual reports of commercial banks and Survey of primary data from Bank Managers and Officers which similarly showed that there is a negative relationship between credit risk and performance of commercial banks in Ethiopia.

Empirical literature on Ethiopian banking sector documented that credit risk and Non performing loans have been major challenges of bank performance in Ethiopia (Alemauhy, 1991; NBE, 2009; Tekilebirhan, 2010; Melkamu, 2012; Gethun, 2012; Mekonen, 2012). Nonetheless, Very few Mekasha 2011; Tefera 2011) examined the extent at which Credit risk affected profitability performance of banks in Ethiopia.

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.

Establishing an appropriate Credit risk environment standard necessitate each commercial bank to establish its own strategies and policies along with clear responsibilities of Developing, Reviewing, Approving, implementing: and Communicating and reporting risk related data, as well as internal control system and monitoring compliance so as to ensure safety , soundness, and profitability of the bank .

It specially states responsibilities of Board and senior management as the key role player in Credit Risk Management activities. The standards under Sound Credit granting process enforce Each Bank to operate its Credit granting activities through establishing and applying sound Credit granting process with Credit policy accompany with well defined Credit-granting criteria and comprehensive credit limits as well as undertaking Creditworthiness analysis on arm's-length basis. Standards of Credit administration, measurement and monitoring process necessitate each bank to establish appropriate Credit administration and monitoring system and procedures, developing and utilizing internal risk rating and management information system, as well as establishing system for monitoring the overall composition and quality of the credit portfolio and assessing potential future change. While establishing a system, policies and procurers for early identification of deteriorating credits sign, managing problem loans and similar work out situations as well as efficient and independent internal credit quality review and reporting system are principles under standard of Adequate Control overall Credit risk.

The management of Credit risk generally include setting out authority and responsibility clearly: developing and applying appropriate Credit risk strategy, policy and procedures: proper understanding and identification of risk: sound Credit granting process: credit administration, monitoring and reporting process and finally Credit risk control along with determining the method and frequency of reviewing Credit policies and procedures.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1. Research Design and Methodology

The study approach is an exploratory as it seeks to explore the practice of credit risk management process, as well as the methods employed by CBE in handling credit risk management. The objective to use exploratory approach is to generate more information about the situation of credit risk management practice, to define clearly the research question in the form of investigative questions and for an in-depth contextual analysis as the study focus on credit risk management practice (case study in commercial Bank of Ethiopia). The research involves both qualitative and quantitative research centered on Credit risk management practice. The techniques were designed in a way that would best suit quick collection of relevant data. The data is seriously collected and presented to give exploratory analysis to particular phenomena with emphasis to cover the extent of the Credit risk management practice in Commercial Bank of Ethiopia (CBE's).

3.2. Sample and Sampling Techniques:

As the main focus for this paper is to explore credit risk management practice of CBE, it is rational to consider credit process employees particularly credit analysts, Experts, Manager, Directors, credit Administrations and vice president in the same process who are in head office as main focal area. Because many of the credit request of CBE are now being processed in central head office. So in this central office there are closer to 90 employees of which 40 of them were taken as samples for this study. The main reason to select forty of them from the total population is they are convenient enough with the credit risk process and management practice. Since Credit risk management by its nature needs detail knowledge, skill and follow up the procedure of credit risk involved with them. It is necessary the researcher to deal with those people who are convenient and are subjected to Credit risk management so as to get the necessary information for the study.

The sampling method used to determine sample size and sample units is non-random sample technique called convenience sampling technique, because the researcher believe that it is very important to distribute questionnaires through walk in around, than randomly so as to get filed each questionnaires properly and collected on time. In addition to this convenience sampling is used in order to generate the data from the employees that are directly engaged in the operation of the credit risk management business of the bank. Hence a very reliable source of information was gathered.

3.3. Source and Tools/Instruments of Data Collection:

The data nature and source are primary sources supplemented with secondary sources as necessary. This because the primary sources helps to find exactly what is going on about the issue with first hand sources, as the paper aims to address credit risk management practice established techniques and principles in Commercial Bank of Ethiopia, against national bank directives, and international banking proclamations and practices. Therefore, the primary sources are collected by both structured interviews & questionnaires from purposively selected credit process expertise, managers and performers in order to better understand the credit risk management practice and culture of the process.

The structured questionnaire consists of certain 36 items sub headed with four important dimensions i.e. credit policies, procedure and limits in managing credit risk, credit risk measurement, monitoring and controlling techniques of CBE, employees training and development in managing credit risk and internal control and reporting practice to contain credit risk. In addition to this questionnaires are the primary data collection method in the study. Here comprehensive self administered questionnaires are the main instrument in the study. The questionnaires are designed to gather information and explore the key variables on credit risk management practice to staff and management. Both open ended and closed ended questions are used to let the respondents give their own opinion about the research problem.

Mean while the interview part consists set of questions on the role of Board and senior management to oversight credit risk management. On the other hand secondary sources like credit risk management process manual, procedures and policies, national bank directives, Basel accords, annual report, journals, brochures, newsletters both locally and internationally, internet about credit risk management policy and collection performance and other related documents are used as necessary.

3.4. Methods of Data Analysis:

Simple descriptive method of analysis is the primary method, comparisons of results of the findings from respondents about the practice of CBE's credit risk management analysis against CBE standards and other standards is made. Furthermore, analysis of some figures like percentages, tables, diagrams and charts are used to elaborate the results in detail. The main reason behind to use descriptive method of analysis to describe the characteristics of the study related to credit risk management practice, to statistically describing, aggregating, and presenting the constructs of interest or associations between these constructs. Generally simple descriptive method of analysis were used to analyze the study based on the respondents feed back in a precise and meaningful way.

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION

4.1. Introduction

As indicated in the methodology and literature review part of this paper, the parameter to analyze subject matter under discussion is based on the standard credit risk management of national bank of Ethiopia and the Basel credit risk management principles. Therefore analyzing the result of the respondents in line with these parameters gives an easy for readers. The empirical analysis consists of both results of interview and questionnaires.

4.2. Overall respondents Background Information.

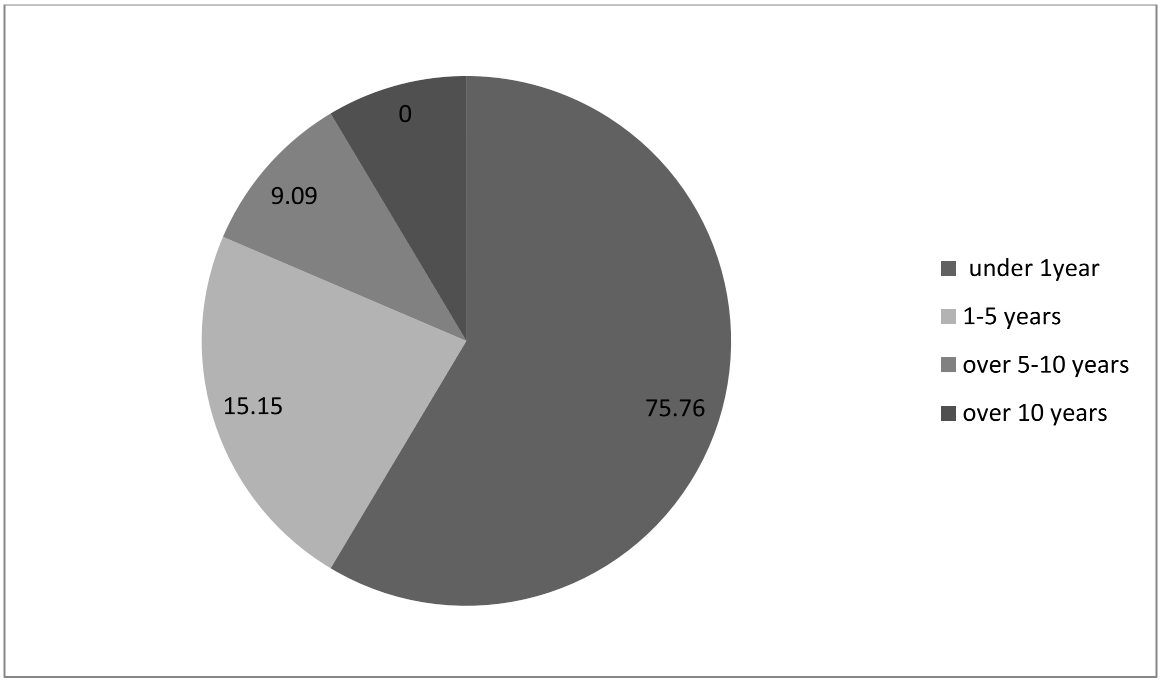
This part of the analysis is just to provide an insight to readers about all respondents. As indicated in the methodology part of the study samples were taken from CBE's Head office credit process employees particularly credit analysis, Experts, Managers, Directors, Credit Administration and vice- presidents in same process primarily, it is necessary to remind readers of this paper that structured interview is conducted with the vice president of credit appraisal and portfolio management wing of credit process and at the same time in this process sample of 40 respondents were given the chance to fill the structured set of questionnaires each containing main four sections. The sample were taken conveniently which are subjected more to credit risk management practice from the total population because all employees in the central office are not equally important to the question of credit risk so it is necessary to take those people with credit risk management knowhow conveniently. Therefore, the analysis is also done accordingly. Although 40 questionnaires were distributed, it was only 33 respondents who were able to fill and give back the final, meaning 82.5% of the questionnaires were only collected, which for our subsequent analysis is considered as 100%.

