ST. MARY'S UNIVERSITY

SCHOOL OF POSTGRADUATE STUDIE

ASSESSMENT OF CREDIT RISK MANAGEMENT PRACTICE IN CASE OF BANK OF ABYSSINIA S.C

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A THESIS SUBMITTED TO ST. MARY'S UNIVERSITY, SCHOOL OF POSTGRADUATE STUDIES, IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF A MASTER'S DEGREE IN ACCOUNTING & FINANCE

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A THESIS ON

Assessment of Credit Risk Management Practices in the case of Bank of Abyssinia s.co

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DECLARATION

I the undersigned declared that the thesis entitled “Assessment of credit risk management practice in the case of bank of Abyssinia s.co” is my original work prepare under the guidance of my. 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 learning institution for the purpose of earning any degree.

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ENDORSEMENT

Assessment of credit risk management practice in the case of bank of Abyssinia s.co has been submitted to St Mary University, School of Postgraduate studies for examination with my approval as a university advisor.

____________________________ __________________________

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Acronyms and Abbreviations

CRM	Credit risk management
NPL	Non-Performing Loans
BOA	Bank of Abyssinia
CHIPS	Clearing House Interbank Payments System
RAROC	Risk Adjusted Return on Capital
ROE	Return on Equity
ROA	Return on Asset
TL	Total Losses
NBE	National Bank of Ethiopia
SPSS	Statistical Package for Social Sciences

Abstract

This study is conducted aiming at investigating credit risk management practice at Bank of Abyssinia. In order to achieve this goal the study targeted current workers of the bank's head office's credit department and gathered primary data. The primary data were collected through questionnaires. The study distributed 89 questionnaires, from which 80 questionnaires were correctly filled and returned. Descriptive statistical methods were used to assess the acquired data. The results show that there is an effective credit risk strategy and policy that clearly identify and recognise areas of credit engagement and the risks associated in these engagements. The result also indicated that respondent employees believed there is good level of credit appraisal and granting process at the bank that checks borrower's history, financial condition and collateral requirements before granting loans. Also, the findings showed that Bank of Abyssinia uses appropriate internal risk scoring system; risk based scientific pricing and has an independent risk management function. But results also indicated there is a room for improvement with regard to monitoring and controlling activities and also risk mitigation undertaken at Bank of Abyssinia. In line with the findings of the study, it was suggested to the bank to enhance its monitoring by assessing the collateral value and make credit quality report. With regard to risk mitigation give training for employees and make advisory role for its client.

Keywords: Credit Risk, Credit Monitoring, Risk Mitigation

Chapter 1: Introduction

1.1 Background of the Study

Every bank in the world operates primarily as a credit provider. Due to this, credit quality is regarded as a key for evaluating the stability and health of banks' finances. Bank an institution that deals that provides money and other money-related services .In its role as financial intermediary, a bank accepts deposits and makes loans. The banking industry is seen as the engine that powers the economy since access to credit enables businesses and households to save more money and spend more of it, both of which are important contributors to the growth of the economy (Mayryem & Younes , 2020).

Bank activities face various risks from this credit risk is the major one. Credit risk is come in to the business of lending funds to the operations. Credit risk is defined as the chance of a credit institution suffering losses due to default late or incomplete execution of the debtors. According to (Fan and Yiljun, 2014) the management of the credit risk has an impact on the bank's profitability. Management determines the effectiveness of credit risk management policies of industrial financial institution incorporate those choice making structures associated with the reduction of exposures to savings asset classification and loan loss provisioning in accordance to the (Basel, 2003)

Banks are effectively managed credit risk to not to minimization borrowing activity rather to maximize shareholders wealth and literally ensure protection of depositors fund banks act as delegated monitors on behalf of lenders. Good credit management can boost depositors and investors trust in bank which growth in funds for loans and advances which leads to increased bank profitability (JN Taiwo et.al, 2017).

Risk management is essential equipment in decision- making that relates to mitigating as properly as managing incidences of credit chance on financial institution portfolio crm. The risk management process encompasses all techniques and management tools required for risk measurement, monitoring, and control Bassie 2nd ed. Policies essentially are designed and applied both internally as an operational tool by way of financial institution administration and externally by financial institution regulatory authorities.

The objective of credit risk management is to minimize the risk and maximize bank's risk adjusted rate of return by assuming and maintaining credit exposure within the acceptable

parameters. It is the practice of mitigating losses by understanding the adequacy of bank's capital and loan loss reserve at any time. Credit score of the borrower is important for banks to determine their ability to repay them on time. This study, therefore, attempted to assess the actual credit risk management practice at one of the private banks, Bank of Abyssinia, to study credit risk management practice exercise in Bank of Abyssinia particular which is the most modern technologically advanced among private banks in Ethiopia.

