ST. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES, MBA PROGRAM

ASSESSMENT OF CREDIT MANAGEMENT PRACTICES: IN CASE OF HIBRET BANK S.C

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Dec 2021
Addis Ababa, Ethiopia

ST. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

FACULTY OF BUSINESS

ASSESSMENT OF CREDIT MANAGEMENT PRACTICES: IN CASE OF HIBRET BANK S.C

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STATEMENT OF DECLARATION

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

Fasika Gebremeskel **Signature** _____

St. Mary's University, Addis Ababa Ethiopia **Dec 2021**

ENDORSEMENT

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

___Mohammed Seid________ ____________________

Advisor **Signature**

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List of Acronyms

NBE	National Bank of Ethiopia
LC	Letter of Credit
CIC	Credit Information Center
NPL	Non-Performing Loan
CM	Credit Management
SPSS	Statistical Package for Social Science
SD	Standard Deviation

Abstract

The main objective of this study was to investigate credit management in light of the practices of modern credit management in financial institutions in case of Hibret Bank. To achieve this objective, descriptive research design has been employed along with both quantitative and qualitative research approaches. For the study both primary and secondary data is used. Primary data is collected using questionnaire, interview and the secondary data is collected from the bank's audited annual reports (2018/19-2020/21). A purposive sampling technique was used to select respondents from Hibret Bank employees who work at the head office and 8 other branches in Addis Ababa. Structured questionnaire was used to collect the data from a sample of 79 employees. Data were analyzed using a descriptive statistics. The findings reviled that the bank is not controlling the borrowers limit as per the NBE requirements and it lacks effective credit management system in controlling the credit limit of borrowers. The existing credit policy and procedure of the bank is encouraging flexibility to guide the loaning activity. The bank has been continuously make sure that the NPL cases has transferred to foreclosure process to get timely decision to reduce additional provision expense of the bank. But this does not help the bank to effectively implement its loan recovery mechanism to reduce its bad loans. Moreover, the bank has failed to make proper follow up on the loans availed whether they are spending on the actual purpose of the loan requested and also the credit monitoring procedure is not regularly reviewed and updated in the bank. Finally based on the findings of the study, the following recommendations are given. The bank should checks the borrower history before granting loans and properly assessed the customer ability to meet obligations in credit processing or appraisal system and properly assess the customer ability to meet obligations. Besides, the bank should give sufficient training to the customers on loan usage.

Key Terms: Credit Management, Credit portfolio, NPL

CHAPTER ONE
INTRODUCTION
1.1 Background of the study

The importances of financial institutions in any developed or developing economy, financial institutions are not only easing the credit flow in the economy but also improve the productivity by stimulating investment in the long run (Richard, 2011). Economic growth is possible with a sound financial sector (Rajaraman and Visishtha, 2002). Economic growth in any country is classified into good performance and poor performance. Good performance of those financial institutions is the symbol of prosperity. On the other side, poor performances of those institutions hinder the economic growth and structure of the particular region affects the whole world (Khan and Senhadji, 2001).

Credit creation is the main income generating activity for the banks. But this activity involves huge risks to both the lender and the borrower. The risk of a trading partner not fulfilling his or her obligation as per the contract on due date or anytime thereafter can greatly risk the smooth functioning of a bank's business. On the other hand, a bank with high credit risk has high bankruptcy risk that puts the depositors in jeopardy. Among the risk that face banks, credit risk is one of great concern to most bank authorities and banking regulators. This is because credit risk is that risk that can easily and most likely prompts bank failure (Conford A., 2000).

Proper credit management sound credit policy guide appropriate credit analysis using physical analytical tools & insure timely follow up loan repayment after disbursements with the aim of averting loans failing in arrears or overdue categorize. Regulation if credit is arrears through the collection efforts & one reschedule exercises .In order to achieve smooth & good repayments & minimization of none performing Loan (Anwar, 2013).

Lending is one of the principal tasks of all banks in any country working for profit. It is evident that a substantial proportion of the total revenue of all banks in Ethiopia comes from interest on loan and advances. Loan and advances comprise a very large portion of a bank's total assets. The strength of a bank is thus judged by the soundness of its loan management. Wise and prudent policies and procedure

with regard to credit management are considered important factors inspiring confidence in depositors and prospective customer of a bank. This also holds true for Hibret bank S.C.

Bank lending is inherently risky; the risk can be minimized and controlled through a high professional management of the lending function and through the formulation of prudent lending practice.

Credit management practice means the total process of lending starting from inquiring potential borrowers up to recovering the amount granted credit. In the sense of banking sector, credit management is concerned with activities such as accepting application, loan appraisal, loan approval, monitoring, and recovery of non-performing loans. Banks take into account many considerations as a factor of credit management, which helps them to minimize the risk of default that results in financial distress and bankruptcy. This is due to the reason that while banks providing credit they are exposed to risk of interest and principal repayment, which need to be managed effectively to acquire the required level of loan growth and performance (Shekhar, 2005).

A strong and effective credit management practice is one that reinforces and compliments its corporate objectives and goals. The main problem that banks encounter in credit administration is that some of the granted credit facilities are not re-paid leading to a loss of depositor's funds and emergence of bad debts. Therefore, it becomes a matter of convincing determination to assess Hibret bank's credit management practice. Since the Non-Performing Loan (NPL) position of the bank has a fluctuating tendency in the past few financial periods.

Hibret bank was incorporated as a share company on September 10, 1998 in accordance with the commercial code of Ethiopia of 1960, with paid up capital of birr 24.8 million by 335 shareholders (nbebank.com, 2021). Lending is one of the most important activities. It is evident that a substantial proportion of the total revenue of all banks in Ethiopian comes from interest on loan and advances. Hibret bank S.C. officially began its operation on September 21, 1998. The first branch, Beklobet Branch, was officially inaugurated and started providing domestic banking services on October 1, 1998. In 1998, the bank's deposits were birr 116 million, loan and advances 83 million, from 1998 onwards, these financial indicators have shown a significant increase and in the fiscal year that ended June 30, 2012, the bank has registered birr 7.26 billion in total assets, birr 4.85 billion in deposits, birr 5.75

billion in loans and advances, Currently, Hibret bank is a full service bank that offers its customers a wide range of commercial banking services with a network of 339 branches and 9 sub-branches, and a number of additional outlets on the pipeline.(UBAnnualReport,2020/21).

As stated above, credit management should be given special emphasis than that of the other operational functions because of that the success or failure of financial institutions depends up on the good performance of credit. Therefore, the purpose of this study is to examine the practices of credit management in light of the practices of modern credit management in financial institutions.

1.2Statement of the Problem

Banking industry is a major source of finance for any type of business. Loan is one of the mechanisms used by financial institutions as a major source of income. Also the process of repayment default is also fraud for the institutions.

According to Colquitt (2014) the banking business is more sensitive due to more of their income will be generated from credit given to their customers. This credit business operation exposes the banks to high credit risk which leads to loss. Without effective credit risk management good bank performance or profit will be unthinkable. Credit is mainly granted by banks. Banks manage credit properly the bank has prepared policy and procedure of useable for adequate credit management practice. Based on this the bank is creating short term, medium and long term credit facility to its customer. Credit management has a profound implication both at the micro and macro level.

Credit Management refers to the efficient credit policy variables to ensure prompt collection of loans granted to customers and at the same time boost their confidence in and loyalty to the bank Ankrah, (2011). This is the function within the bank to control credit policies that will improve revenues and reduce financial risks. It is an aspect of financial management involving credit analysis, credit rating, credit classification and credit reporting. Sound credit analysis, credit rating, credit classification and credit reporting standards are an excellent point of collectability performance and effective credit policy management leads to enlargement of economy and construct the self-reliance of customer by reducing the frequency and depth of loan problem Koch, (2005).

Hibret bank S.C, like the other commercial banks in Ethiopia, is very successful in mobilizing deposits from customers. However, the rate of the growth in loans and advances is not keeping pace with fast growth of deposits on which the bank incurs cost. Based on the management report of June 2012, total deposits (demand, fixed, and saving) is birr 4.85 billion and total loans and advances is birr 5.75 billion. This fact underlies that serious moves should be made to enhance the bank's loan portfolio.

On the other hand, the bank's financial statement (annual report 2020/21) shows that on the average 2.72% in the level of the non-performing loans. As Hibret bank expands and reaches more customers, it has also increased its exposure to risk. An increase in the non-performing loan portfolio is an indication of the deterioration to the total portfolio. Due to the increasing amount of non-performing loans of banks, the National Bank of Ethiopia (NBE) directs all commercial banks to review loans and advances regularly and classify them in a manner consistent with five categories, which are pass, special mention, substandard, doubtful and loss.

Regarding to Hibret bank, Non-performed Loan (NPL) calculated based on the National bank provision calculation guideline. For instance, by 2020/21, NPL of Awash bank, Bank of Abyssinia and Dashen bank are less than 3% (Annual report of Awash, Abyssinia and Dashen banks, 2020/21). The same Hibret bank has less than 3% NPL in the year 2018/19, 2019/20 & 2020/21 and the following table indicates NPL's position of the bank for the last three years and it is higher than other competitive private banks of Ethiopia.

No.	Year	NPL %
1	2018/19	1.48%
2	2019/20	1.9%
3	2020/21	2.72%

(Annual Report of Hibret bank 2018/19, 2019/20, 2020/21)

Additionally, some researches were conducted in Ethiopia mainly focused on credit management practice of different commercial banks. Saheb and Krishna (2018) assessed on credit risk management technique and practice of Commercial Bank of Ethiopia and Awash Bank;Gedefaw, (2019) has

assessed credit risk management system and practice of four Ethiopian private commercial banks Berhan International Bank S.C, Bunna International Bank S.C, Debub Global Bank S.C and Enat Bank S.C. Hable, (2018) has assessed credit management practice of United Bank S.C. Sahlemichael, (2009) has investigated credit management on Ethiopian Commercial Banks; many researches were focusing on the effect of assessment of credit management practice. As a result, this paper is to assess and find out what tools and techniques are used in the bank and to what extent their current performance are supported by proper credit management practice policy, procedure and strategy and to what extent Hibret bank can manage its credit management.

1.3 Research questions

This researcher tries to answer the following question:

- What are the major factors influencing the credit management practice of Hibret Bank s.co?
- What is the implication of loan performance in Hibret Bank's profitability (Performance)?
- How is the credit collection strategies adopted in the management of credit department in Hibret Bank?
- How the Bank manage non - performing loan?
- What measures are taken by the bank to minimize non- performing loans?
- How appropriate is the credit processes and evaluation follow up system in the bank?

1.4 Objective of the study

1.7.1. General objective

- The general objective of the study is to evaluate credit management and practices of the bank and recommend possible solutions.

1.5.2. Specific objectives

- To assess factor influencing the credit management practice of Hibret Bank s.co
- To assess the implication of loan performance in Hibret Bank's profitability
- To asses credit collection strategies adopted in the management of credit department in Hibret Bank
- To assess how to Hibret Bank manages non - performing loan

- To assess the measurements taken by the bank to minimize non- performing loans
- To assess the credit processes and evaluation follow up system of the bank

1.6 Significance of the Study

Among the various financial services given by banks, lending is the most important and principal activity which generate higher profit and existence of the bank. The optimum utilization of efforts to increase the bank's loan portfolio is unquestionable. Following this, the significance of this paper focus emphasize on showing relative position of Hibret Bank in the banking industry in terms of total deposits, loans, and advances and other performance measures especially which related to the credit area. After assessing the problems associated with lending activity of the bank, this studies advance recommendations that can provide possible solutions for the identified problems. Beside this, the finding has significant in indicating the best practice and concepts for practical lending to enhance the performance of credit management to all managers and policy makers of the bank as well as to all financial institutions and banks. Moreover, it may help as a benchmark and a reference for researchers who are interested in the area to extend it further.

1.7 Limitation and Scope of the Study

1.7.1. Scope of the Study

The scope of the study is restricted to assess the credit management practice in case of Hibret Bank S.C. at corporate level only in some selected directorates which are directly and indirectly engaged in the same related role in the credit management process. All Hibret bank districts, Branches and other financial institutions involved in the banking service are not included in the study due to shortage of time and more importantly to make the study manageable, it has been delimited to only Hibret Bank S.C.