Table 4.2: General back ground information of respondents.

Items		Total population	Number of respondents	Percentage
Over all banking years of experience		33		
	Under 1 year		-	
	1 – 5 years		3	9.09
	5 – 10 years		5	15.15
	Over 10 years		25	75.76
Credit field experiences		33		
	Under 1 year		-	
	1 – 5 years		14	42.42
	5 – 10 years		3	9.09
	Over 10 years		16	48.49
Level ofeducational qualification		33		
	High school		-	
	Diploma		2	6.06
	Degree		28	84.85
	Masters		3	9.09
Major field of study		33		
	Banking with credit		-	
	Banking and finance		2	6.06
	Mgmt/Acct/Econ.		29	87.88
	Engineering/Law		2	6.06

Basically the back ground set of questionnaires are composed of issue like over all banking years of experience and credit experience, major filed of specialization in their study and level educational qualifications etc. as indicated in the pie chart below, more than half of the respondents, which are 75.76 % of them are found to have over 10 years experience in overall banking operations. However, unlike the overall banking experience, relatively high proportion of employees, 42.42% of respondent's experience in the credit operation is found to be in between 1- 5 years.

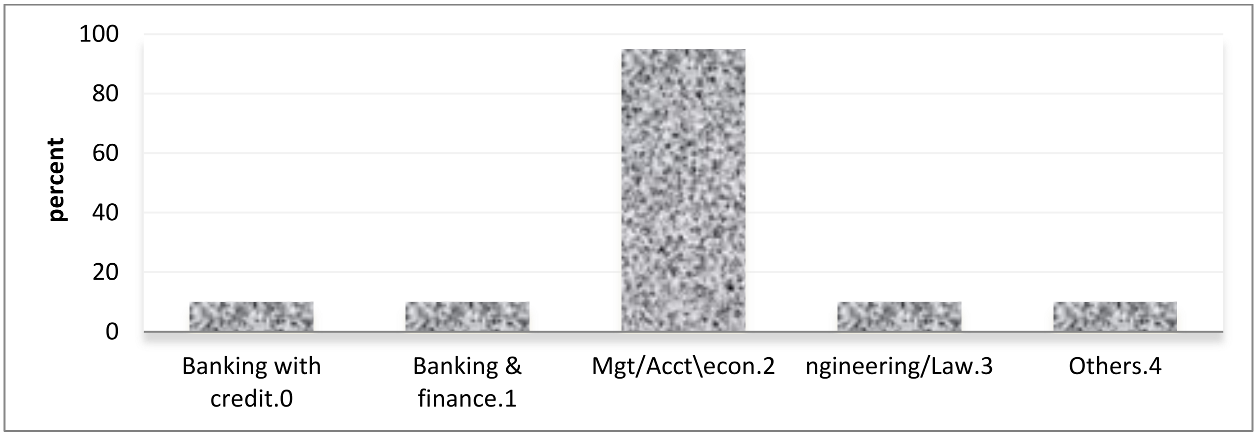
This fact indicates most employees in credit process are not stable and many are claiming that they are relatively busy with no extra incentives. Although this needs further study why this is happening but from credit risk management point view, it is believed that retaining experienced employees in the credit would benefit in managing credit risk than otherwise.



Sources: Own questionnaires survey result 2015.

Figure 3. Overall banking service year's experiences of respondents.

Educational level of most of the respondents, (84.85%), is with first degree and the least number of respondents (6.06%) are diploma holders but in terms of specialization or composition of work force in the process, it is dominated by generic business (management/accounting and economics) professionals. That is (87.88) of the respondents have confirmed that they are from generic business with no special training relevant to credit specialization except some training given by the bank itself. This fact is presented with chart below, which is there are no workers who are qualified in banking with credit specialization as major field of study in university. This would be probably taken as an assignment to the CBE's human resource process to think strategically in designing training programs to the credit process in conjunction with local universities.



Source: Own survey 2015.

Figure 4. Indicating Educational Specialization of expertise in the credit process

Table 4.3. : Importance of credit policies, procedures, and limits in managing credit Risk

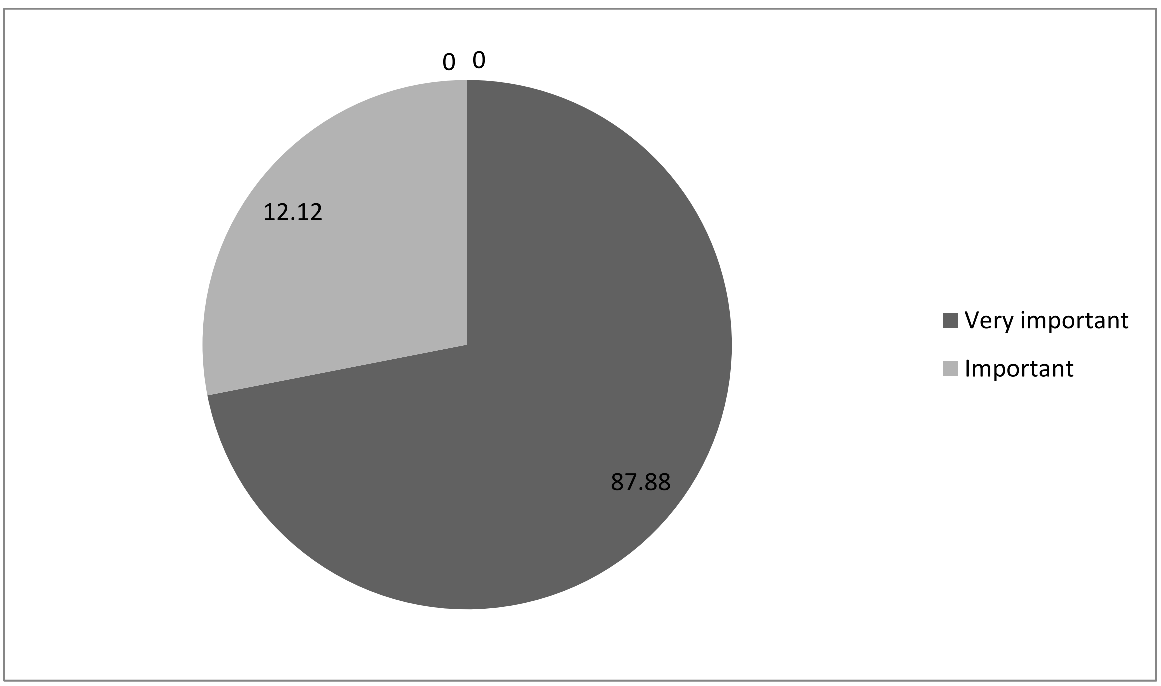
Items		Total population	Number of respondents	Percentage
		33		
Rating CBE's Credit risk exposure against others banking risk?	Not at all significant		-	
	Not significant		-	
	Not so significant		-	
	Significant		14	42.42
	Very significant		19	57.58
		33		
Importance of credit risk management for CBE's?	Not at all important			
	Not important			
	Not so important			
	Important		4	12.12
	Very Important		29	87.88
		33		
Level understanding of Credit risk towards the bank's credit product	I don't know any			
	I know very little			
	I fairly understand			

and services?	I understand clearly		25	75.76
	I understand very clearly		8	24.24
Degree of agreement/disagreement about CBE's established credit policy in containing credit risk		33		
	Strongly disagree			
	Disagree			
	Neutral			
	Agree		12	36.36
	Strongly agree		21	63.64
importance of introducing credit limit based on sector, industry and other limits		33		
	Strongly disagree			
	Disagree			
	Neutral			
	Agree		5	15.15
	Strongly agree		28	84.85