1.2 Statement of the Problem

In modern economy of banking sector risk management is the major issue because of economic consequence. Bank failure could be disaster for the entire financial system. Poor credit management would have a negative impact on bank profitability and live successfully (Ahmadyan, 2018) and also Cause to increase legal cost to the bank.

It is believed that generally banks face credit risk, market risk, operational risk, among which credit risk will have negatively affected. As a result, it is necessary to emphasize the significance of credit risk management and good credit management requires qualified personnel and the establishment of sound credit policies, procedures. If credit is well managed, the bank's profitability and sustainability will improve in the future. However, if this is not done, it will be a major threat to the bank's survival.

Banks should now be acutely aware of the need to identify, measure, monitor, and control credit risk, as well as to ensure that they have adequate capital to cover these risks and are adequately compensated for losses. Banks must investigate the relationship between market- and liquidity-sensitive exposures and the borrower's default risk.

In Ethiopia, to the knowledge of the researcher, researches were conducted in this area of credit risk management. Studies undertaken by (Girma, 2011) (Meti, 2021) and (Flagot, 2021) focused on credit risk practice, credit management aspect such as performance, profitability. Thus, As a result, the researcher attempts to fill the gap, taking into account the bank technologically advanced well-structured financial service system connected with the latest upgraded T-24 core banking system (BAO Annual report 21/22) as we know todays dynamic business environment how well the bank's present performance supports effective credit risk management policies, practices, and strategies**.** This study focused on investigating the credit management practices of

the Bank of Abyssinia in order to describe the major credit management policy & practices used there and to reach empirical conclusions.

1.3 Guiding Research Questions

This study Assessment of credit risk management practice in the case of bank of Abyssinia s.co about seeks to answer the following questions:

- What is the existing polices and guidelines that Bank of Abyssinia S.C used in relation to general principles of sound credit risk management?
- What actions that bank of Abyssinia takes in the past to reduce the NPL Status?
- What Kind of mechanism used by the bank to handle credit risk?
- What are methods employed to control & mitigate credit risk at Bank of Abyssinia?

1.4 Objective of the Study

Objective of the study is to investigate credit risk management practices in Bank of Abyssinia S.C. Based on this goal the sincerely specific goals of this look up were:

To specifically investigate how well associated events transactions particularly is behaviour of Bank of Abyssinia.

- To examine the soundness of the existing policies and guidelines at bank of Abyssinia in relation with general principles of sound credit risk management.
- To assess the procedure that the bank use to reduce the amount the NPL in the past.
- To assess the credit risk management techniques & tools used by the bank.
- To examine the methods employed to control & mitigate the risk at Bank of Abyssinia.

1.5 Scope of the Study

The study specifically focuses on solely assessing credit risk management practices in Bank Abyssinia s.co disregarding operational, interest rate, liquidity and other types of risks that affect banks. Despite the fact that credit risk management is an issue for all banks in the nation the paper definitely is limited only Bank of Abyssinia s.co credit risk management practices. The study cantered only on respondents living at Head Office credit department of Bank of Abyssinia S.C.

1.6 Significance of the Study

After the research has been completed, its output will essentially contribute a lot to these events who have comparable goals and for all intents and purposes seek records on problems associated to the find out about below investigation in a subtle way. The following definitely are the feasible significance of the research output.

- It will help the bank by highlighting the location the issues strength and weakness.
- It will be used as a source of information or documents when the bank develop/review its credit risk management strategy.
- It will be used as a secondary information for those who wish to study about related topics in the future.
- It is expected to improve the level of practical understanding between theoretical knowledge of credit risk management and actual application in this area in the banking industry.

1.7 Limitation of the study

The researcher seeks to successfully complete the study's goal. However, time constraints will be the key obstacles to the paper's successful completion.

1.8 Structure of the thesis

The thesis report is organized in to five chapters. Chapter one provided the general introduction about the whole report. The second chapter explains about the review of the related literatures, the third chapter shows research design and methodology, the forth chapter shows the analysis of the data's collected, and the final section draws conclusions from the empirical data and offers suggestions.

Chapter 2: Literature Review

2.1 Introduction

This chapter provide theoretical and empirical reviews frame work for the study by reviewing related literature on the credit risk management practice. The first section provides theoretical literature, definition and concepts, credit management processes and arguments. The second section devoted to review empirical studies on large along with gaps observed.

2.2 Theoretical Literature

2.2.1 Definition and Concepts of Credit risk

Credit origin comes from Latin word “credere” which means to trust there is a strong implication of confidence when a seller transfers his supply to a buyer who has committed to pay later and payment will be made at the predetermined date. Credit rule are a major contributor to serious financial issues a poor assessment of the portfolio, changes in economic conditions, and consistent monitoring of their capital ratio and riskiness (Fawad & Taqadus , 2013).