1.7.2. Limitation of the Study

Because of financial, COVID 19 and time constraint, the study was conducted only in Hibret Bank head office and other eight branches located under South East AA district (Bole Medhnialem, Wello Sefer, African Venue and Millennium branches) and North Addis Ababa district (Meskel flower, Legahar,

Sidist Kilo and Megenegna branches. Since banks are profit making organizations and most information are held secret, assessing information as needed is a bit difficult.

1.8 Organization of the paper

The Study is organized into five chapters. The first chapter includes brief the introduction including background of the study and the organization, statement of the problem, research questions, objectives of the study, limitation of the study, scope of the study, significance of the study and organization of the paper. The second chapter covers related literature review, the third chapter deals with the research methodology part including the research design, the study area, the sampling techniques, data gathering technique and instruments and data analysis techniques. In the fourth chapter presets the results & discussion and in the fifth chapter conclusion & recommendations of the study were included

CHAPTER TWO

LITERATURE REVIEW

2.1. Introduction

The purpose of this chapter is to describe and document what has been written and recorded in different manuals, magazines, journals, literatures and authors about Bank Credit Management and Practices. For this particular study, the researcher has arranged under four sections that include the theoretical review, empirical review, conceptual framework, research gap and conclusion.

2.2. Theoretical Review

2.2.1. Concept and definition of credit management practice

Credit is derived from a Latin word 'creditum', which means to believe or trust. In economics, the term credit refers to a promise by one party to pay another for money borrowed or goods or services received. It is a medium of exchange to receive money or goods on demand at some future date, ML JhiNGan (2002).

Another definition of credit is that has originated from the Latin word "credo" which means ,I believe "credit is matter of faith in the person & not less than in the security offered credit is increasing a purchasing power an individual organization derived from financial institution the total amount offset of idle income held by depositors in the banks, or as a net addition to the total amount of purchasing power .In facts no economy can function without credit all economic transactions today .It is the very life blood of modern business & commercial system, K.C Shekhar (1974).

It is a term used to identify accounting functions usually conducted under the umbrella of Accounts Receivables, Wise-geek (2010). Essentially, this collection of processes involves qualifying the extension of credit to a customer, monitors the reception and logging of payments on outstanding invoices, the initiation of collection procedures, and the resolution of disputes or queries regarding charges on a customer invoice. When functioning efficiently, credit management serves as an excellent way for the business to remain financially stable.

Banks as financial institutions extend credit to their customers in f or m of loans, over drafts and off

balance sheet activities (i.e. letter of credit (LC) and guarantees). Banks grant credit to enhance their re venues streams, maintain a competitive edge, to act as its bargaining power in the industry, as the industry practice as well as to enhance the relationship with their customers.

Credit Management from a debtor's point of view is managing finances especially debts so as not to have a tail of creditors lurking behind your back. Credit management is a responsibility that both the debtor and the creditor should seriously take. When it functions efficiently credit management serves as an excellent instrument for the business to remain financially stable.

2.2.2. Credit Management Practice

According to Asiedu-Mante (2011) credit management practice involves establishing formal legitimate procedures and policies that will ensure that the proper authorities grant credit, the credit goes to right people, the credit is given for the productive activities or for businesses which are economically and technically viable. The appropriate size of credit is given, the credit is recoverable and there is adequate flow of management information within the organization to monitor the credit activity.

Loans management refers to the effective use of the four major credit policy variables to ensure that there is quick collection of loan given to borrowers when due and at the same time improve on their confidence and loyalty to the bank, Van Home (1995). Myers and Brealey (2003) consider credit management to be made up of techniques and strategies used by an enterprise to ensure that an optimal level of credit and its effective management are kept. This is one aspect of monetary administration including credit examination, credit assessment, and credit scoring and credit reports.

Nzotta (2004) opined that credit management greatly influences the success or demise of banks and other financial institutions. This is because the failure of deposit banks is determined largely by the quality of credit decisions and thus the quality of the risky assets. He further notes that, credit management provides a leading indicator of the quality of deposit banks" credit portfolio. One important precondition for effective credit management is the ability to intelligently and efficiently manage customer credit lines. He continued by stating that to reduce over exposure to bad debts, overbooking and insolvency, financial institutions should have a better understanding of the financial

strength of customers, credit account history and evolution of payment methods of clients.

Office of the Controller of the Currency (2011, Ghana) defined Loan portfolio management as the mechanism by which risks that are inherent in the credit granting process are controlled and effectively administered. It involves evaluating the steps taken by management of financial service providers of credit to identify and exercise adequate control over the element of risk throughout the credit delivery process. Credit management starts with granting of a facility and does not stop until the full and final payment has been made. Technically a transaction cannot be termed as complete until full payment has been made. Good lending therefore ensures that the borrower follows the repayment plan set up for him in a timely and prompt manner otherwise; this eventually leads to the total loss of interest that the institution could have earned due to the opportunity cost of the loan, the risk involved and time value of money.

Credit management is primarily concerned with the effective management of debtors as well as judicious financing of receivables. The objectives of credit management can therefore be expressively stated as safeguarding the portfolio of the banks‟ investments in debtors and maximizing shareholders wealth. Policies and practices ought to be rigorously enforced for granting credit facilities to customers, collection of repayments that are due and limiting the high risk factor of non-performing loans.

2.2.3. Process of Credit Management

The process of credit management begins with accurately assessing the credit -worthiness of the customer base and his/her business viability. This is particularly important if the company chooses to extend some type of credit line or revolving credit to certain customers. Hence, proper credit management is setting specific criteria that a customer must meet before receiving the proposed credit arrangement. As part of the evaluation process, credit management also calls for determining the total credit line that will be extended to a given customer, Yalemzewed (2013).

According to Agyman (1987), several factors used as part of the credit management process to evaluate and quality a customer for the receipt of some form of credits. These factors include;

- Gathering data on the potential customer's current financial condition, including the current credit score.
- The current ratio between income and outstanding financial obligations
- Competent credit management which not only protects the vendor/bank from possible losses, but also protects the customer from creating more debt obligation that cannot be settled in a timely manner.

According to Edwards (2004), Banks Credit Management process can be summarized in three main stages. Theses stages are:

- Credit initiation
- Documentation and disbursement
- Credit Administration

When the process of Credit Management function becomes, efficient, everyone involved benefits from the effort. The vendor /bank has a reasonable amount of assurance that invoices issued to a client will be paid within terms, or that regular minimum payments will be received on credit account balances. Customers have the opportunity to build a strong rapport with the vendor and thus create a solid credit, Habtamu (2015).

2.2.4. Credit Policies and Procedures

A Credit Policy is not something that is only operated by the Credit and risk Department. All employees involved with customers, in any way, need to be aware of the credit policy and ensure that it is operated consistently, Hagos(2010).

Economic conditions and the firm's credit policies are the chief influences on the level of a firm's account receivable. Economic conditions, of course, are largely beyond the control of the financial manager. As with other current assets, however, the manager can vary the level of receivables in keeping with the tradeoff between profitability and risk. Lowering quality standards may stimulate demand, which, in turn, should lead to higher profitable receivables, as well as a greater risk of bad debt. The credit and collection policy of one firm are not independent of those of other firms. If product and capital markets are reasonably competitive, the credit and collection practices of one company will

be influenced by what other companies are doing.

The credit and collection policy of one firm are not independent of those of other firms. If product and capital markets are reasonably competitive, the credit and collection practices of one company will be influenced by what other companies are doing. Such practice related to the pricing of the product or service and must be viewed as part of the overall competitive process. The examination of certain policy variables implies that the competitive process is accounted for in the specification of the demand function as well as in the opportunity cost associated with taking on additional receivables, Hagos (2010).

2.2.5. Credit Administration

The credit administration refers to the credit support, control systems and other practices necessary for the effective monitoring of credit risks taken by the Bank. Some of the important points of the credit administration are:

- Control of Credit files.
- Safekeeping of credit and documentation files.
- Follow-ups for expirations of essential documents like CA's and insurance.
- Control of credits and excesses over approved lines.
- Monitoring of collateral inspections, site visits and customer calls.
- Monitoring of repayments under term credits.
- Reporting: the portfolio is periodically reviewed to make sure that the names tiered are still complying with the risk acceptance criteria.

2.2.6. Credit Process

Banks succeed when the risks they assume are reasonable, controlled commensurate their resources & credit competence. Lending officers must accurately identify measure & moorage, if their banks are to succeed. Before a bank agrees to commit its funds to a company its credit officers have responsibility to grasp the quantitative & qualitative details of each transaction thoroughly analyze its variables & make adequate for their impact, P.Henry,(1981).

2.2.6.1. Credit Application

The credit application is the primary step in the credit management process. Regardless of the size and purpose of the loan a loan application is required. Though it may appear as simple questions to the applicants they should understand the importance of the document. The application documents contain detail information about the applicant. The information among other things include: name of the applicant, address, residential address, age, telephone number, marital status, number of dependents, educational background, hometown, the type of business, business location ,number of years in business, reasons for the loan, amount required, the repayment period, security pledge if any and guarantors Michael Danso (2015).

The loan application form makes provision for loans committee's member's approval signature and rejection comment. This document is the most important document as far as the loan agreement is concerned. It is the content of this document which the credit union can take any legal action against a borrower who defaults. Since this is the initial stage of the credit management process any error committed at this stage goes a long way to negatively affect the whole process. A loan defaulter can escape legal punishment if the content of the loan application form is not properly structured. Hence the need to evaluate the existing loan application forms to ensure that they are properly structured to protect the credit unions (Ibid).

2.2.6.2. Credit Information

Is information related to applicant performance & credit worthiness have to be collected from different source carefully & as much as possible genuinely .Other banks could be useful sources. In resents time national banks under go certain processes while dealing with credit .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.

2.2.6.3. Credit Analysis

Credit analysis is the evaluation of borrower's capacity in properly servicing the loan. It is done to ensure that loans are made in appropriate terms to clients who can and will pay it back. What analysis is needed and in what scope, is primarily determined by the type and size of loan, but the ultimate purpose is to place good loans so that both parties can benefit from it and meet their objectives. In properly analyzing the credit worthiness of borrowers, lenders often look at some five factors that are known as the five C's of credit. (James Ballard, 2003)

Credit analysis refers to the process of deciding whether or not to extend credit to a particular customer. 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 official attempts to evaluate a borrower's ability and willingness to repay (Koch, 1995).

Koch explained in his book that Eric Compton identified three district areas of commercial risk analysis related to the following questions:

A. What risks are inherent in the operations of the business?
B. What have managers done or failed to do in mitigating those risks?
C. How can a lender structure and control its own risks in supplying funds?

The first question forces the credit analyst to generate a list of factors that indicate what could harm a borrower's ability to repay. The second recognizes that repayment is largely a function of decisions made by a borrower. The last question forces the analyst to specify how risks can be controlled so the bank can structure an acceptable loan agreement.

Pandey (1990) and Kich (1995) stated in their book that there principal factors taken in to consideration when granting credit. Pandey states 3c"s of credit: character, capacity and capital, but Koch mentions 5 c's: character, capital, capacity, condition and collateral.

Character - It is the extent to which the borrower is willing to pay the credit .The debt repayment capacity is useless without the will of the borrower to repay the debt character is about the manner of the borrower interims of having a well defining purpose, a responsible attitude toward. Using the borrowed sum responsibility, truthfulness, serious purpose, & intention to pay are important elements to evaluating character. The credit officer can ensure this through serious interview. Example previous credit experience which including manner of Meeting finical obligation with individual companies, groups. E.g. that has good performance & character to pay their debt, James (2002).

Capital - The success of business depends on motivation attached to ownership interest; banks will have to make sure that there is proportional risk of owners in the venture, hence the level of capital will have to evaluate to ensure that the shoulder the risk party with ownership interest. In this connection factors like customers net worth equity in horn & other assets should be taken as indictors, James, (2002).