The importance of credit risk management can never be undermined when carrying our lending decisions because the bank has to be sure to recover the money it is giving out especially as its continuous functioning depends on it. So, in this section of analysis, I tried to explore the degree of consciousness of respondents for credit risk management in their lending decisions, the consequences of these decisions, contribution of policies and procedures in handle lending decisions and the type of risks connected to lending decisions. Accordingly respondents have rated CBE's credit risk exposure against other banking risks as very significant and significant 57.58 %, and 42.42% of them respectively. Further more respondents were given questions regarding the importance of credit risk management for CBE to manage this exposure and accordingly 87.88% of respondents believe it is very important. Another component of the question given to respondents was to state their degree of agreement/disagreement about CBE's established credit policies and procedures in containing credit risk and 63.64% of the respondents explained they strongly agreed that these documents helped the bank to manage the credit risk.

By same analogy respondents were asked to state the level of understanding towards credit risk policies and procedures and 75.76% of respondents said that they understood it clearly and 24.24% very clearly. In addition some respondents have remarked that norms developed through policies and procedures are helping a lot in containing credit risk. Another dimension that respondents were asked about the importance of introducing credit limit based on sector, industry and other limits, and 84.85% of respondents strongly agreed that introducing credit limit in CBE credit policies; procedure is helpful to contain credit risk. Last valuable comment that respondents given at the open ended part is that collateral coverage or collateral estimation process in banking operations are subjective in nature and needs ethical integration of performers than inculcating technical details in policies and procedures. This is also common in CBE credit policies and procedures as result it seems that poor collateral estimation is also problem to it. Generally respondents' fact on CBE's credit policies and procedures in containing credit risk management could be summarized as good.

Similarly by the parameters of NBE and Basel credit risk management principles of – operating under a sound credit granting process, such as clearly established credit policies and procedures in place for approving new credits as well as the amendment, renewal of existing credits practice is found good in CBE, therefore, it should continue to maintain this perspective.



Sources: Own Survey 2015.

Figure 5: shows importance of credit risk management policies, procedure in CBE'sso as to maintain credit risk management in good manner.

Table 4.4. **statements related to credit risk measurement, monitoring and controlling techniques of CBE's.**

Items		Total population	Number of respondents	Percentage
Which techniques/instrument, does CBE use for credit risk management?		33		
	Credit approval authority		1	3.03
	Prudential limit		2	6.06
	Risk rating/grading		30	90.91
	Risk pricing			
At what interval credit risk assessment and monitoring is done?		33		
	Monthly		2	6.06
	Quarterly		22	66.67
	Bi - annually		5	15.15
	Annually		4	12.12
	More than yearly			
Does CBE's perform periodic credit call, visits plants, annual review of accounts and management information system For credit risk management		33		
	Poor		3	9.09
	Satisfactory		6	18.18
	Good		23	69.70
	Very good		1	3.03
	Excellent			
How do you evaluate CBE'S effectiveness in controlling and monitoring credit policies and procedures?		33		
	Poor			
	Satisfactory		3	9.09
	Good		27	81.82
	Very good		3	9.09
	Excellent			
At what interval Credit policy is reviewed in the bank?		33		
	Monthly			
	Quarterly		3	9.09
	Bi - annually		5	15.15
	Annually		5	15.15
	More than yearly		20	60.61
Do you agree that CBE's involvement in long term credit/financing in project pose financial distress on its operation?	Strongly disagree	33		
	Disagree			
	Neutral		2	6.06
	Agree		28	84.85
	Strongly agree		3	9.09

From the above table analysis made in a such manner:

It is essential for a bank to have internal control and monitoring practice so as to increase its efficiency, reduce costs and reach its objectives, in CBE the most common forms of internal control exercised are credit policies and procedures that every performer is adhering with vested power and authority. Consequently it is found that 90.91% of the respondent's stated risk rating/grading approach is one of the most common techniques used, followed by setting authority limits for different approval teams and making audit practice. In addition to this 66.67% of respondents were indicated the interval of risk assessment and monitoring is done quarterly, 15.15% bi- annually and 12.12% annually. This shows CBE's should make frequent credit risk assessment and monitoring so as to manage credit risk easily. By the same analogy respondents were asked the interval of credit policy reviewed in the bank and 60.61% of respondents indicated more than yearly, 15.15% bi- annually and annually. Their responses were aligned with the current practice since credit policy shall be revised in every three years. How ever, if a need arises, it may be amended at any time. So respondents were taken this as first motive to give feedback.

On the other hand, 84.85% of respondents have remarked their worry on CBE's existing techniques of credit risk monitoring and controlling practice effectiveness in monitoring long term loans given to developmental projects. According to respondents belief this worry seems to be witnessed in the bank, as they informally heard that CBE is facing some liquidity problem due to many project finance. Further they said that proportion of loan portfolio is also increasing in areas of huge projects and government bonds these days than it was.

Finally, CBE uses the above mentioned techniques of risk controlling and monitoring techniques is limited in variety. For example risk pricing /risk return analysis of credits, setting limits in sector/region are not being used as credit controlling techniques which are common in other countries practices.

The above facts and claims when viewed in parameters of NBE and Basel credit principles of-setting limits is important tool to monitor credit risks and concentrations of credit risks. Limits could be established for particular industries or economic sectors, geographic regions specific products, a class of security, and group of associated borrowers etc. However CBE doe s not have such technique in its current credit risk monitoring and controlling practice, therefore, it would be good if CBE could make possibility of introducing such technique in credit risk management process. Because limits help in CBE to avoid excessive concentration of loans that renders it to adverse changes in the area in which the credit is concentrated and to violations of statutory and regulatory limit and finally from loss.

Table 4.5.**Statements related to employee straining and development in managing credit risk.**

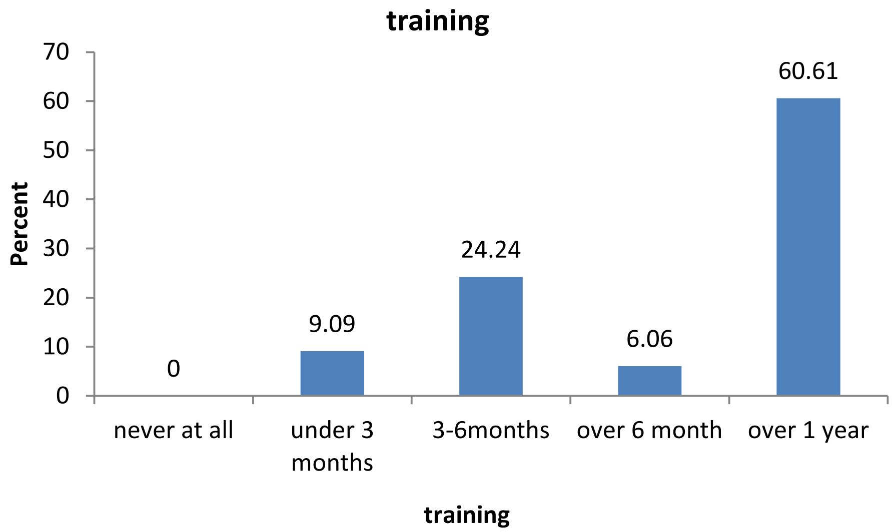
Items		Total population	Number of respondents	percentage
Evaluation of their job relation to credit risk management?		33		
	Not so related at all		0	
	Not so related		0	
	Least related		0	
	Fairly related		6	18.18
	Most related		27	81.82
How long have you participated in credit-related staff training?		33		
	Never at all			
	Under 3 months		3	9.09
	Over 3- 6 month		8	24.24
	Over 6 month		2	6.06
	Over 1 year		20	60.61
How do you rate the existing work force composition & level in credit appraisal is competent with the bank credit risk exposure?		33		
	Poor		0	
	Satisfactory		2	6.06
	Good		28	84.85
	Very good		3	9.09
	Excellent		0	
Additional training & specializations are requiring performing new credit form like project financing?		33		
	Strongly disagree			
	Disagree			
	Neutral			
	Agree		3	9.09
	Strongly agree		30	90.91
Credit should be worked with those who have been there for long in order to have effective credit risk management.		33		
	Strongly disagree			
	Disagree		18	54.55
	Neutral		6	18.18
	Agree		9	27.27
	Strongly agree			

How do you rate practice of Credit approval process in complying with CBE's credit policies, procedures & Manuals?		33		
	Poor			
	Satisfactory		4	12.12
	Good		27	81.82
	Very good		2	6.06
	Excellent			
How do you rate the credit risk management practice of each and every Performer in CBE's?		33		
	Poor			
	Satisfactory		3	9.09
	Good		28	84.85
	Very good		2	6.06
	Excellent			

from the table analysis were made in a such manner that:

For any activity to achieve success, the human resource is always at the heart because activities are exercised by the humans, or in other words, the employees at the organization. Adequate staffing is a most for healthy credit risk management. Accordingly in this paper staffs in credit process were given the chance to evaluate their job relation to credit risk management process, and 81.82% of them have responded that their job is most related to credit and credit risk. Thus, efforts done on such staffs related to managing credit risk will clearly help the bank in containing credit risk. On the other hand, staffs were given question on how often they have taken training related to their job, and 60.61% of respondents have clearly indicated that it is more than a year, 24.24% of respondents indicated over 3-6 months and least number of respondents which is 6.06% indicated under 3months since they took job related training/credit related training/. It seems that frequent training need analysis is required to increase in level of efficiency and reduce possible credit risks that emanate from poor credit appraisal.

Length of periods training is given to credit staffs.



Own survey2015

Figure 6: length of periods training is given to credit staff.

Significant number of respondents (84.85%) rated work force composition in skill variety and level in credit appraisal is competent enough with the bank credit risk exposure as good, 9.09% very good and the least 6.06% satisfactory. (84.85%) rated employees or performers contribution to credit risk management practice as good. However, 90.91% of same respondent have put their strong agreement, on the other question saying that they need additional training on appraisal particularly in huge sugar and other agricultural projects, irrigation and dam construction etc importantly training that contain simulated context would give them confidence on handling such cases. More than half of respondents 54.55% disagree on credit should be worked with those who have been there for long in order to have effective credit risk management, 27.27% agree, and 18.18%as neutral. This means there are employees who are working a long time but are not competent enough. So here level of competency on employees to have effective credit risk management doesn’t depend on time of period rather on giving additional training and specialization.

On another question 81.82% respondents were rated credit approval process of CBE’s are complying with its credit policies, procedure and manuals as good. Respondents also have remarked in their valuable comment section that fundamentally the credit analyst follow what is stated in the lending procedures, especially manuals or the credit rating. But we sometimes face challenge over the tip on assessing customer's credibility based upon the information provided by the relationship managers. That is, how much it is trustworthy? The acceptable terms that the relationship mangers report mentioned in the due diligence report is hard to define and quantify for analysts, what if the customer tries to deceive the relationship manger and take advantage of it, there are cases also where some high-profile customers need favorable treatment or else jumping to higher level officials and trying things to happen for them and these are some extent dangerous situations respect to credit risk management in CBE. Factors mentioned in the above and personal integrity and ethics of performs sometime may cause credit risk to happen or not. Therefore, according to respondents' suggestion they suggested that empowering and training employees in overall technical capacity should be another important function that CBE has to work on in order to minimize risks associated to employees and reach its vision of achieving world class commercial. Although NBE and Basel parameters of credit risk management principles does not have specific principles about employees in credit process it has stated the significance of employees' contribution towards management of risk is undeniable and institutions must work strategically in this perspective too. Therefore, CBE'S current status on employees training to mange credit risk is good but I do share the suggestion of respondents that capacity building and retention of trained employees by the bank must be given serious attention particularly as it aspires to be world class commercial bank by the year 2025.

Table 4.6. **Statements related to internal control and reporting practice.**

Items		Total population	Number of respondents	Percentage
Integration of credit approval process with IT/MIS department in providing relevant data for making credit assessment?		33		
	Poor		26	78.79
	satisfactory		7	21.21
	Good			
	Very good			
	Excellent			
How complete, plausible and aggregate the data in approving loans to maintaining credit risk?		33		
	poor		25	75.76
	satisfactory		8	24.24
	Good			
	Very good			
	Excellent			
How do you evaluate credit administration and documentation in preventing and containing credit risk of CBE's?		33		
	poor			
	satisfactory		1	3.03
	Good		5	15.15
	Very good		27	81.82
	Excellent			
Capacity of CBE's MIS in providing adequate information on composition of credit portfolio including identification of any concentration of risk?		33		
	poor		26	78.79
	satisfactory		6	18.18
	Good		1	3.03
	Very good			
	Excellent			
Role of Internal control in credit risk management of CBE's, does internal control conducted on timely basis?		33		
	Poor			
	satisfactory		3	9.09
	Good		28	84.85
	Very good		2	6.06
	Excellent			
Does the bank call your option whenever there is an adjustment to the policies associated to credit risk management/		33		
	Never			
	Rarely		3	9.09
	Sometimes		22	66.67
	Regularly		8	24.24

From the above table analysis were made as follows:

There should be ongoing reporting of information system embedded in business processes that should be performed by all employees within the framework of their tasks in institutions. For instance, in credit process of CBE just like other process, we make use of internal and external sources of information to make regular loan review and loan status evaluations. From the above table 84.85% of respondent's internal control in conducted on timely basis as good and play significant role in managing effective credit risk management. For example, CBE's credit process conducts loan review on monthly basis, top 100 borrower's credit status review in every six month, and single borrower limit quarterly basis, said respondents. On the other hand 81.82% respondents evaluated credit risk administration and documentation in preventing and containing credit risk of CBE's as very good.

To prevent credit risks CBE uses internal sources of information like credit policies, procedures and manuals that describe approval processes very well. Apart from this, these documents clearly set the dos and don'ts, the credit administration and reporting structures as part of internal controlling systems the credit approval authority reporting and control is the most satisfactory part CBE does have. It is extremely transparent with a structure map of ascending approval delegation, principles of approval and the authorization hierarchy and committee. However, this process is negatively affected by the increasing difficult arise out from scarcity of complete, plausible and aggregate data base system both internally and externally

This fact is supported by 78.79% respondents that CBE's major challenge in internal credit risk rating and controlling is lack of accurate data / information system on macro variables, industry, and customers /projects with respect to time so that unforeseen risks associated with credit could have been possibly minimized than it is.

Internally also according to respondents valuable comment section stated that the existence off poor horizontal integration among departments in exchanging valuable information are still problem to the bank. For example, because of poor flow of information from among departments, and with management information systems department we sometimes take risks that otherwise could have been avoided. Even some times the quality of shared information from management information system department itself is under question.

Because usually figures coming form it are inaccurate, not summarized and out dated. However CBE is on the process of improving this problem by initialing and introducing technology supported by on line system and improving reporting structure and content aligned with the technology.