Capacity – It represents the debt payment capacity a good borrowers earning can be taken as indicator of credit payment capacity .for instance, for a poor farmer, the capacity can be determined by looking

the possible discretionary income he/she can have .That income left after meeting requirements like food, & clothing. The average family size should be taken in to consideration since it affects the discretionary income to a large extent. A family with three members can have better discretionary income than a family with six members because the total income that seem to be fixed is going to be shared by large numbers as the family size increase .Another factor that can dictates the capacity of borrower is the indebted of the borrower so far .for instance, if he is indebted to someone else (may be to local informal money lender) he may use proceed he gets from selling. The product toward the payment of his earlier debt, James (2002).

Condition – The environment surrounding them affects borrowers. For instance: climatic condition (absence of rain for example) is one factor that affects agriculture sectors. Farmers are affected by droughts, hails& an even rainfall. The ability of farmers to repay their debts is directly linked to such risk in terms of successful crops, selling stocks etc…in addition to this market for the product is another condition that affects the capacity of farmers to pay back their credits .for example; if the productivity in other area of the country is good, then the prices of agriculture product will decline flow which adversely affect the cash of the farmer. All conditions that can affect the borrower in the future should be assessed before the credit is granted, failure to recognize such things may lead to bankruptcy especially if the credit portfolio is concentrated on certain region, Lulseged (2002).

Collateral – collateral is the lenders secondary source of repayment or security in the case of default. Having an asset that the bank can seize and liquidate when a borrower defaults reduces loss, but it does not justify lending proceeds when the credit decision is originally made.

2.2.7. The Loan System

The financial intermediary needs to establish the amount of credit risk latent in the credit proposal and within the boundaries of that risk, a decision has to be made whether to accept or reject the proposal. An effective credit management system provides the right framework for such decisions to be made Puri and Poli (2013) For any provision of credit line within the retail sector for instance, a borrower must have a pre-existing capacity to repay the loan either from his/her salary or income from self-employed business or profession. But financing in the commercial sector is somewhat different.

A borrower is not always required to have a pre-existing capacity to repay a working capital or a term loan that he or she seeks from the bank. The capacity to repay is built over the duration of the facility with the help of the bank loan. As the borrower's business expands, incremental cash flows are generated from which the debt can be serviced and repaid as per agreement. Growth of business in the right direction supported by the bank credit drives the cash flow of the business upwards. It is the assessment of incremental cash flows which helps the lender to determine the repayment capacity of the borrower to meet loan obligations in a timely manner, Yaw Adu (2015).

Bank lending is premised on the assertion that the debtor has the willingness and capability to requite the loan at all stages in their business transactions with the bank. However, the capacity to pay back depends on future income streams and the disposition to repay has to be based on the pre-existent commitment that has been undoubtedly demonstrated by the borrower. It is a statement of faith because the lender relies largely on the debtor's ability and competence despite business downturns to at least guarantee future cash flows and ensure the flow of regular payments. These are some of the factors that are necessary in carrying out an effective appraisal of the customer and provide the basis for making well-informed decisions as regards the credit granting process.

2.2.8. Proposed Lending Tools

The current economic difficulties crave for new credit management processes to be put in order to help reduce the lending risk, Fatemi and Fooladi (2006). Consequently, several tools and technologies will be discussed that have emerged from other research work which could be integrated in the management of credit in the unions.

2.2.8.1. Credit Limits

Credit limit is one of the tools financial institutions use to control their loan portfolio. Setting credit limit is one of the main ways financial institution use to control its' credit process to reduce risks associated with lending. Bessis (2002) shows the significance of employing the credit limit process so as to avoid any credit risk which could imperil the financial position of the institution. Dekker (2004) argues that the credit officers‟ responsibility is to set repayment period and principle amount that

would support the affordability of the customer.

Nevertheless, Bessis (2002) also states that the setting of credit limit could conflict with the development of the financial institutions business volume as it will control the customer's rate of taking Loans. Furthermore, he states that a shorter loan repayment period affects the interest income generated by the banks. This further increases the possibility of customers not being able to meet their repayment installment as it will increase big.

Consequently borrowers are needlessly grouped into a delinquency state (Dekker, 2004). Contrary to this, Dekker (2004) indicates that the longer the repayment period of a loan facility the greater the likelihood that borrower will default in repayment. This is due to the changing environment and possibly the changing circumstance and situation of the borrower. Accordingly, the question then arises that, are financial institutions employing a rigorous credit limit procedure in their credit assessment? The amendment of credit unions system of credit assessment is to support their basic values of their formation which is assisting their members in the time of difficulties.

2.2.8.2. Loan Rescheduling

Loan rescheduling is a process by which the loan repayment agreement is changed as a result of loan default in loan repayment. Most credit unions have rescheduling policy in place which helps them to minimize the effect of none performing loans. Practice that involves restructuring the terms of an existing loan in order to extend the repayment period . Debt rescheduling may mean a delay in the due date(s) of required payments or reducing payment amounts by extending the payment period and increasing the number of payments.

In the other wards it refers to loans that have been restructured and re-negotiated between authorized institutions and borrowers because of deterioration in the financial position of the borrower or of the inability of the borrower to meet the original repayment schedule and for which the revised repayment terms, either of interest or the repayment period, are non- commercial.

In line with this, Jensen (2016) states that, once the going concern value of a financial institution is

more than the liquidation value, its value of debt will have to be controlled in order to guarantee the survival of the financial institution. A well-developed literature has focus on the borrower – lender bargaining process in the design of debt contract (Hart and Moore 1998). At this point the new terms is done in favor of the loan defaulter thus it is done to the ability of the loan defaulter. The essence is to ensure that the loan does not go bad.

2.2.9. Credit Collection Techniques

Effective credit collection techniques are one of the necessities for financial institutions in any economic climate. Knowing how to encourage customers to pay their outstanding debts to financial institutions like banks on time can increase the cash flow of banks.

Therefore a number of collection techniques are employed. Under normal circumstances loan clients are expected to pay in cash or deposit or keep their installment repayment as per the agreement made. As the loan account becomes past due or overdue the collection effort becomes more personal and strict. The basic techniques are:

- Telephone call**:** If the loan client passes the due date, a telephone call may be made to the customer to request immediate repayment and up to date his or her account.
- Personal visits: - If the telephone call made is not resulted positive response vesting his business and discussing the issue with the customer can be a very effective collection procedure.
- Letters: - If the efforts made so far is unsuccessful and not resulted positive response a polite letter is to be served reminding the customer of its obligation followed by warning letters for the action to be taken in future and its consequence. Collection letters are the first step in the collection process for past due and overdue loan accounts.
- Using collection agencies: Firms can turn uncollectible accounts over to a collection agency or an attorney for collection. The fees for this service are typically quite high; the firm may receive less than fifty percent on accounts collected in this way.
- Legal action: legal action is the most stringent step in the collection process. It is an alternative to the use of a collection agency not only is direct legal action expensive, but is may

force the debtor in to bankruptcy, thereby reducing the possibility of future business without guarantying the ultimate receipt of overdue amount.

2.2.10. Credit Monitoring & Review

Proper credit risk management involves due credit analysis, having the position approved cash disbursed & ultimately follows up the credit in order to have the extended credit repaid back. Many good credits could become the problem of credits unless a continuous follow up made which enables to detect signs that reveal difficulties. The objective of the credit monitoring & review, among the others, include:

- Ensure that credits are directed to the intended purpose
- Ensuring that credit covenants are compiled with
- Follow up borrower's business condition
- Maintaining good quality of the credit
- Identify emerging problems

Attention should be given to the following particulars while condition of monitoring & review credits (ibid).

- Check on all early warning signals
- Check the end of the credit funds
- Asses all condition of the credit funds
- State finding & interpret them/improvements, deterioration & changes

2.2.11. Non-Performing Loan (NPL)

Credit is concerned to be non-performing when principal or interest is due& unpaid for 90 days or more. National bank of Ethiopia's directive No. SBB/32/2002, define non-performance loan whose credit & validity has deteriorated, so that full collection of principal and/or interest in accordance with the contractual terms of the credit is in question. Credit with pre-established repayment program shall be considered non-performing when:-

- The debt remains outstanding for ninety consecutive days or more beyond the scheduled payments date or maturity
- The debt exceeds the borrowers approved limit for ninety consecutive days or more
- Interest is due & uncollected for ninety days or more
- For over draft the account has been in active for ninety consecutive days and/or deposit are insufficient to cover the interest capitalized during the period (IBF)
- Non-performing loan are whose credit quality is deteriorated, full, collection principal and/or interest in accordance with contractual terms of the credit is in question.

Non-performing Loans represent bad loans, the borrowers of which failed to satisfy their repayment obligations. Banks as intermediaries of funds are responsible for attracting resources and inject it in various economic sectors. In the process of resources allocation, banks encounter several risks and nowadays while making profits, one of the most important risks is default risk, which leads to increase in non-performing loans (NPLs). Based on rules in banking system, the amount of non-performing loans should not be more than 5% of remaining facilities of each bank, but increasing growth of NPLs amount concerned officials and with considering the role of banks in the country's economy, this phenomenon could be named a "national" concern (Ghasemi,2010).

Despite ongoing efforts to control bank-lending activities, non-performing loans are still a major concern for both international and local regulators. To date there is no bank crises happened in Ethiopia due to non-performing loans, but there is an indicator of high NPL in the country, which may lead to that direction if not controlled on time (NBE, 2010).

2.2.12. Provisions

Loans and advances are financial instruments originated by the bank by providing money to the debtors. There is a 50% chance the loan might be repaid on time, delayed or not at all. For this reason banks set aside finance to cover this loans since they lend out customers deposit which needs to be repaid on demand. This finance to be set aside is called provision. It is stated as costless impairment losses. Impairment losses comprise specific provisions against debts identified as bad and doubtful and

general provisions against losses which are likely to be present in any loans and advances portfolio. The Bank follows the National Bank of Ethiopia Supervision of Banking Business Directives SBB/43/2008 in determining the extent of provisions for impairment losses.

The Directive classifies loans and advances into the following.

1) **Pass:** - credits which are categorized fully protected by the current financial &paying capacity of the borrowers.
2) **Sub-standard:-** Non-performing credit past due 90 days or more but less than 180 days shall at minimum be classified sub-standard.
3) **Doubtful**: - Non-performance credit past due 180 days or more but less than 360 days will be referred to doubtful
4) **Loss**: - Non-performance credit past due 360 days or more shall be classified as loss.

2.2.13. Credit Risk Management

According to Singh (2013) credit risk management includes all management function such as identification, measurement, monitoring and control of the credit risk exposure. The writer further indicated that for long term achievement of banking sector effective credit risk management practice is a vital issue in the current business environment and poor credit risk management policy will create serious source of crisis in the banking industry.

According to Atakelt (2015) credit risk management practice define as the process of analyzing and renewing credit risk management documents and apply constantly in actual credit granting process, credit administration and monitoring and risk controlling process with suitable credit risk environment, understanding and identification of risk so as to minimize the unfavorable effect of risk taking activities and the effectiveness of credit risk management process is dependent on different variables such as proper application of best Risk management documents, staff quality, credit culture, devoted top management bodies, sufficient training program, proper organizational structure, ample level of internal control and performance of intermediation function. This indicates that credit risk management includes different issues such as developing and implementing suitable credit risk strategy,

policy and procedure, accurate identifications of risk, best credit granting process, credit administration, monitoring and reporting process determining and controlling the frequency and methods of reviewing credit policy and procedure and setting authority and responsibility clearly. Besides he mentioned that by establishing suitable credit risk environment, acceptable level of credit limit, best credit granting process, proper monitoring and controlling credit risk and optimizing risk return of a bank credit risk management develop credit performance.

Cebenoyan & Strahan (2004) examine empirically how active management of credit risk using loan deal affects capital structure, lending, profits, and risk of banks. They find that banks which are Active in the loan sales market hold less capital and make more risky loans than other banks. They conclude that advances in credit risk management improve credit accessibility rather Than decrease risk in the banking system.

The management of credit risk has become a key objective for all financial institutions across the world. The goal of credit risk management is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters Basel (1999).

According to Anuj A. (2011) through designing and implementing a credit risk framework, performing a credit risk assessment, building credit risk scoring models and credit risk reporting control panel and forecasting loan loss we can construct effective credit risk management and he also believe that most effective credit risk management focuses on processes, culture, people and organization because we are working with them.