The reporting and information system of CBE practice in credit risk management principles when compared against the parameters of NBE and Basel principles remains with full of challenges. On the other hand, the effectiveness of a bank's credit risk management process is highly dependent of the quality of its management information systems since this information is used by the board and management to fulfill their respective oversight roles. Therefore, the quality, detail and timeliness of information are critical. From the above table 78.79% respondents were rated the capacity of CBE's management information system in providing adequate information on credit portfolio, including identification of any concentrations of risk as poor. The information system should provide adequate information on the composition of the credit portfolio, including identification of any concentrations of risk and should have and efficient internal review and reporting system as an effective oversight mechanism in respect of its credit function. In addition to this question were asked whether the bank call opinion of its employees whenever there is an adjustment to the policies associated to credit risk management 66.67% respondents indicated sometimes, 24.24% regularly and the least 9.09% rarely. So the CBE's should work to improve accepting and lessen employees' opinion so as to contain effective and efficient credit risk management. Therefore, CBE in this perspective should work to solve existing challenges and reach to the standards information system which is efficient, reliable and updated. Finally, respondents were asked to comment about over all CBE's likely in achieving its vision to become one of the world class commercial bank by the year 2025 and its capability in managing credit risk. The result of respondents is summarized in two extreme ways: one group said that **CBE** although remarked considerable changes in recent years by introducing **BPR**, **BSC**,**T24** and other initiatives still it lacks to focus on the important resource, i.e. **human** resources development and retention strategy is far behind from one could expect from it as it is the leading bank in the industry even below private banks in the country and this could cost a lot let alone achieving its vision whereas others said that they hope that achieving the vision is likely given the current market share and profit is maintained in the future too. Well this will be seen in courses of time.

4.7. Analysis of interview on the Role of the Board and senior management to control Credit risk Management

Structured set of interview questionnaires were provided to the relevant process and purposively selected higher officials of the bank particularly to the Vice president Credit appraisal and portfolio. Accordingly, interview result is structured in line with the interview guide to the following sequences; general questions, role of board of directors and management in managing credit risk, credit risk management strategy and philosophy, degree of board of directors and management's attention towards credit risk culture and internal control in credit risk management, existing work force composition competency in skill variety and level to critically manage and control credit risk.

The triggering interview question was focused on, does the board of directors exercise their role in containing the credit risk, how relevant is the contribution and how effective it is, etc?

And the respondent answered that surprisingly CBE has good structure of separate board of directors which is composed of government agents and traders agents and management body in accomplishing its business, however, the level of expertise knowledge and degree of commitment in setting the bank's tolerance for credit risk in the context of types of credits, economic sectors, geographical locations, and maturity or in sighting other technical contribution towards managing credit risk is very low as compared to other international standards of board of directors. This is because mainly that board of directors in our case is "people who are assigned by and their profession mix is usually not related with whom our business demands, instead, our board of directors are flexible in empowering the management to come up with any technical amendments in the credit policies and procedures towards managing credit risk for approval."

From the above fact, it seems that the responsibilities to revise credit policies, strategies and introduce new procedures to manage credit risk falls on the management body of the bank. The implication of the flexibility given by board of directors to management in managing credit risk in the bank may be seen in positive or negative prospective. For example, according to NBE& Basel parameters of credit risk management principles; board of directors should exercise separate and independent oversight on the credit risk management of the banks.

It is the board of directors that sets business level credit strategies and policies that govern or influence the management of credit risk of the bank, review and approve bank's credit risk strategy and policies inline with changing situation and management body's responsibilities are to adapt and implement these strategies. But in CBE'S case, it seems that there is a gap on the role and responsibilities of board of directors.

Therefore, according to this paper' parameters of interest, i.e. credit risk management principles of NBE and Basel, CBE should work to improve on role and responsibility board of its directors on credit risk management practice if it wants to become world class commercial bank.

The respondent continued to elaborate his view about the overall banking operation in our country; he said that banking operation in our country currently is found at traditional level. This is related to many factors, for instance, overall capacity problem and under developed infrastructure etc however this does not mean that it remains same for future. Cognizant of this fact, CBE's undertakes several strategic programs in banking operation that includes credit risk management. For instance, it has introduced modern art of state of technology T- 24, BSC and BPR at corporate level that helps the bank to excel its services and particularly in credit approval process we have shifted from collateral base practice to project's viability in repaying loan.

Another focus of interview was on the question why credit risk management is important to CBE in achieving its vision of becoming world class commercial bank. He said credit risk management is important because credit/loans are the largest and most common source of credit risk. Therefore, credit business involves credit risk management policies and procedures while lending decisions is taken. Moreover my respondent said that lending decisions have been effective these days than ever especially because the bank use already set down credit procedure, manuals and an effective credit process from time of application to collection and as result the banks overall non performing loan is found to be less than (1%) which is acceptable to international standards. This is because in the credit process there are different committees from approving to follow-up and reviewing status of the loan being disbursed and classification of loans. For example, in CBE, we made overall loan review on monthly basis, top 100 borrower's credit status review in six month, and single borrower limit quarterly basis. And in the discussion the most common sources of bad loan credit products are mentioned. These are loans given to construction machineries and vehicles, and pre- shipment facility but in these areas effective amicable and legal procedures are being used to collect.

In the interview discussion my respondent has also remarked that considerable amount of loan given to “higer bus and condominium house projects “were categorize as bad loans, in fact, these loans were non- convincing from the beginning of their approval process. Now these loans are partially returned to healthy loan and normal track.

The other section of the interview process was focused on issues related to overall credit risk management culture, employee’s perception, attitude and risk taking /managing nature in the credit process, workforce skill variety and composition in effectively appraising each and every kind of loan request particularly in project and long term finance loan, the availability of relevant information for the right decision in CBE during credit appraisal process etc?

The respondent continued in explaining that “credit risk taking and managing culture of CBE is reflection of its employees and its policies to take risk and manage. Usually credit risk taking and /or managing culture are associated with the credit approval process”: he said that:

Conservativeness. The issue of conservativeness is related to decline loan request or reducing the amount of request by some amount in fear of not to take risk associated with it. In fact both types of conservativeness have risk on the bank’s objective. One, by declining viable loan request we are missing possible economic benefits that the projects could create in the economy and interest income the bank could get from viable loan. Two, approving an amount less than request means we are creating problem on the borrower, that is we made it short of finance to move in to operations of project hence repayment of loan on schedule would become impossible and later becomes defaults. Therefore, in CBE culture of conservativeness should be changed. Given the loan request is viable we have to approve. It is important even sometimes to notice; i.e. there should be cases of approving above the requested amount because of the projects contribution towards the development of economy.

Another way of credit risk in the bank is inadequate appraisal that is related to deficiency of skills not with culture. To fill skill gap, in CBE, loan appraisals are done at different stages from application to final disbursement so as to minimize possible overlook of loops that causes defaults. But still there are points they are working to fill it, both from employees and organizational perspectives. For example, in some agriculture projects appraisal we have used pooling of different expertise, inviting external consultants for projects that demand extra technical skills, and upgrading of internal employees skills through training are some to mention. Apart from these the most challenging problem that the banking industry including CBE's facing is lack of accurate, reliable and consistent information/data base in which we can make analysis on important variables, customer profile and over all industry analysis. Although CBE working to improve its internal data base this remains challenge for them as it requires external institutions concern and commitments like NBE, CSA, and MOFED. Finally, I have provided to my respondent the chance what can add as valuable comment and my respondent has put on by saying the bank's (CBE'S) strong action on the shift that collateral comes in the second place next to the viability of projects in obtaining credits is an important move. This move by itself is one of the best mechanism and management thinking shift in containing credit risk in the bank. Another comment is that also the importance maintaining a good relationship with customers because it helps the bank to have information directly and quickly from them. The customers feel free to inform bank in time when things are not moving well and to handle the situation early before the loan went to bad loan. When we have long relationship with the customers, it often makes the credit assessment easier and faster because we already know the customer well, have information about background and previous performance. But, it is so hard at times especially if the customers lack a professional management in maintaining important variables in documented ways.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

The preceding pages introduced credit risk management practice based on findings of data from respondents in CBE and against the parameters of NBE and Based credit risk management principles. The paper begins with some research background information that triggers interest in CBE's credit risk management practice. In the paper an attempt is made through the literature review and finding of facts from respondents to answer research questions relevant to research objectives raised in first chapter.

5.1. Conclusion

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 in facilitating saving and boasting productive investments. While carrying out its activity, the banks are faced with a number of risks with credit risk. Credit risk arises when the borrowing party fails to repay the debts partly or wholly to the lending partly. Credit risk belongs to financial risk category and is one of the biggest risks in banking business as lending is core to any banking services. The question of credit risk management has continuously been an issue for banking business.

Therefore, this paper has made an attempt to assess the credit risk management practice of CBE against the parameters of NBE and Basel credit risk management principles. Accordingly, based on findings of analysis the following conclusions are made.

- ❖ It is evidenced that overall banking operation including CBE in our country currently is found at traditional level. This is because of many factors however this does not mean that it remains same for future. CBE cognizant of this fact is in the process of undertaking several strategic programs in banking operation that improve credit risk management practice such as initiating overall risk management guide lines preparations and technology supported operations, BSC etc that will help it to achieve its vision and meet international standards.
- ❖ The organizational structure of board of directors' role and responsibilities in CBE is found good. It is composed of government agents, traders agents and management body

in accomplishing its business, however, degree of commitment in exercising its role and responsibilities towards managing credit risk is low as compared to NBE and Based international parameters of credit risk management guide lines /principle From the analysis, it seems that the responsibilities to revise credit policies, strategies and introduce new procedures to manage credit risk in CBE case falls on the Management body of the bank. For example, according to NBE& Basel parameters of credit risk management principles, boards of directors are expected to exercise separate and independent oversight on the credit risk management of banks. That is, it is the board of directors role to set business level credit risk strategies and policies that govern or influence the management of credit risk of the bank, review and approve bank's credit risk strategy and policies, set credit limit in line with changing situation and management body's roles are to adapt and implement these strategies. But in CBE's case, it seems that there is a gap on these role and responsibilities of board of director with respect to credit risk management process.

- The credit risk taking and managing culture of and institution is reflection of its employees understanding towards its policies, procedures and norms as well as organizational risk appetite to take risk and manage it. In this regard, conservativeness is noticed as culture in credit risk taking and management process rarely in CBE.
- Operation of credit granting process, such as clearly-established credit policies and procedures in place for approving new credits as well as the amendment, renewal of existing credits practice is found good in CBE.
- It is also found that the most challenging problem, banking industry including CBE facing is lack of accurate, reliable and consistent information/data base in which they can make analysis on important variables, customers profile and industry analysis to mange credit risk.
- In CBE the practice of internal controls of credit policies and procedures from application to collection of loan is found to be relatively good than it was before some years back as result the proportion of overall non- performing loan(NPL)is found to be less than(1%) which is acceptable to the international standards.

- ❖ Risk rating/grading approach is found as the most common internal control used method to risk management process in CBE followed by setting authority for different approval teams and making loan review/ audit. However other methods like setting limits and risk pricing are important tools to monitor credit risks in international contexts are not currently practiced by CBE.
- ❖ Poor integration among departments in exchanging valuable information to credit risk management process is also another finding of CBE's practice in credit risk management.
- ❖ Current status on employees training to mange credit risk is found good however facts from respondents indicate that capacity building and training must be given serious attention particularly as it aspires to be world class commercial bank by the year 2025. Further it is evidenced that frequent training is required to reduce possible credit risks that emanate from poor credit appraisal and increase in level of efficiency of performers.
- ❖ Similarly workforce composition in CBE credit process it is dominated by generic business (management/accounting and economics) professionals with no one with credit specialization as major field of study in university unlike the international credit team composition. This may have its own impact on the quality of credit risk management practice of CBE although it needs further study.
- ❖ The reporting and loan reviewing practice of CBE to contain or manage credit risk is found good but the quality of information system they use to report and review when compared against the parameters of NBE and Basel standards of information systems, CBE remains with some challenges.
- ❖ Finally it was found that the likelihood of achieving CBE's vision to become one of the world class commercial bank by the year 2025 and its capability to manage credit risk in the minds of its employees equally optimistic but suspicious.

5.2. Recommendation

In line with analysis of facts and conclusions of findings the following recommendations are forwarded.

- Since there exists gap on current role of board of directors of CBE in setting corporate credit governance and credit strategies against principles of NBE and Basel credit risk standards, efforts on improving role and responsibilities of board of directors on credit risk management process should\be\made particularly if the bank wants to become world class commercial bank by the year 2025 and meet international standards in managing its credit risk.
- Although the credit risk taking and management culture of employees in CBE is good there remains some culture of conservativeness. Although it needs further study why this culture is there, awareness creation, and capacity building about risk taking and management should be given to minimize this culture among employees.
- Problem of information system/data base system remains challenge in the credit process of CBE. Therefore, solutions like improving internal capacity development of management information system department, outsourcing or else forming an independent external agency in collaboration of eternal organizations could be taken as options by the researcher of course after cost-benefit analysis is made so that CBE could minimize possibility of credit risks as result of inaccurate and poor quality of information.
- Although CBE has recently managed its overall non- performing loan (NPL)proportion to less than 1%, it should not be taken as and end by itself. Since CBE's year to year loan amount disbursed in developmental projects is increasing, therefore, new approaches like stress testing, on spot inspections and checking projects of changing scenario should be practiced apart from regular loan review and re-grading of borrowers risk management activities in the bank.
- Internal rating is the most common credit risk appraisal technique used in CBE However as CBE is aspiring towards world class commercial bank, it is better to diversify and include other internationally used techniques like setting credit limits for sectors, regions, products etc so as to mange credit risk and /or avoid concentration of credit risks.

- Considerable number of respondents fact indicated that there exist skill gaps in long term projects appraisals like agriculture projects in CBE therefore it is recommended to give trainings to fill this gap and mange credit risks and ease this problem.
- The problem of poor integration and communication among\departments in exchanging valuable information timely is common practice in CBE. Thus strong administrative action may be required solution to break this problem and mange risks by simply sharing on hand information to concerned units in our bank including process.
- CBE's credit policies, procedures for approving new credits as well as amendment and renewal of existing credits are found good in managing credit risk so that theses kind of documents should be continued to serve such functions with the changing contexts too.

Overall, according to this paper's assessment of credit risk management practice of CBE against NBE and Basel parameters of credit risk management principles, is found to be good and it seems that efforts are required to have outstanding credit risk management and take actions materialize this vision.

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RESEARCH QUESTINNAIRE

ST. MARY'S UNIVERSITY SCHOOL OF GRADUATE STUDIES

Questionnaires Objectives: This questionnaire is designed to gather valuable information regarding the Credit Risk management practice of CBE's for partial fulfillment of the requirements for Masters Degree in Business Administration. The data collected is used only for study purpose. Thus, your ideas and comments are highly honored and kept confidential. Writing your name is not required and please put tick mark( ) to indicate your choice. You are also kindly requested to write your opinion on the space provided for the questions that demands your additional view. **Target groups**: credit analysts, Experts, Managers, Directors, Credit Administrators and vice – Presidents.

Part one. General back ground information.

1. Your current position in the credit office is ________________________________

2. Your main duties are____

3. Educational level ☐ High school complete ☐ Diploma ☐ First Degree (B.A,BSc) ☐ Second Degree(MA, MSC,MED) ☐ other, please specify________________
4. Your Major at study/ University is

☐ Banking , with credit specialty ☐ Banking and finance in general

☐ Management/Accounting/Economics ☐ Engineering/Law

☐ Others please specify___________________________

5. Over allbanking service years in the CBE

☐ Under 1 year ☐ 1 – 5 years ☐ Over 5 – 10 years ☐ Over 10 years

6. Your experience in credit field is :

☐ Under 1 year ☐ 1 – 5 years ☐ Over 5 – 10 years ☐ Over 10 years

Part two: Statements designed to asses Credit risk management practice of CBE.

Please read each statement and show your agreements on the statements by putting the tick mark in the boxes accordingly.

I. **Statements related to establishment of credit policies, procedures and limits in managing credit risk.**

1. How do you rate the exposure of CBE to credit risk as compared to other types of risks?

- ☐ Grade 1: Not at all significant.
- ☐ Grade 2: Not significant
- ☐ Grade 3: Not so significant.
- ☐ Grade 4: Significant.
- ☐ Grade 5: Very significant

2. What do you think of the importance of credit risk management in the bank?

- ☐ Grade 1: Not at all important
- ☐ Grade 2: Not important
- ☐ Grade 3: Not so important
- ☐ Grade 4: Important
- ☐ Grade 5: Very important

3. How do you evaluate your understanding of risk management policies to wards the bank's credit products and services?

- ☐ Grade 1: I don't know any.
- ☐ Grade 2: I know very little.
- ☐ Grade 3: I fairly understand.
- ☐ Grade 4: I understand clearly.
- ☐ Grade 5: I understand very clearly.