Credit risk management includes both preventive and curative measure. Preventive measure comprise risk assessment , risk measurement , and risk pricing , early warning system to pick signal of future default in advance and undertake better credit portfolio diversification. The curative measure aim at minimizing post sanction loan losses through steps such as securitization, derivative trade, risk sharing and legal enforcement, Jain (2014).

2.2.14. Credit Control

According to O. Fatima (2010) credit control is concerned with the post approval and monitoring of the credit facility, to ensure that each credit remains qualitatively satisfactory during the tenure of the credit. It is very important to monitor (control) the facility after it has been approved to ensure that:

A. the borrower complies with the stipulated conditions
B. The facilities are utilized with the purpose for which they were approved
C. Any deterioration or negative trends in the customers‟ business or prospects are determined and corrective actions taken.

Credit controls also entail making some basic credit returns as required by the banking act for the purpose of monitoring the banks total commitments to clients in a particular period. Based o n David T.R‟s statement made on the Hong Kong Monetary Authority's Quarterly Bulletin of 1997 edition, poor asset quality attributable to over-concentration and poor risk selection remains main causes of problems in banks.

In maintaining sound credit controls, a clear credit philosophy, and ongoing management of credit portfolio with a view to identifying early warning signals of deteriorating asset quality helpful. The bank identifies three main causes of these asset quality problems, some of which were present in more than one case. One could be over concentration, where the failure of one loan places the bank in jeopardy. Another was specialization, where there was a concentration of loan book in one sector, region, or group of individuals. The third one may be poor risk selection, where the bank extends loan without correctly price a risk.

Office of the Comptroller of Credit Portfolio Management (1998) states that besides the loan policy, the primary controls over a bank's lending activity is its credit administration, loan review, and audit functions. Independent credit administration, loan review, and audit functions are necessary to ensure that the bank's risk management process, management information systems, and internal and accounting controls are reliable and effective. The bank's control functions can also provide senior management and the board with a periodical assessment of how the bank's employees understand its

credit culture and whether their behaviors conform to the bank's standards and values.

2.3. Empirical review

2.3.1. Empirical Evidence from other countries

There is large number of empirical literature on the study of determinants of nonperforming loan with macro level and bank specific analysis. Some of important studies that are relevant for this study are reviewed as follows:

Saba et al (2012) determinates of nonperforming loan in US banking sector from 1985 to2010. They employed correlation and regression tests. The study considers the Real GDP per Capita, Inflation, and Total Loans as independent variables, and Non-Performing Loan Ratio as dependent variable. The regression tests shows all the independent variables have significant impact on the depended variable, however, values of coefficients are not much high.

On the other hand, Joseph et al (2012) examined the causes of non-performing loans in Zimbabwe. They used descriptive analysis of interpreting factors affecting NPL. The paper revealed that external factors are more prevalent in causing non-performing loans in CBZ Bank Limited. Their findings indicated that non-performing loans were caused by internal and external factors. In the context of CBZ Bank Limited, internal factors such as poor credit policy, weak credit analysis, poor credit monitoring, inadequate risk management and insider loans have a limited influence towards non-performing loans. However, external factors namely natural disaster, government policy and the integrity of the borrower as the major factors that caused non-performing loans in CBZ Bank Limited.

In another study, Messai and Jouini (2013) tried to detect the determinants of non-performing loans for a sample of 85 banks in Italy, Greece and Spain for the period of 2004 to 2008. They used macroeconomic variables and specific variables to the bank as determinates of NPL. The macroeconomic variables are included the rate of growth of GDP, unemployment rate and real interest rate with respect to specific variables opted for the return on assets, the change in loans and the loan loss reserves to total loans ratio (LLR/TL). After the application of the method of panel data, they found that NPL is negatively with the growth rate of GDP, the return on assets and positively with the

unemployment rate, the loan loss reserves to total loans and the real interest rate.

In the contrary, Farhan M. et al, (2012) study the economic factors causing non-performing loans in the Pakistani banking sector. The study was conducted via a well-structured questionnaire and data was collected from 201 bankers who are involved in the lending decisions or analyze the credit risk or handling non-performing loans portfolio. Correlation and regression analysis was carried out to analyze the impact of selected independent variables (Interest Rate, Energy Crisis, Unemployment, Inflation, GDP Growth, and Exchange Rate) on the non-performing loans of Pakistani banking sector. Top 10 Pakistani banks were selected as a sample. According to the results Pakistani bankers perceive that Interest Rate, Energy Crisis, Unemployment, Inflation, and Exchange Rate has a significant positive relationship with the non-performing loans of Pakistani banking sector while GDP growth has significant negative relationship with the non-performing loans of Pakistani banking sector.

Shingjergji and Shingjergji (2013) also analyzed the nonperforming loans in the Albanian banking system. They used a simple regression model. In the model are taken into consideration some macroeconomic and banking factors that have contributed to increase the nonperforming loans level. They found out that real effective exchange rate is positively related with the nonperforming loans according to which the international competition of the economy of a country is an important determinant of the credit risk. In other words any time there is a deterioration of the competition in a country's economy the nonperforming loans level that derives from the main export sectors is likely to increase.

In Kenya, Wanjiru (2013) examined the cause of nonperforming loan using multiple regressions over a period of 2008 to 2012. The study revealed that non-performing loans of commercial banks in Kenya are positively correlated with inflation rate. The study also found that non-performing loans are negatively correlated with real interest rate and growth rate in loans.

Similarly, Evelyn Richard (2011) critically examined the reasons for non-performing loans (NPLs) in commercial banks in Tanzania and strategies employed in dealing with NPLs. A semi-structured questionnaire was administered to 48 bank officers from 14 commercial banks that provide corporate

loans and had been in operations for at least five years. Findings suggest that use of funds for purposes different from agreed ones as a major factor that cause NPLs. Creating an environment to make banks seen as problem solvers and trusted advisor to borrowers was cited as the main strategy towards solving NPLs problems.

The study of Hippolyte Fofack, (2005) investigated the leading causes of nonperforming loans during the economic and banking crises that affected a large number of countries in Sub-Saharan Africa in the 1990s using causality and pseudo-panel models. Empirical analysis shows a dramatic increase in these loans and extremely high credit risk, with significant differences between the CFA and non-CFA countries, and substantially higher financial costs for the latter sub-panel of countries. The results also highlight a strong causality between these loans and, economic growth, real exchange rate appreciation, the real interest rate, net interest margins and interbank loans, consistent with the causality and econometric analysis, which reveal the significance of macro and microeconomic factors.

Ali S. and Iva (2013) who conducted study on "the impact of bank specific factors on NPLs in Albanian banking system" considered Interest rate in total loan, credit growth, inflation rate, real exchange rate and GDP growth rate as determinant factors. They utilized OLS regression model for panel data from 2002 to 2012 period. The finding reveals a positive association of loan growth and real exchange rate, and negative association of GDP growth rate with NPLs. However, the association between interest rate and NPL is negative but week. And also inflation rate has insignificant effect on NPLs.

Similarly, Shingjergji (2013) conducted study on the "impact of bank specific factors on NPLs in Albanian banking system". In the study, capital adequacy ratio, loan to asset ratio, net interest margin, and return on equity were considered as a determinant factor of NPLs. The study utilized simple regression model for the panel data from 2002 to 2012 period and found as capital adequacy ratio has negative but insignificant whereas ROE and loan to asset ratio has negative significant effect on NPLs. Besides, total loan and net interest margin has positive significant relation with NPLs. The study justifies that an increase of the car will cause a reduction of the NPLs ratio. Besides, an increase of ROE will determine a reduction of NPLs ratio.

Besides, Mileris (2012) on the title of "macroeconomic determinants of loan portfolio credit risk in

banks” was used multiple and polynomial regression model with cluster analysis, logistic regression, and factor analysis for the prediction. The finding indicates that NPLs are highly dependent of macroeconomic factors.

However, Swamy (2012) conduct study to examine the macroeconomic and indigenous determinants of NPLs in the Indian banking sector using panel data a period from 1997 to 2009. The variables included were GDP growth, inflation rate, per capital income, saving growth rate, bank size, loan to deposit ratio, bank lending rate, operating expense to total assets, ratio of priority sector`s loan to total loan and ROA. The study found that real GDP growth rate, inflation, capital adequacy, bank lending rate and saving growth rate had insignificant effect; whereas loan to deposit ratio and ROA has strong positive effect but bank size has strong negative effect on the level of NPLs.

Chirwa (1997) used a probity model to estimate the probability of agriculture credit repayment in Malawi. The result indicated that crop sales, income transfers, degree of diversification and quality of information are positively related while size of club negatively related to the probability of repayment. Other factors like amount of loan, sex, household size and club experience were found to be insignificant.

Keeton and Morris (1987), investigated the causes of loan losses for a sample of nearly 2,500 US commercial banks for the period 1979–1985. Using simple linear regressions, they found out local economic conditions along with the poor performance of certain sectors like agriculture and energy explain the variation in loan losses recorded by the banks. The study also stated that commercial banks with greater risk desire tend to record higher losses.

Hu et al (2006) examined the relationship of ownership structure, size of banks and income diversification with NPLs of commercial banks in Taiwan with a panel dataset covering the period 1996-1999. The study shows that banks with higher government ownership recorded lower NPLs. Hu et al (2006) also show that bank size is negatively related to NPLs while diversification has not found a significant association with banks NPLs in Taiwan commercial banking sector.

A study by Rahman et al (2017) on the impact of financial ratios on non-performing loans of

Bangladesh commercial banks applied an econometric model to find out correlations among financial ratios and a sample of 96 observations has been analyzed from 20 banks out of 30 listed commercial banks during 2010-2015. The study mostly agrees with the existing literature that, credit-deposit ratio, net interest margin have a positive influence on the non-performing loans and capital adequacy ratio, return on assets have a negative influence on the non-performing loans. It also reveals that, sensitive sector‟s loan, priority sector's loan have significant positive influence on the non-performing loans and unsecured loans, profit per employee, investment deposit ratio have significant negative impact on gross non-performing loan.

Salas and Saurina (2002) analyze problem loans of the Spanish commercial and savings banks and find that credit risk is determined by microeconomic individual bank level variables, such as bank size net interest margin, capital ratio and market power, in addition to real GDP growth.

Louzis et al., (2010) examined the determinants of NPLs in the Greek financial sector using dynamic panel data model and found as real GDP growth rate, ROA and ROE had negative whereas lending, unemployment and inflation rate had positive significant while loan to deposit ratio and capital adequacy ratio had insignificant effect on NPLs.

Vogiazas and Nikolaidou (2011) investigated the credit risk determinants of the Bulgarian banking sector by means of time series modeling approach covering the time period from January

2001 to December 2010. The results indicate that, the macroeconomic and financial markets‟ variables, specifically the unemployment rate, the construction index, the industrial production index and the real effective exchange rate jointly with the credit growth and the global financial crisis influence the NPLs of Bulgarian banks.

2.3.2. Empirical Studies in Ethiopia

Different researchers were conducted on this area of studies in different financial institutions.

Tekeste (2016) in his study assessment of credit management performance in emerging private commercial banks in Ethiopia: the case of Berhan international bank S.C. The main purpose of the study was to assess the performance of credit management of Berhan international bank as compared

to National bank requirements vis-à-vis its loan policy and procedures. The methodology used for the study is population census for bank staff and convenience non- probability sampling for clients to verify the bank respondents as the bank is the main study. The major findings of the study show that impeding loan growth and rising loan clients complaint on the bank are regarding the lengthy of loan processing, amount of loan processed and approved, loan period, and discretionary limits affecting the performance of credit management.

Wendemagegnehu (2012) in his study on Determinants of non-performing loans: the case of Ethiopian banks. The study intends to assess determinants of nonperforming loans. The researcher used mixed research approach for the study. Descriptive statistics was employed to analyze data and the results were tested with non-parametric tests of significance. Structure questionnaire was distributed for the survey in both private and state-owned Banks in Ethiopia to fill by professionals holding different positions. The findings of the study showed that the causes for loan default are poor credit assessment, failed loan monitoring, underdeveloped credit culture, lenient credit terms and conditions, aggressive lending, compromised integrity, weak institutional capacity, unfair competition among banks, willful default by borrowers and their knowledge limitation, fund diversion for unintended purpose, over/under financing by banks.

Geletta (2012) in his study on determinants of non- performing loans the case of Ethiopian Banks, using descriptive statistics approach that focus on Bank specific NPLs determinant variables; indicated that Poor credit assessment ascribing to capacity limitation of credit operators, institutional capacity drawbacks and unavailability of national data for project financing that had also led to setting terms and conditions that were not practical and/or not properly discussed with borrowers had been the cause for occurrences of loan default.

Geleta (2012) also despite the fact that credit monitoring/ follow-up plays pivotal role to ensure loan collection failure to do this properly was also found to be causes for sick loans. The research also indicated that over financing due to poor credit assessment, compromised integrity of credit operators were cause for incidences of NPL. In fact, cases of under financing loan requirement that meant shortage of working capital or not being able to meet planned targets were associated with defaults. In addition, the study also found out that due to underdevelopment of credit orientation/culture borrowers

engaged in business that they had no depth knowledge, diverted loans advanced for unintended purpose and at times made a willful default.

Seyoum, et.al,(2016), in his study on the "specific factors for non-performing loans" by using descriptive statistics (Mean, median, mode, standard deviation). Poor credit assessment and credit monitoring are the major causes for the occurrence of NPL in DBE. Credit size (includes aggressive lending, compromised integrity in approval, rapid credit growth and Bank's great risk appetite); high interest rate, poorly negotiated credit terms and lenient/lax credit terms, and elongated process of loan approval were Bank specific causes for the occurrence of nonperforming loans. On the other hand, poor credit culture of customers, lack of knowledge of borrower for the business they engaged in, willful default, loan diversion, and project management problems were identified as the major customer specific causes of NPL.

2.4. Research gap

In general, the above empirical studies can be categorized as External/ macroeconomic factors, Bank specific factors and Borrower specific factors. External /macroeconomic factors includes, government policy, interest rate, unemployment, inflation, GDP growth, exchange rate, sensitivity to change in stock market, sensitivity to change in inflation, economic cycle, asset and house price, currency depreciation are major external determinants of loan default.

Bank specific determinants of non-performing loans are also identified by various empirical studies as week credit assessment, lack of proper skill by the loan officers, long loan processing/approval time, agency problem, poor credit policies, loan recovery procedures, lenient credit terms and conditions, credit growth, poor credit assessment, failed loan monitoring, aggressive lending, compromised integrity, ownership structure of the bank, bank size and weak institutional capacity , un fair competition among banks, poor asset quality, poor corporate governance and risk management practice are the major Bank specific determinants of loan default.

And borrower specific determinants of non-performing loan are identified by various studies as uncompromised integrity of the borrower, lack of technical training for loan beneficiaries, under-developed credit culture, and willful default by the borrower, knowledge limitation of the borrower,

fund diversion for unintended purpose and misuse of loan amounts states as a reason for loan default.

Varies determinants of NPL have been identified by various literature. As stated earlier, these determinants have been categorized under External/macro-economic factors, Bank specific factors and Borrower specific factors of loan default; however, there are still gaps identified in empirical literatures discussed above.

The studies conducted were focused on some bank specific factors. But for non- performing loans this are not the only factors, there are also specific factors that will lead the loan to become NPL. Most of the studies are conducted in developed countries but very few studies are conducted in Ethiopia context. Therefore this study aim to fill the previous studies gap on research made on Hibret bank S.C. by applying different techniques of risk management tools like risk identification, risk understanding, risk evaluation, monitoring and controlling. According to the researcher those tools are major tools for assessing credit management practice. This study uses to measure the credit management practices of Hibret bank S.C. through collecting primary data and secondary data, the questionnaires were adapted to staffs of the bank.

CHAPTER THREE
RESEARCH METHODOLOGY

3.1. Introduction

This chapter deals with research design and methodology that was used to carry out the research. In this stage, most decisions about how research was executed and how respondents were approached, as well as when, where and how the research was completed is discussed. Therefore, in general this part of the study describes the research design and methodology that were used to guide the study under the following sub-headings: the research approach, research design, sampling design, source of data, data collection methodology data collection instrument, data analysis methods and validity and reliability.

3.2. Research approach

The research approach in this study is chosen based on the purpose and the research questions set out to be addressed. By doing this, the study aimed to describe, and interpret the current credit management practice of the bank. The techniques used to collect data is by distributing a questionnaire and interview to respondents those worked on credit business department specially directors, managers and senior officers of the departments at head office level. Accordingly, to achieve the research the objective of this study and answer the research questions mixed methods approach were employed to obtain understanding about the problem related to credit management and in order to benefit from the advantages of both quantitative and qualitative approaches.

3.3. Research design

According to Babies (2003), a research design is the program that guides the investigator in the process of collecting, analyzing and interpreting observations. It provides a systematic plan of procedure for the researcher to follow. The design of this study is descriptive type because it describes the overall practices of Credit Management of Hibret bank S.C.

3.4. Population and Sampling procedures

3.4.1. Target Population

A population is also known as a "universe" refers to all the items in the field of inquiry (Kumar, 2008). As indicated in the sampling technique below, the target population of this study is 79 credit department employees who are involved in credit processing and administering at Hibret bank. This means department heads, division heads; branch managers who are working at the selected branches, Assistant branch managers, Loan section heads, Loan officers, Loan supervisor, and Loan Committee members are included in the target group.

3.4.2. Sampling technique and sample size

In this study, respondents were selected using a purposive sampling technique. The rational for using this sampling technique was because it helps to focus on people who are directly involved in credit operations. On other words, purposive sampling is used to generate the data from the employees that are directly engaged in the operation of the credit business of the bank.

Table 1 Lists of selected branches and sample respondents

District	**Grade**	**Selected Branch**	**Population size**	**Total number of sample**
Hade office		Hade office	63	63
South East AA	A	Bole Medhanialem	2	2
		Wello Sefer	2	2
	B	African Venue	2	2
		Millinum	2	2
North AA	A	Meskel Flower	2	2
		Legehar	2	2
	B	Sidist Kilo	2	2
		Megenagna	2	2
Total		9	79	79

Source: Hibret bank HR working document, 2021

With regard to the sample size of this study, it is considered all employees who are engaged in credit and credit related operation at head office level and selected branches. Those employees are particularly credit analysts, experts, managers, directors, on the same process at head office. Because it is the focal area and many of the credit requests of Hibret bank are now being processed in central head office. So, in central (head) office's credit business department there are 63 employees and 16 employees at branches, who are engaged on credit and credit related operations and those are as a whole were taken as participants of the study.

3.5. Sources of Data

To collect the necessary data, both primary and secondary data sources were employed.

3.5.1. Primary sources of data

The primary source of data was collected through the use of self- administered questionnaires and interviews. The questionnaire was used as an instrument to collect primary data from the respondents about their opinion at every question that designed to evaluate the credit management practice of the bank. The questionnaire has two parts, the first part focused on general characteristics of the respondent, and the second part of the questions focuses on the credit management practices of the bank.

3.5.1.1. Questionnaire

The main primary source of data was through the use of questionnaires. The questionnaire was structured in close- ended questions by which the respondents were asked to indicate their level of agreement using a five scale likert rating measurement and was distributed to Hibret bank staffs. This technique helps to maintain the focus of the work on its primary objectives. The questionnaires for the purpose of this study the questionnaires are distributed right inside the case study both at branch and head office level.

3.5.1.2. Interview

The word "interview" refers to a one-on-one conversation between an interviewer and an interviewee. In undertaking this research, face -to-face interview was used to gather information from the member of credit portfolio and management staffs of the bank. Even though data is collected from branches and other departments at head office level involved in credit service, the credit portfolio and management department is chosen for an interview since it is directly involved with credit management. As it is centered on the objective of the study and the research questions, interview affords a follow up questions to respondents for clarity.

3.5.2. Secondary source of data

Secondary data was obtained from reports of the Bank, published and unpublished articles or thesis, books and organizational brochures. Secondary data were collected from annual report (2018/19-2020/21) of the bank related journal, in order to strength the result and findings of the study the researcher examined the finding and conclusion some related research. This helped to see what others say about the subject matter, what are their findings and recommendations.

3.6. Data collection methods

In order to achieve the research objectives, both primary and secondary data were collected. The questionnaires were used because they are straight forward and less time consuming for both the researcher and the participants (Owens, 2002). The questionnaire includes both the close - ended questions. Questionnaires are appropriate for studies since they collect information that is not directly observable as it is inquire about feelings, motivations, attitudes, accomplishments as well as experiences of individuals (Borg and Gall, 1996). The questionnaire was prepared in two parts. The first part was prepared to collect some basic demographic data and the second part to collect data related to the research questions.

3.7. Data analysis methods

This study used descriptive statistics. It addresses the objectives of the study by assessing the organization's credit management practice and providing elaborative description of the bank. The data collected via the questionnaire was recorded, encoded with the help of a Statistical Package for Social Sciences - SPSS version 26 and analyzed using descriptive statistics.

In this study, the descriptive statistics such as percentages and frequency distribution were used to analyze the general profile of the participants. And the study used Mean values to interpret data on the key research questions.

Table 2 Interpretation Responses

Rating scale	Mean Range	Interpretation Response Made
1.0 - 1.7	strongly disagree	Very low
1.8 - 2.5	Disagree	Low
2.6 - 3.3	Neutral	Not Sure
3.4 - 4.1	Agree	High
4.2 - 5.0	Strongly Agree	Very High

Source: Andrich, 1978

3.8. Validity and reliability

3.8.1. Validity

Validity refers to the test of the level of ability and appropriateness of measurements to measure so that differences in individual scores can be taken as representing true references in the characteristics under study. The content validity will be used to determine the validity of the instruments. In subjecting the tools to validation, the process started by discussing with the supervisor of the study who scrutinized all the questions in the tools to assess their appropriateness in addressing critical issues in the study ARAKA et al (2018).

3.8.2. Reliability

Reliability indicates consistency in test, survey and observation. It is the ability of research instruments to consistently yield the same results when repeated measurements are taken under same condition Sharma (2012). The most common method to test reliability is a Cronbach's alpha index. This study also implemented this method to check reliability of the constructs. It is recommended the value of 0.5 is a sufficient value and 0.7 is a more reasonable value. All variables were assessed through this test.

CHAPTER FOUR
ANALYSIS, RESULT AND DISCUSSION

4.1. Introduction

This chapter highlighted the analysis of the data and discussed the major findings of the study in relation to the credit management practice of Hibret bank. The findings of the study are analyzed based on the specific objectives and hypotheses of the study. In this chapter respondent's profile, descriptive analysis, correlation analysis and regression analysis are discussed, which were collected from the primary data source using questionnaire from employees of Hibret bank S.C specifically credit involved staffs and secondary sources collected from the banks' annual reports, manuals and databases.

A total of 84 questionnaires were distributed to the respondents, which were current employees of Hibret bank S.C, and 79 respondents were correctly filled and returned the questionnaire with a response rate of 94%. The remaining 5 respondents didn't respond and never returned the questionnaire.

4.2. Demographic Characteristics of Respondents

Based on the questionnaire's this assesses some demographic information/profile of the respondents. Demographic profiles of the respondents were analyzed using descriptive analysis with the help of SPSS. The demographic nature of the employee has a great contribution in the credit management systems of the loan in understanding the credit policies, procedures as well as exercising and improving it when demanded. Therefore, in this process the demographic characteristics of respondents like educational level, field of specialization and credit related experience are assessed.

Table 3 Socio Demographic Characteristic of the study participants

No		Demographics	Frequency	Percentage
1.	Gender	Female	38	48
		Male	41	52
	Total		79	100
2.	Educational level	First Degree	51	65
		Master's Degree	28	35
	Total		79	100
3.	Field of specialization	Accounting	18	23
		Management	33	42
		Economics	7	9
		Business Administration	21	27
	Total		79	100
4.	Position of respondents	Managerial	19	24
		Expert and officers	60	76
	Total		79	100
5.	Credit related experience	< 1 year	7	9
		1-5 years	19	24
		6-10 years	28	35
		More than 10 years	25	32
	Total		79	100

Source: survey data, 2021

As shown in the table above (Table 3), from 79 respondents, 48% were females and the rest 52% were males. This showed that the proportion males are higher than females, who are working on the credit

management units.