4. Do you agree the credit policy of the bank has helped a lot in containing possible credit risk in CBE'S?

☐ 1: Strongly disagree. ☐ 2: Disagree ☐ 3: Neutral. ☐ 4 Agree ☐ 5: Strongly agree

If you strongly agree/strongly disagree, would you please state your reason?

____

5. How do you rate the board of directors and management in exercising their power properly to oversight the credit risk management practice of CBE?

☐ 1: Poor ☐ 2: Satisfactory ☐ 3: Good ☐ 4: Very good ☐ 5: Excellent.

6. HOW do you evaluate the credit culture, which is the attitude, perceptions, behaviors, styles, practices, and believes of CBE's employees in managing the credit risk?

☐ 1: Poor ☐ 2: Satisfactory ☐ 3: Good ☐ 4: Very good ☐ 5: Excellent

7. In the credit approval process of a borrower, most commonly, from where comes the credit risk?

☐ Borrower's cash flow/ economic condition

☐ Borrower's legal condition

☐ Borrower's Environmental condition

☐ Inadequate appraisal process of credit

☐ Any other conditions, please specify, ________________________________

8. What do you think of the importance of having credit limit in the bank?

☐ Grade 1: Not at all important

☐ Grade 2: Not important

☐ Grade 3: Not so important

☐ Grade 4: Important

☐ Grade 5: Very important

If you say not important/ very important please state your reason ________________________

9. In CBE credit risk measurement practice take account of:

☐ Specific nature of the credit ☐ contractual and financial condition

☐ Exposure profile until maturity in relation to potential market movement

☐ Existence of collateral or guarantees ☐ Internal risk rating

10. Any valuable comment on procedures, policies and credit risk management of the bank, if any, please? ____

II. Statements related to credit risk measurement, monitoring and controlling techniques of CBE'S. You may tick more than one from the list.

1. Which techniques/instrument, does CBE use for Credit risk Management in the bank?

☐ Credit Approval authority
☐ Prudential Limits
☐ Risk Ratings/gradings
☐ Risk Pricing
☐ Any other, please specify _______________________

2. Please indicates the relative importance of the following aspects of credit, you consider while defining prudential limits. (on scale of 1 to 5, where 1 = not important; 2 = less important; 3 = moderately important: 4 important = and 5 = very important)

	1	2	3	4	5
☐ Financial ratio for Benchmark	_____	______	______	_____	______
☐ Single/Group borrower limits	_____	______	______	_____	______
☐ Exposure limits	_____	______	______	_____	______
☐ Maximum exposure limits to industry	_____	______	______	_____	______
☐ Consideration maturity loan profile	_____	______	______	_____	______

3. At what interval the Credit Risk assessment and monitoring is done in the bank?

☐ Monthly. ☐ Quarterly. ☐ Bi – annually ☐ Annually ☐ More than yearly.

4. Does the CBE'S perform the following activities for Credit Risk management Purpose?

☐ Industries Studies/Profiles ☐ Periodic Credit Calls ☐ Periodic Visits of plants
☐ Develop Management information system (MIS)
☐ Credit risk Rating/ Risk Scoring
☐ Annual Review of Accounts

5. **5.** How do you evaluate the CBE'S effectiveness in controlling and monitoring credit policies and procedures?

☐ Poor ☐ 2: Satisfactory ☐ 3: Good ☐ 4: Very good ☐ 5: Excellent

6. At what interval the Credit Policy is reviewed in the bank?

☐ Monthly. ☐ Quarterly. ☐ Bi – annually ☐ Annually ☐ Any other, specify

7. Do you agree that CBE's involvement in long term credit/financing in projects pose financial distress on its operation?

☐ 1: Strongly disagree ☐ 2: Disagree ☐ 3: Neutral ☐ 4: Agree ☐ 5 Strongly agrees.

If you strongly agree/strongly disagree, Would you please state your reason____________

____

8. Please indicate the level of Credit risk being faced by the bank, CBE on the following transactions. . (on scale of 1 to 5, where 1 = no risk; 2 = less risk; 3 = moderately risk: 4 high risk = and 5 = very high risk)

	1	2	3	4	5
☐ Business Lending	____	_____	_____	____	_____
☐ Guarantees or Letter of Credit	____	_____	_____	____	_____
☐ Bonds	____	_____	_____	____	_____
☐ Inter banking loans	____	_____	_____	____	_____
☐ Others	____				

9. Does directors and CBE make an independent, ongoing assessment of the bank's loan portfolio and communicate directly to the board of directors and senior management?

☐ Yes ☐ No

10. If yes, what portfolio of loan/sectors is with highest non- performing loan and the least non- performing loan? Please write it ____

11. Any valuable comment on credit risk measurement, monitoring and controlling techniques of, if any, please? ____

III. Statements related to employees training and development in managing credit risk.

1. What grade do you give for the relation between your job and credit risk management?

☐ Not related at all ☐ Not so related ☐ least related ☐ Fairly related ☐ Most related

2. How long have you participated in credit- related staff training?

☐ Never at all ☐ under 3 months ☐ Over 3- 6 months ☐ 6 months -1year ☐ over 1 year

3. How do you rate the existing work force composition in skill variety and level in credit appraisal is competent enough with the banks credit risk exposure with project finance?

☐ 1: Poor ☐ 2: Satisfactory ☐ 3: Good ☐ 4: Very good ☐ 5: Excellent

4. In your opinion, do you think/agree that additional training and specializations are require to perform new credit forms like project financing?

☐ 1: Strongly disagree 2: ☐ Disagree ☐ 3: Neutral ☐ 4: Agree ☐ 5: Strongly agree

5. Some people says in the bank credit should be worked with those who have been there for long in order to have effective credit risk management practice. Do you agree with the above statements?

☐ 1: Strongly disagree 2: ☐ Disagree ☐ 3: Neutral ☐ 4: Agree ☐ 5: Strongly agree

6. In your opinion, how do you rate the practice of credit risk approval process in complying with CBE's credit policies, procedures and Manuals?

☐ 1: Poor ☐ 2: Satisfactory ☐ 3: Good ☐ 4: Very good ☐ 5: Excellent

7. Overall, how do you rate the credit risk management practice of each and every performer in CBE's?

☐ 1: Poor ☐ 2: Satisfactory ☐ 3: Good ☐ 4: Very good ☐ 5: Excellent

8. Any valuable comment on employees training and development in managing credit risk, if any, please specify? ____

IV. Statements related to internal control and reporting practice.

1. How efficient is the integration of Credit approval process with IT/MIS department in providing relevant data for making credit assessment?

☐ 1: Poor ☐ 2: Satisfactory ☐ 3: Good ☐ 4: Very good ☐ 5: Excellent

2. How complete, plausible and aggregate is the data being used in approving loans to maintaining credit risk at acceptable level in the bank.

☐ 1: Poor ☐ 2: Satisfactory ☐ 3: Good ☐ 4: Very good ☐ 5: Excellent

3. How do you evaluate the credit administration and documentation in preventing and containing credit risk of CBE's?

☐ 1: Poor ☐ 2: Satisfactory ☐ 3: Good ☐ 4: Very good ☐ 5: Excellent

4. How do you rate the capacity of CBE's management information system in providing adequate information timely on the composition of the credit portfolio, including identification of any concentrations of risk?

☐ 1: Poor ☐ 2: Satisfactory ☐ 3: Good ☐ 4: Very good ☐ 5: Excellent

5. What do you think of the role of internal control in Credit Risk management in your bank? Is internal control conducted on a timely basis?

☐ 1: Poor ☐ 2: Satisfactory ☐ 3: Good ☐ 4: Very good ☐ 5: Excellent

6. Does the bank call for your options whenever there is an adjustment to the policies associated to credit or credit risk management?

☐ Never ☐ Rarely ☐ Sometimes ☐ Regularly

7. Generally, what strengths and weakness do you observe in CBE's internal control practice to contain credit and other risk in line with its vision?

____

____

Thanks you for your time and cooperation!!!!!!!!!

Interview Question

Part three: Interview Question on the role of Board and senior management to oversight Credit risk management (Target group – vice Presidents).