Educational background of employee is an important factor to be considered with regard to making credit business decision. As indicated on the table above (table 3) , majority (65%) of the respondents were first degree holders and the remaining 35% were master degree holders. Based on this finding, all loan service users had high literacy rate and well qualified to understand about the credit management practice. This indicated to succeed as a credit professional they need to upgrade their educational level constantly.

Regarding the field of specialization of the respondents, majority (42%) of them were specialized by management and the remaining 27%, 23% and 9% of the respondents were specialized by business administration, accounting, and economics respectively. Field of specialization is an important factor to be considered with regard to conduct the credit business operation at professional way. This implies that the majority of the respondents working in credit area are graduates of business and business-related fields and they have adequate professional mix for the area and this enables them to undertake the credit management operation professionally because credit management is one element of business administration.

As indicated in the table above (table 3), concerning the position of the respondents, majority of the respondents (76%) were at the position of experts and officers and the remaining 24% were at managerial position. The experts and officers are assigned on the activities of credit business operation such as on corporate credit, commercial credit, credit underwriting, workout loan and credit portfolio management and the managers supervised them, and approved the operation done by experts and officers.

Regarding the professional experience of the respondents, as indicated in the table above (table 3), majority of the respondents has more than 5 years' experience. In this regard, 35% and 32% of them have 6-10 years and greater than 10 years' experience which helps the researcher to obtain good quality of data on credit granting, monitoring and controlling process of the bank. The remaining 24% and 9% have 1-5 years and less than 1 year experience. The results revealed that, majority of the respondents have an ample experience.

4.3. Assessing the Bank's Credit Management Practice

Table 4 Practical loaning activities and alignment against NBE requirements

No		Strongly Agree		Agree		Neutral		Disagree		Strongly Disagree		Total		Mean	SD
		Fre	%	Fre	%	Fre	%	Fre	%	Fre	%	Fre	%		
1	The bank credit management has a policy for credit provisioning and write-off that are aligned with NBE requirements.	16	20	45	57	-	-	13	16	5	6	79	100	3.68	3.35
2	The bank maintains effective credit management system to control the single borrower limit while extending additional loan.	6	8	24	30	2	3	38	48	9	11	79	100	2.75	2.51
3	The existing credit policy and procedure of the bank is encouraging and flexible to guide credit activities of the bank.	10	13	29	37	1	1	26	33	13	16	79	100	2.96	2.77
4	Client appraisal considers the character of the customers seeking credit facilities.	15	19	22	28	3	4	27	34	12	15	79	100	3.01	2.84
5	To better the state of management of credit, reviews concerning collection policies have been done on a regular basis.	18	23	24	30	-	-	23	29	14	18	79	100	3.11	2.96
6	Client appraisal makes proper analysis on the cash flow statement of a borrower while deciding on loan repayment schedules.	7	9	18	23	-	-	35	44	19	24	79	100	2.48	2.32
7	The practical loan processing and appraisal activities of the district offices comply with the banks credit policy and procedure.	19	24	30	38	2	3	20	25	8	10	79	100	3.41	3.17
8	The credit management at a district level improves the credit control of the bank.	21	27	37	47	-	-	15	19	6	8	79	100	3.66	3.36
9	Imposing loan size limits is a viable strategy in credit management.	24	30	32	41	3	4	17	22	3	4	79	100	3.72	3.41

Source: survey data, 2021

The majority respondent agreed with the mean and SD of 3.68 and 3.35 this implies that the bank credit

management policy of credit provisioning and write-off are aligned with the NBE requirements under table 4 item (Q1) shows that 20% of the respondents strongly agreed, 57% agreed, 16% are disagreed and 6% strongly disagreed. This implies that the bank credit management policy for provisioning and write-offs comply with asset classification and provisioning directive of the central bank.

As the NBE directive no SBB/53/12 requires banks to maintain their single borrower limit up to 25% of their paid up capital. Regarding this the researcher desires to investigate the activity of the bank in controlling the borrowers limit as per the bank procedure and NBE requirements As shown on table 4.6 item (Q2) majority of respondents were strongly disagree with the mean 2.75 and SD 2.51. As indicate 8% of the respondents strongly agreed, 30% agreed, 3% are neutral, 48% are disagreed and 11% strongly disagreed. This entails that there is lack of effective credit management system in controlling the credit limit of borrowers.

Respondents were questioned whether the existing credit policy and procedure of the bank is encouraging and flexible enough to guide the loaning activity as indicated under table 4 item (Q3) they were disagree with a mean of 2.96 and SD 2.77 respondent shows that 13% of the respondents strongly agreed, 37% agreed, 1% are neutral, 33% are disagreed and 16% strongly disagreed. This finding implies that the current credit policy and procedure of the bank is not encouraging and flexible enough to attract and satisfy the credit demand of customers.

Respondents were questioned whether the client appraisal considers the character of the customers seeking credit facilities as indicated under table 4 item (Q4) they were disagree with a mean of 3.01 and SD 2.84.This table shows that 19% of the respondents strongly agreed, 28% agreed, 4% are neutral, 34% are disagreed and 15% strongly disagreed. This finding implies that the client appraisal does not consider the character of the customers seeking credit facilities.

Regarding this, under table 4 item (Q5) respondents were asked whether regular reviews have been done on collection policies to improve state of credit management .As a majority of the respondents agree with the mean of 3.11 and SD of 2.96 result shows that 23% of the respondents strongly agreed, 30% agreed, 29% are disagreed and 18% strongly disagreed. This implies that the collection policy of the bank is regularly reviewed to improve state of credit management.

On table 4 item (Q6) respondents were asked whether Client appraisal makes proper analysis on the cash flow statement of a borrower while deciding on loan repayment schedules. Majority of respondents were disagree with mean value of 2.48 and SD 2.32. 9% of the respondents strongly agreed, 23% agreed, 44% are disagreed and 24% strongly disagreed. This indicates that there is poor analysis cash flow statement of borrowers before approval of the loan repayment period.

On table 4 item (Q7) respondents were questioned whether the practical loaning activities at district offices comply with the banks credit policy and procedure. Majority of respondents agree with the mean value of 3.41 and SD 3.17 24% of the respondents strongly agreed, 38% agreed, 3% are neutral, 25% are disagreed and 10% strongly disagreed. This denotes that the practical loaning activity of district offices comply with credit policy and procedure of the bank.

Previously Hibret bank credit appraisal and administering process were done centrally at head office. Loan requests were processed, approved and administered at the head office but currently the bank has disseminated its credit operation to district offices, Regarding this, under table 4 item (Q8) respondents were asked whether the credit control of the bank were improved after the credit processing and administering is disseminated to district offices. The majority of respondents agree with the mean value of 3.66 and SD of 3.36. 27% of the respondents strongly agreed, 47% agreed, 19% are disagreed and 8% strongly disagreed.

Barusa's (2011) view that in setting up the credit limit, considerations must be taken to maximize the returns in terms of the sales and also the financial strengths of the customer to ascertain whether he will be able to pay the credit obligation. Regarding this respondent were asked whether imposing credit limit is viable strategy in credit management under item (Q9) majority of respondents were agreed on the issue by mean value of 3.72 and SD 3.41. 30% of the respondents strongly agreed, 41% agreed, 4% are neutral, 22% are disagreed and 4% strongly disagreed.

4.4. Non-Performing Loan Management

Table 5 Management of non-performing loan by the bank .

No		Strongly Agree		Agree		Neutral		Disagree		Strongly Disagree		Total		Mean	SD
		Fre	%	Fre	%	Fre	%	Fre	%	Fre	%	Fre	%		
1	The bank effectively implements its loan recovery mechanism to reduce its bad loans.	12	15	22	28	2	3	29	37	14	18	79	100	2.86	2.7
2	The bank continuously make sure the NPL cases transferred to foreclosure process get timely decision to reduce additional provision expense of the bank.	19	24	30	38	1	1	20	25	9	11	79	100	3.38	3.15
3	Collateralizing loans help protect loan default.	14	18	19	24	3	4	32	41	11	14	79	100	2.91	2.73
4	Assessments of secondary source of repayments help the bank as another fallbacks for outstanding loan balances of non-performing borrowers account.	20	25	32	41	-	-	18	23	9	11	79	100	3.46	3.22
5	The bank make proper follow up on the loans availed whether they are spending on the actual purpose of the loan requested.	8	10	19	24	2	3	35	44	15	19	79	100	2.62	2.44
6	Poorly assessed and advanced loans may perform well if properly monitored.	7	9	21	27	-	-	37	47	14	18	79	100	2.62	2.43
7	The bank prepares regular report on selected credit accounts to help reduce future failures.	11	14	23	29	-	-	33	42	12	15	79	100	2.85	2.67
8	Collection policies available have helped in effective management of credit practices.	5	6	29	37	-	-	30	38	15	19	79	100	2.73	2.54
9	Each districts having their own credit monitoring and follow up team would sustainably reduce the bank NPL.	17	22	31	39	-	-	22	28	9	11	79	100	3.32	3.09

Source: survey data, 2021

As per the response result that is indicated under table 5 item (Q1) respondents were with mean 2.86 and SD 2.70. 15% of the respondents strongly agreed, 28% agreed, 3% are neutral, 37% are disagreed and 18% strongly disagreed. On the statement the bank effectively implements its loan recovery mechanism to reduce its bad loans. As the majority of the respondents disagree on the effective implementation of loan recovery mechanism the bank towards reduction of bad loans it indicates that the loan recovery mechanism of the bank is not sufficiently implemented to reduce bad loans.

According to Solomon (2013) point out that the major contributing factors for the increment of NPL in NIB bank are poor risk assessment, poor monitoring/follow-up, credit culture and relaxed credit terms. Foreclosure is a legal process in which the bank attempts to recover the amount of loan granted to the borrower who has stopped making payments by forcing the sale of the asset used as the collateral for the loan and timely decision must be made on the sale of the collateralized property to avoid additional costs and other related risk that might be faced by the bank. Regarding this under table 5 item (Q2) respondents were asked whether the NPL cases that are transferred to foreclosure process get timely decision to avoid additional provision expense and reduce the ratio of NPL. The majority of the respondents with mean 3.38 and SD 3.15 were agreed on the issue.24% of the respondents strongly agreed, 38% agreed, 1% are neutral, 25% are disagreed and 11% strongly disagreed. This shows that the foreclosure cases get timely decision.

In lending agreements, collateral is a borrower's pledge of specific property to a lender, to secure repayment of a loan. The collateral serves as a lender's protection against a borrower's default and so can be used to offset the loan if the borrower fails to pay the principal and interest satisfactorily under the terms of the lending agreement. Regarding this under table 5 item (Q3) respondent was asked whether collateralizing loans help protect loan default. Accordingly, majority of the respondents were disagreed with mean 2.91 and SD 2.73. 18% of the respondents strongly agreed, 24% agreed, 4% are neutral, 41% are disagreed and 14% strongly disagreed. This reveals that borrowers pledged asset cannot protect a loan from being defaulted.

Responses have agreed for the statement that assessment of secondary source of repayments help the bank as other fallbacks for outstanding loan balances of non-performing borrowers. Evidenced under

table 5 items (Q4) by mean value of 3.46 & SD 3.22 .25% of the respondents strongly agreed, 41% agreed, 23% are disagreed and 11% strongly disagreed. This implies that assessing for additional source of repayment will help the bank recover outstanding loans in case the initial collateralized property or business defaults.

As shown on table 5 item (Q5) respondents were disagree with 2.62 mean and SD 2.44 .10% of the respondents strongly agreed, 24% agreed, 3% are neutral, 44% are disagreed and 19% strongly disagreed. On the statement that the bank makes proper follow up on the loans availed for they are spend on the actual purpose of the loan requested. This indicates that there is lack of proper follow up for actual outlay of the loan after it is granted.

As indicated under table 5 item (Q6) majority of respondents didn't support the argument that loan would perform well only by proper monitoring even if they are poorly assessed while advancing the credit this is evidenced with mean value of 2.62 and SD 2.43. 9% of the respondents strongly agreed, 27% agreed, 47% are disagreed and 18% strongly disagreed. This indicates that follow up would never substitute credit assessment.

According to the respondents under table 5 item (Q7) results showed that regular reports are not prepared on selected credit accounts to help the bank reduce future failures, this statement is evidenced with the mean value of 2.85 and SD 2.67. 14% of the respondents strongly agreed, 29% agreed, 42% are disagreed and 15% strongly disagreed. This shows that there is lack of follow up on the selected credit accounts so as to detect early sign of future repayment failures.

As shown on table 5 item (Q8) respondent were disagree with mean of 2.73 and SD 2.54. 6% of the respondents strongly agreed, 37% agreed, 38% are disagreed and 19% strongly disagreed. That the available collection policies have helped in effective management of credit practices. This indicates that the collection policy must be organized in such a way that it would help to the management of credit activities effectively.

Solomon (2013) shows on his study NIB bank have adequate policy procedure and defined credit granting criteria and the bank lend by properly checking the borrower's history and follow up. The

other researcher Norton and Andenas (2007), concludes that the future performance of the credit doesn't grant only through conducting effective credit appraisal and credit worthiness evaluation work, instead to assure the long-lasting sustainability and health of the project the financial institutions should conduct regular follow up works. Regarding question presented under table 5 item (Q9) respondents were questioned that district offices having their own credit monitoring and follow up team would sustainably reduce the bank NPL. Accordingly, the respondents with mean 3.32 and SD 3.09 were agreed on the issue. 22% of the respondents strongly agreed, 39% agreed, 28% are disagreed and 11% strongly disagreed. This indicates that the bank maintaining credit monitoring and follow-up staff at all district offices would strengthen the credit management of the bank and enable the bank to sustainably reduce its non-performing loans.

4.5. Credit monitoring process

Table 6 Credit monitoring process

No		Strongly Agree		Agree		Neutral		Disagree		Strongly Disagree		Total		Mean	SD
		Fre	%	Fre	%	Fre	%	Fre	%	Fre	%	Fre	%		
1	The bank strictly monitors loan terms and conditions that have been stipulated at the time of loan approval.	42	53	25	32	-	-	10	13	2	3	79	100	4.2	3.83
2	The bank uses a loan covenant checklist that routinely tracks its customer's adherence to covenants.	19	24	37	47	3	4	16	20	4	5	79	100	3.65	3.33
3	The bank regularly reviews and monitors the performance of Credit quality at individual level.	41	52	33	42	-	-	5	6	-	-	79	100	4.39	3.94
4	The bank regularly reviews and monitors the performance of credit quality at portfolio level	19	24	47	59	-	-	13	16	-	-	79	100	3.91	3.5
5	Credit file is regularly updated in our bank.	40	51	35	44	4	5	-	-	-	-	79	100	4.46	3.97
6	The bank has properly applied its own internal risk rating system.	45	57	28	35	6	8	-	-	-	-	79	100	4.449	4.01
7	Credit monitoring procedure is regularly reviewed in our bank.	-	-	12	15	4	5	31	39	32	41	79	100	1.95	1.71

8	Credit monitoring procedure is regularly updated in our bank.	-	-	16	20	-	-	27	34	36	46	79	100	1.95	1.76

Source: survey data, 2021

As indicated in table 6 item (Q1) respondents were requested about the bank strictly monitors loan terms and conditions that have been stipulated at the time of loan approval; majority of respondents with mean of 4.20 and SD 3.83 strongly agree. 53% of the respondents strongly agreed with this point, 32% agreed, 13% disagreed and the remaining 3% of the respondents are strongly disagreed. As it is showed that most of the respondents replied as the bank strictly monitors loan terms and conditions that have been stipulated at the time of loan approval. This implied that the bank ensures the fulfillment of the contract terms and conditions of the client to identify and take corrective action if there are any changes in the ability to repay the loan. According to Desalegn (2014) the risk management policy, procedure and limit are adequate to identify, measure, monitor and control risk of banks. It should have well established internal control system, which includes segregation of duties, clear management reporting lines and adequate operating procedure. The finding on monitoring and controlling of credit, Solomon (2013) concluded that there is no proper functioning monitoring and controlling of credit in NIB bank.

In the same table item (Q2) majority of respondents with mean of 3.65 and SD 3.33 agree were requested whether the bank uses a loan covenant checklist that routinely tracks its customer's adherence to covenants. With this regard 24% of the respondents strongly agreed, 47% of them also agreed, 20% of them are disagreed, 5% of strongly disagreed and the remaining 4% of the respondents are neutral. As it is indicated that most of the respondents replied as the bank uses a loan covenant checklist that routinely tracks its customer's adherence to covenants. This implied that the bank ensures the fulfillment of client's obligation and this enables the bank to take the required corrective action before the loan is non-performed.

On item (Q3) of table 6, majority of respondents with mean of 4.39 and SD 3.94 strongly agree the bank regularly reviews and monitors the performance of credit quality at individual level. 52% of the respondents strongly agree, 42% of them also agreed and the remaining 6% of them are disagreed. All respondents replied as the bank regularly reviews and monitors the performance of credit quality at

individual level. This enables that the bank to know the client's status on the ability to meet their commitments at individual level.

On item (Q4) of table 6, majority of respondents with mean of 3.91 and SD 3.50 agree the bank regularly reviews and monitors the performance of credit quality at portfolio level. 24% of the respondents strongly agree, at the same time 59% of them agreed and the remaining16% of the respondents are disagreed. Even if 16% of the respondents are disagreed on the issue, the majority of respondents replied as the bank regularly reviews and monitors the performance of credit quality at portfolio level. This enables that the bank to know the client's status on the ability to meet their commitments at portfolio level.

On item (Q5) of table 6, majority of respondents with mean of 4.46 and SD 3.97 strongly agree as credit file is regularly updated in the bank.51% of the respondents strongly agreed with the issue while 44% agreed and the remaining 5% of the respondents are neutral. As it is indicated on the above figure, even if 5% of the respondents standing as neutral, we can confidently say that the bank updated the credit file. This enables that the bank to have current information on the overall loan status.

Regarding the question presented whether the bank has properly applied its own internal risk rating system on item (Q6) of table 6, majority of respondents with mean of 4.49 and SD 4.01 strongly agree. 57% of the respondents strongly agree while 35% of them agree and 8% of the respondents were neutral. As it is indicated here above most of the respondents replied as the bank properly applied its own internal risk rating system. This enables that the bank to develop and maintain necessary data on loan defaults of borrowers as per their rating category as it would help to manage credit portfolio in proper way and to have a prior estimate of expected defaults, expected contribution and capital requirement to maintain the portfolio.

On item (Q7) of table 6 about credit monitoring procedure is regularly reviewed in the bank; majority of respondents with mean of 1.95 and SD 1.71 strongly disagree .41% of the respondents strongly disagree, 39% of them also disagreed, 5% were neutral and the remaining 15% of them agreed.As it is indicated that most of the respondents replied as the bank does not regularly reviewed the monitoring procedure. Due to this the bank cannot detect the problem that is associated with credit monitoring

procedure to take an immediate course of action.

On item (Q8) of table 6 majority of respondents with mean of 1.95 and SD 1.76 strongly disagree. 46% of the respondents strongly disagree 34% of them also disagreed and the remaining 20% of them agreed that credit monitoring procedure is regularly updated in the bank. As it is indicated that most of the respondents replied as the bank does not regularly updated the monitoring procedure .This leads the bank to follow and implement outdated credit monitoring procedure.

4.6. Credit Risk Management

Table 7 Credit risk management activities of the bank

No		Strongly Agree		Agree		Neutral		Disagree		Strongly Disagree		Total		Mean	SD
		Fre	%	Fre	%	Fre	%	Fre	%	Fre	%	Fre	%		
1	The credit risk assessment of the bank considers a quick response to market changes.	25	32	31	39	2	3	16	20	5	6	79	100	3.7	3.41
2	Financial interest between the borrower and the bank official leads to loan default risks.	28	35	22	28	1	1	20	25	8	10	79	100	3.53	3.32
3	The existing credit risk measurement tools used by the bank safeguard the bank from major credit risks.	19	24	31	39	2	3	17	22	10	13	79	100	3.41	3.18
4	The bank credit risk management procedures enable staffs to identify major credit risks.	11	14	23	29	-	-	32	41	13	16	79	100	2.84	2.66
5	The Practical credit risk assessment activity of the district offices help the bank reduce risks associated with loan granting.	20	25	28	35	3	4	23	29	5	6	79	100	3.44	3.18
6	Poor credit risk assessment on the process of analysis would lead to loan default.	17	22	33	42	2	3	24	30	3	4	79	100	3.47	3.17
7	Providing credit risk management training courses will practically enable the bank reduce credit risks.	15	19	31	39	1	1	22	28	10	13	79	100	3.24	3.02

8	There is a proper system implementation for understanding credit risks in the bank.	13	16	22	28	2	3	31	39	11	14	79	100	2.94	2.75

Source: survey data, 2021

Credit collection is a key component of the credit management life cycle and the impact of getting it right can have a significant influence in reducing the risk associated with credit management (Benoit 2009). The credit risk assessment of Hibret bank considers a quick response to market changes is evidenced the respondents with mean 3.70 and SD 3.41 were agreed on under table 7 item (Q1) 32% of the respondents strongly agreed with the issue while 39% agreed, 20% disagreed, 6% strongly disagreed and the remaining 3% of the respondents are neutral. This shows that the bank credit risk assessment considers taking fast response to changes in the market.

As indicated under table 7 item (Q2) accordingly the respondents with mean 3.53 and SD 3.32 were strongly agreed on the issue.35% of the respondents strongly agreed with the issue while 28% agreed, 25% disagreed, 10% strongly disagreed and the remaining 1% of the respondents are neutral. That financial interest between the borrower and the bank official leads to loan default risks this indicates the benefit that the bank official is going to receive will lead the analysis to poor appraisal of the loan requested.

As per the question presented under table 7 item (Q3) majority of respondents with mean of 3.41 and SD 3.18 agree. Respondents were asked whether the credit risk measurement tools used by the bank safeguard are the bank from major credit risks. Accordingly, respondents were 24% of the respondents strongly agreed with the issue while 39% agreed, 22% disagreed, 13% strongly disagreed and the remaining 3% of the respondents are neutral. This denotes that the existing credit risk measurement tools capable of securing the bank from major credit risks.

Respondents under table 7 item (Q4) majority of respondents with mean of 2.84 and SD 2.66 disagree. 14% of the respondents strongly agreed with the issue while 29% agreed, 41% disagreed and 16% strongly disagreed. The respondents were disagreed that the bank credit risk management procedures enable staffs to identify major credit risks. This shows that the credit risk management procedure of the bank is not efficient enough to enable staffs identify major credit risks.

It is advisable for banks to measure the credit risk of each loan requests made by clients before approval at least to minimize the risk of adverse selection. In this regard, respondents were questioned whether the Practical credit risk assessment activity of the district offices help the bank reduce risks associated with loan granting. The findings under table 7 item (Q5) majority of respondents with mean of 3.44 and SD 3.18 agree. 25% of the respondents strongly agreed with the issue while 35% agreed, 4% neutral, 29% disagreed and 6% strongly disagreed. This implies that the practical credit risk assessment activities of the district offices enables the bank reduce risks associated with the loan granting.

On the same table item (Q6) majority of respondents with mean of 3.47 and SD 3.17 agree. Respondents showed that 22% of the respondents strongly agreed with the issue while 42% agreed, 3% neutral, 30% disagreed and 4% strongly disagreed. That poor credit risk assessment would lead to loan default. This also shows that proper assessment of credit risk is required in the analysis process.

Regarding the statement providing credit risk management training courses will practically enable the bank reduce credit risks respondents under table 7 item (Q7) majority of respondents with mean of 3.24 and SD 3.02 agree. Respondent showed that 19% of the respondents strongly agreed with the issue while 39% agreed, 1% neutral, 28% disagreed and 13% strongly disagreed. This indicates that providing proper training to staffs on credit risk management will help the bank enable in identifying and avoiding major risks.

As per the assessment question presented under table 7 item (Q8) respondents were asked if there is a proper system implementation for understanding credit risks in the bank. Majority of respondents with mean of 2.94 and SD 2.75 disagree. Accordingly, respondents showed that 16% of the respondents strongly agreed with the issue while 28% agreed, 3% neutral, 39% disagreed and 14% strongly disagreed. This denoted that the bank did not implement a system to develop understanding about credit risks.