1. Does CBE has separate board approved credit risk management strategy? How closely the board is exercising its role in monitoring such risk?
2. How do you explain the role of board in managing credit risk?
3. What is the credit risk management strategy and philosophy of CBE?
4. Do you believe that credit culture is well established in the bank? How much do employees understand it? Does it contain the points that an effective culture consists?
5. Do you believe that the existing work force composition in skill variety and level in credit appraisal is competent enough with the banks credit risk exposure with project finance?
6. What are the formal documents related to credit and credit risk management that the bank has published? , lending activity and Other credit activities?
7. In practice, do you strictly follow procedures stated in the documents? How is the authority of your transaction office?
8. Is there any client categorization? What are the criteria for that categorization? Are there any limits to certain group of clients? (Industry, geographical location etc)
9. Could you please tell in details about the bank's internal credit rating system? In your opinion, is it helpful to your bank's credit risk management?
10. What do you think of the role of internal control in credit risk management in your bank? Is internal control conducted on a timely basis?
11. Are the policies and procedures constantly reviewed to adjust to the new conditions? Usually on what basis? Please give an example of the most recent change?
12. How are the credit staffs in the transaction office notified of the new policies or any modifications? Are the notifications timely and complete? Was there any loss resulting from inaccurate notification?
13. How frequently are update reports made to the management? In what form are the reports? Is the report content much related to risks or risk management?

14. Did you ever have to loosen credit approval standards due to profit pressure?
15. Is there any group of customers that are more favored than others? Who are they?
16. How is bad debt and loan loss provision in the transaction office? What type of customers is most likely to generate bad debts?
17. How often the business results from credit are critically reviewed?

Thank you for your contribution!

Appendix Loans Disbursement versus Loans collection

Table 1: Trends in loans Disbursement, by Sector (in millions Birr)

Particulars	2006/07	2007/08	2008/09
Agriculture	1,609	3,534	2,516
Manufacturing	546	918	711
Domestic trade	1,406	2,643	1,746
Export	788	976	368
Import	566	4,440	3,403
Building& Construction	260	960	1,494
Personal	67	105	178
Mortgage loans	0	0	676
Total loans Disbursement	5,232	13,575	11,902

Sources Annual report CBE’s 2006/07, 2007/08, 2008/09.

Due to agriculture, manufacturing and export sectors performance failure loans disburse in 2008/09 were decreased than the preceding year.

Table1.1: Trends in loans Disbursement, by Sector (in millions Birr)

Particulars	2009/10	2010/11	% Change
Agriculture	3,737	7,521	101.3
Manufacturing	1,585	5,520	248.3
Domestic trade	1,348	1,370	1.6
Export	791	672	-15
Import	436	1,324	203.7
Building& Construction	1,121	191	-83
Personal	65	71	9.2
Disbursement to banks	0	89	
Mortgage loans	1,268	1,022	-19.4
Bond Disbursement	9,874	19,930	104.3
Total loans Disbursement	20,225	37,710	86.4

Sources Annual report CBE's 2009/10, 2010/11.

The amount of fresh loans disbursed to various economic sectors during the review year was Birr 37.7 billion. This constituted an increase of 86.4% when compared with the level in the preceding year.

Table 1.2: Trends in loans Disbursement, by Sector (in millions Birr)

Particular	2011/12	2012/13	Percentage change
Loans and bonds disbursement	55,441	56,506.64	1.9
Loans	31,940	34,631.64	8.42
Bonds	23,501	23,670	7.2
Pres-shipment(net increase)	2,170	2,184	6.4
Receivables	3,263	-	
Total Disbursement	60,874	66,506.64	92.5

Sources Annual report CBE's 2011/12, 2012/13.

The amount of fresh loans Disbursed to the various economic sectors during the reporting year 2011/12, 2012/13 was Birr 60.9 billion and 66.5 billion. This constituted an increase of 61.4% when compared with level in the preceding year.

Table below shows Loans collection trend:

Table1.3Trends in loans collection, by Sector (in millions Birr)

Particulars	2006/07	2007/08	2008/09
Collection from customers	5,694	7076	9203
Agriculture	1,540	2,553	2,201
Manufacturing	429	428	554
Domestic trade	1,832	1,555	1,981
Export	627	753	568
Import	875	1,426	2,410
Building& Construction	228	290	1,420
Personal	53	71	69
Other Projects	111	-	-
Collection from banks	61	59	81
Mortgage loans	-	-	53
Total loan collection	5,755	7,135	9,336

Source Annual report of CBE's 2006/07, 2007/08, 2008/09

From the above table total loan collection stood at Birr 9.3 billion in 2008/09, from Birr 7.1 billion a year ago (i.e., up by 30.8 percent). Loan collection from building and construction sector, import sub sector and from banks increased by 389 percent, 69 percent and 36.3 percent respectively and they represented as major contributors to such good performance.

On the other hand, loans collection from the export sub-sector, the agriculture sector and personal loans fell by 24.6 percent,13.8 percent and 2.4 percent, respectively, compared with their preceding year's status.

Accordingly, the ratio of loan collections slightly increased to 84.2 percent in 2008/09 from 52.6 percent in 2007/08, testifying the fact that all the concerned staff paid the required effort towards the timely collection of loans. Accordingly, the Bank's stock of non –performing loans reduced remarkably during the year, which is one of the major achievements of the bank during this period.

Table1.4Trends in loans collection, by Sector (Mn. Birr)

Particulars	2009/10	2010/11	% Change
Collection from customers	8,641	9,610	11.2
Agriculture	2,984	4,451	49.2
Manufacturing	540	1,086	101.1
Domestic trade	1,749	1,635	-6.5
Export	627	780	24.4
Import	1,521	1,080	-29
Building& Construction	1,166	514	-55.9
Personal	54	64	18.5
Other Projects	-	-	
Collection from banks	145	153	5.5
Mortgage loans	193	393	103.6
Bond collection	1,254	7,424	492
Total loan collection	10,233	17,580	71.8

Source annual report of CBE'S2009/10, 2010/11

From the above table total loan collection stood at Birr 10.2 billion in 2009/10, from Birr 9.3 billion a year ago (i.e., up by 31.9 percent). Loan collection from manufacturing sector, agriculture and export sector increased by 101.1 percent, 49.2 percent and 24.4 percent respectively and they represented as major contributors to such good performance. On the other hand, loans collection from the building and construction-sector, the import sector and domestic trade fell by 55.9 percent,29 percent and 6.5 percent, respectively, compared with their preceding year's status.

Accordingly, the ratio of loan collections slightly increased from 84.2% in 2008/09 to86.7% percent in 2009/10, testifying the fact that the Bank had put the required effort towards the timely collection of loans. Accordingly, the Bank's stock of non –performing loans fell remarkably during the year. This is one of the major achievements of the bank has to be proud of. The non- performing loans ratio has decreased from 3.66% in the preceding year to 1.74%.

In addition to this the loan collection of 2010/11 reached birr 17.6 billion, showing an increase of 71.8% over the preceding fiscal year. This large increase was attributed mainly to the large loan collections from the disbursement effected during the year under review.

Table 1.5Trends in loans collection (Mn. Birr)

Particular	2010/11	2011/12	Percentage change
Term loan collection	10,156	14,643	44.2
Bonds collection	7,424	4,822	-35
DBE and Housing		2,855	
EEPCO		1,682	
Government Bonds		285	
Sub-total	17,580	19,465	10.7
Receivables- EGTE	0	1040	128.2
Total Loans collection	17,580	20,505	16.6

Sources Annual report of 2010/11, 2011/2012

The total loan collection reached Birr 20.5 billion, showing an increase of 16.6% over the preceding fiscal year. This increase was attributed mainly to the large loan collections from disbursements effected during the year under review.

Table 1.6 Trends in loans collection (Mn. Birr)

Particular	2011/12	2012/13		Percentage change
Term loan collection	14,643	27,597.20		88.5
Bonds collection	4,822	8,855.50		83.6
DBE and Housing	2,855	5,165.80		80.9
EEPCO	1,682	3,600.80		114
Government Bonds	285	88.90		(69.0)
Sub-total	19,465	36,452.70		79.2
Receivables- EGTE	1040	2,372.80		128.2
Total Loans collection	20,505	38,825.50		89.3

Source Annual report of CBE’S 2011/12, 2012/13.