4.7. In depth Interview Questions

To gather more information about credit management policies and practices in Hibret Bank S.C., interview questions were forwarded to division heads, directors of credit and appraisal department, customer relation managers department, credit information and portfolio management division, as well as eight branch managers of the bank. Accordingly, the interviewee's responses to the questions are depicted briefly as follows.

1. Summary of responses how do you evaluate the performance of the bank in terms of its loan recovery performance? NPLs portfolio?

According to the interviewee's response regarding to their perception about evaluate the performance of the bank in terms of its loan recovery performance measures the bank efficiency and effectiveness by recording several years of loan collection, disbursement, and annual performance. The measures that are used include strict follow up and insisting the client, debt rescheduling, court proceeding, and foreclosure. In the bank, credit is transferred to the legal service when it fails to regularize or settle the loans in default and when all efforts to amicably settle the loans fail and it is ascertained that legal action is to be the last alternative. NPLs portfolio respondents indicated that several factors contribute to loan default. As per the outcome of the interview the factors can be categorized as banks internal situations and borrowers related.

2. Summary of the responses is that necessary training for employees in area of credit management practice?

According to the interviewee's response, in my opinion training is necessary for employees in area of credit management practice increase productivity, positively affect staff morale and motivation, improve the quality of work, reduce faults, waste or customer complaints

3. Summary of the responses do you think the branch lending limit and overriding limit has any difficulty in your branches loan providing capacity and growth?

According to the interviewee's response, banks are required to hold significant amounts of capital which typically causes lending limits to only apply to institutional borrowers. The legal lending limit for national banks was established under the United States Code (U.S.C.) and not difficulty in our branches loan providing capacity and growth.

4. Summary of the responses any other comments or suggestions or ideas you may have with regard to the credit collection strategies are adopted in the management of credit department in Hibret bank?

According to the interviewee's response, indicated that several suggestions to the credit collection strategies is an important service that helps to both maintain clients and free up money for lending again. Collections are an integral part of the credit department in Hibret bank.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

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 by receiving savings from the "haves‟ and making it available to the "haven't" thus boasting productive investments. While carrying out its activity, the banks are faced with a number of risks with credit management being cited as the most important since its poor management can lead to a total disaster in the bank.

Hibret bank has a documented credit management policy. The bank used collateral as a primary technique of credit risk management mechanism. The bank used different credit risk management tools and techniques to manage the credit risk, the credit risk management and that they all have one main objective, i.e. to reduce the amount of loan default which is a principal cause of the bank's failure.

The NBE directive no SBB/53/12 requires banks to maintain their single borrower limit up to 25% of their paid up capital. However, Hibret bank is controlling the borrowers limit as per the NBE requirements and this kind of credit management tells how effective credit management system in controlling the credit limit of borrowers. The existing credit policy and procedure of the bank is encouraging and flexible enough to guide the loaning activity.

As far as the Management of non-performing loan is concerned; the bank has been continuously make sure that the NPL cases has transferred to foreclosure process to get timely decision to reduce additional provision expense of the bank. But these kinds of practice help the bank to effectively implement its loan recovery mechanism to reduce its bad loans. The bank has failed to make proper follow up on the loans availed whether they are spending on the actual purpose of the loan requested and not preparing regular report on selected credit accounts to help reduce future failures. Consequently, proper collateralizing of loans protects the bank from the risk of loan default.

As the bank's credit monitoring process is concerned; there is strict monitoring of loan terms and conditions that have been stipulated at the time of loan approval and a regularly reviews and monitors

of the performance of the Credit quality at individual level and regular reviews and monitors of the performance of credit quality at portfolio level is carrying out. However, Credit monitoring procedure is not regularly reviewed and updated in the bank.

Though, the bank credit risk management procedures does not enabled staffs to identify major credit risks to a maximum extent; the existing credit risk measurement tools used by the bank has still yet safeguarded the bank from major credit risks.

5.2. Recommendations

Each day, credit professionals are trusted to scrutinize complex situations and to make an educated judgment about how to financially interact with other companies. Moreover, these professionals are supposed to be naturally curious and constantly educating themselves in their industry. However, most of the Credit professionals of Hibret bank are First degree holders. So, to succeed as a credit professional they need to upgrade their educational level constantly.

It is reported that, credit professionals of the bank are not curious to identify major credit risks and credit monitoring procedures are not regularly reviewed and updated in the bank. Thus, the bank should made remarkable regular changes on its credit manual, procedures, policy and develop its strategies to make simplified and flexible so that they could fit to the dynamic market environment that incorporate or meet the idea and business plan of the clients, to satisfy the delivery of loan to its clients, to detect poorly underwritten credits and prevent weak credits from being granted. In addition, the bank should make the customers and employees to aware about the merits of current bank structure and current credit manual, policy and procedure so that every customer and employee will be a risk manager and the bank should monitor for the effective and proper implementation.

The bank has registered some sort of futile in making a proper follow up on the loans availed whether borrowers are spending on the actual purpose of the loan requested and collateralizing of loans fully help to protect the loan default. Hence, the bank should checks the borrower history before granting loans and properly assessed the customer ability to meet obligations in credit processing or appraisal system and properly assess the customer ability to meet obligations. Besides, the bank should give

sufficient training to the customers on loan usage.

The bank's credit professionals are advisable to conduct a face-to-face meeting to discuss the customer's history and future plans before the loan is granting. This is very essential to know the background of the customer and it is also one of the best ways to get to know the customer's needs and establish the bank as a valued financial institution is through face-to-face meetings to discuss the customer's history and future plans.

It indicated that a regular reviewing and updating of credit monitoring procedure monitoring has assumed greater significance in the effective management of credit risk, but the bank does not review and update the credit monitoring procedure on regular basis. Hence the bank should review and update the credit monitoring procedure consistently.

Recommendation for Further Studies

Current studies focus on assessment of credit management practices in case of Hibret Bank s.c and used some sample branch. Further studies would be recommended to be conducted larger sample branch generating more accurate findings of credit management on the structure of financial organizations.

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APPENDIX

St. Marry University

Department of Business Administration

Dear respondents, this questionnaire is designed to collect relevant information about "credit management practices of Hibret bank s.c." which will be used as an input for a thesis in a partial fulfillment of Masters of Degree in Business Administration. I appreciate your cooperation to give me your time for the success of this research thesis. I assure you that the information to be shared by you will be used only for academic purpose and kept confidential.

Therefore, your genuine, frank and timely response is very important to the outcome of the study and you are kindly requested to complete all questions.

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

E-mail: fasigreal@gmail.com

Thank you for your cooperation

Yours sincerely

Fasika Gebremeskel

Tell: 0912476558

Part I: General Information

Direction: Please select an appropriate option by encircling the appropriate number.

1.Gender

1. Male 2. Female

2.Age

1. Less than 30 years 3. 31 to 40 years

2. 41 to 50 years 4. Above 50 years

3.Level of Education

1. College Diploma 3. Second Degree (Master's Degree)

2. First Degree 4. Third Degree (PhD)

4.Area (field of specialization) or major field of study

1. Accounting 3. Economics

2. Management 4. Business Administration

5. Current position

1. Managerial 3. Clerical

2. Professional

6.Years of work experience

1. < 1 Year 3. 1-5 Years

2. 5-10 Years 4. > 10 Years

Part II. Research Related Questions

Direction: Please indicate your degree of agreement/disagreement with the following statements related to your perception by encircling the appropriate number. Where, (1=strongly agree (SA); 2=Agree (A); 3= neutral (neither agree nor disagree (N)); 4=Disagree (DA); and 5=strongly agree (SD).

S. No	Items	SA	A	N	DA	SDA
1	The bank credit management has a policy for credit provisioning and write-off that are aligned with NBE requirements	1	2	3	4	5
2	The bank maintains effective credit management system to control the single borrower limit while extending additional loan.	1	2	3	4	5
3	The existing credit policy and procedure of the bank is encouraging and flexible to guide credit activities of the bank	1	2	3	4	5
4	Client appraisal considers the character of the customers seeking credit facilities	1	2	3	4	5
5	To better the state of management of credit, reviews concerning collection policies have been done on a regular basis	1	2	3	4	5
6	Client appraisal makes proper analysis on the cash flow statement of a borrower while deciding on loan repayment schedules.	1	2	3	4	5
7	The practical loan processing and appraisal activities of the district offices comply with the banks credit policy and procedure	1	2	3	4	5
8	The credit management at a district level improves the credit control of the bank	1	2	3	4	5
9	Imposing loan size limits is a viable strategy in credit management	1	2	3	4	5

Part III: Non-Performing Loan Management

Direction: Please indicate your degree of agreement/disagreement with the following statements related to your perception by encircling the appropriate number. Where, (1=strongly agree (SA); 2=Agree (A); 3= neutral (neither agree nor disagree (N)); 4=Disagree (DA); and 5=strongly agree (SD).

S. No	Items	SA	A	N	DA	SDA
1	The bank effectively implements its loan recovery mechanism to reduce its bad loans.	1	2	3	4	5
2	The bank continuously make sure the NPL cases transferred to foreclosure process get timely decision to reduce additional provision expense of the bank.	1	2	3	4	5
3	Collateralizing loans help protect loan default.	1	2	3	4	5
4	Assessments of secondary source of repayments help the bank as another fallbacks for outstanding loan balances of non-performing borrowers account	1	2	3	4	5
5	The bank make proper follow up on the loans availed whether they are spend on the actual purpose of the loan requested	1	2	3	4	5
6	Poorly assessed and advanced loans may perform well if properly monitored.	1	2	3	4	5
7	The bank prepares regular report on selected credit accounts to help reduce future failures	1	2	3	4	5
8	Collection policies available have helped in effective management of credit practices.	1	2	3	4	5
9	Each districts having their own credit monitoring and follow up team would sustainably reduce the bank NPL	1	2	3	4	5

Part IV: Credit monitoring process

Direction: Please indicate your degree of agreement/disagreement with the following statements related to your perception by encircling the appropriate number. Where, (1=strongly agree (SA); 2=Agree (A); 3= neutral (neither agree nor disagree (N)); 4=Disagree (DA); and 5=strongly agree (SD).

S. No	Items	SA	A	N	DA	SDA
1	The bank strictly monitors loan terms and conditions that have been stipulated at the time of loan	1	2	3	4	5
2	The bank uses a loan covenant checklist that routinely tracks its customer's adherence to covenants.	1	2	3	4	5
3	The bank regularly reviews and monitors the performance of Credit	1	2	3	4	5
4	The bank regularly reviews and monitors the performance of credit quality at portfolio level	1	2	3	4	5
5	Credit file is regularly updated in our bank.	1	2	3	4	5
6	The bank has properly applied its own internal risk rating system.	1	2	3	4	5
7	Credit monitoring procedure is regularly reviewed in our bank.	1	2	3	4	5
8	Credit monitoring procedure is regularly updated in our bank.	1	2	3	4	5

Part V: Credit Risk Management

S. No	Items	SA	A	N	DA	SDA
1	The credit risk assessment of the bank considers a quick response to market	1	2	3	4	5
2	Financial interest between the borrower and the bank official leads to loan default risks.	1	2	3	4	5
3	The existing credit risk measurement tools used by the bank safeguard the bank from major credit risks	1	2	3	4	5
4	The bank credit risk management procedure enable staffs to identify major credit risks	1	2	3	4	5

5	The Practical credit risk assessment activity of the district offices help the bank reduce risks associated with loan granting	1	2	3	4	5
6	Poor credit risk assessment on the process of analysis would lead to loan default	1	2	3	4	5
7	Providing credit risk management training courses will practically enable the bank reduce credit risks	1	2	3	4	5
8	There is a proper system implementation for understanding credit risks in the bank	1	2	3	4	5

Thank you once again for your participation.

Interview Questions

1. Being a Management/Employee of the Bank, how do you evaluate the performance of the Bank in terms of its Loan recovery performance? NPLs portfolio?

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2. In your opinion, is that necessary training for employees in area of credit management practice?

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3. Do you think the branch lending limit and overriding limit has any difficulty in your branches loan providing capacity and growth?

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4. Any other comments or suggestions or ideas you may have with regard to the credit collection strategies are adopted in the management of credit department in Hibret Bank?

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