Credit risk is most simply defined as the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms. Credit risk management aims to increase a bank-adjusted rate of return by keeping credit risk exposure within reasonable bound. Banks need to manage the credit risk in the entire portfolio as well as the risk in individual credits or transactions. Banks should also consider the relationships between credit risk and other risks. The long-term survival of any banking company depends on the efficient management of credit risk, which is a crucial element of a comprehensive risk management strategy (Basel, 2000).

In the same way (Singh, 2021) states that another term for credit risk is default risk, which is defined as the bank's risk of loss from a counterparty who doesn't keep his or her agreement to make payments. He also points out credit risk is the earliest and the basic source of risk in the banking sector. Credit risk includes both the possibility of a borrower defaulting by failing to pay back principal and interest on time and the possibility that the obligation's credit standing will decline, creating a financial loss (Li Lian Ong et.al, 2006).

Credit risk arises when one of the counterparties to a transaction does not clear up in full, either while the funds are still outstanding or at a later period, and it could lead to the counterparty's bankruptcy (Beker, 1998).

Credit risk is delay of one's own obligation in accordance with stetted contractual financial obligation within the deadline of payment by counter party. Credit risk is the possibility that debtors or borrowers incapability of paying its obligation in a way that predetermined contractual agreement made during credit approval process which adversely affect the working environment of the lender.

The (Basel, 2001), defines credit risk as a chance when borrowers fail to repay their loan partially or fully due to different circumstances. It also state that the extent to which the bank exposed to higher credit risk will lead to unexpected financial crises and lower credit risk will minimize the probability of the crises because large amount of profit will be generated from this department of the bank. When a borrower, counterparty, or obligor fails to fulfil their debt obligation as they have agreed and contracted, a lender is exposed to risk of loss Colquitt (2017).

2.2.2 Types of credit risk

According to (Ken & Peter , 2014) there are two sub-types of credit risk country risk and industry risk which affect multinational enterprises.

Country risk

Country risk arises from having contact to individuals and institutions in countries that have legal systems, business codes and standards that differ from those of the lender. There are four factors relevant to this.

1st Political risk, develops whenever the conflict of administration in a nation is opposed from beyond or within its borders. Political risk is more serious in long-term financing arrangements than in short-term deals.

2nd Economic risk, which arises from depressed or declining economic stability in a country.

3rd Currency risk, which always arises with cross-border lending.

4th Enforcement risk from the legal system in the debtor country. Because a creditor has to go through a foreign legal system, it has been known for debtors to use their domestic legal process to stand or attempt to avoid paying, claiming that rules from their home country apply.

Industry risk

This applies particularly when the domestic or international economy is in recession and the poor economic conditions particularly affect certain industries. Industry structure may have credit consequences because of the supply chain within which most firms operate. It is a form of concentration risk.

2.2.3 Credit Risk Management

According to (Singh, 2021) credit risk management includes all management function such as identification, measurement, monitoring and control of the credit risk exposure. The author also stated that in the current economic climate, good credit risk management practices are a crucial issue for the long-term success of the banking sector, and that inadequate credit risk management policies will seriously contribute to crisis in the banking sector.

Credit risk management practice define as the process of analysing and renewing credit risk management documents and consistently apply in the actual credit-granting procedure, Credit administration, monitoring, and risk management procedures in an environment with the right level of credit risk, To reduce the negative impact it must be understood and identifications 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.

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.

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). Through the creation and application of a Credit Risk Framework, Conducting a credit risk analysis, Building Credit Risk Scoring Models and Credit Risk Reporting control panel and Forecasting Loan Loss we can construct effective credit risk management.

Most effective credit risk management focuses on processes, culture, people and organization because we are working with them. Both preventive and remedial measures are part of credit risk management. 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 corrective measures work to reduce post-sanction loan losses through activities like securitization, derivative trading, risk sharing, and judicial enforcement.

2.2.4. Process of Credit risk Management

Credit management process is the process of granting credit, setting the terms on which it is granted, recovering this credit when it is due and ensuring compliance with company credit policy & other credit related functions. Credit represents more than 80% of the balance sheet of financial institutions. Because of this, banks should carful while handling credit. Credit management procedure begins with a precise evaluation of the client base's creditworthiness and viability as a firm. This is done by looking in to loan applications carefully which is part of the loan process. Hence, proper credit management is setting specific criteria that a customer must meet before receiving the proposed credit arrangement.

Basu and Rolfes (1995) indicate that the success of a financial organization is based on its ability to manage credit well. The entire credit line that will be offered to a certain consumer must also be determined as part of the appraisal process for credit management. Several factors are used as part of the credit management process to evaluate and qualify a customer for the receipt of some form

of commercial credit. This includes gathering data on the potential customer's current financial condition, including the current credit track record that discloses the character of a customer in meeting obligations as well as collateral value. As a result different procedures that can be employed in each of these areas with the sole aim of examining the present loan management procedure of financial of institution mainly bank. It is important to be aware that one of the primary causes of the failure of the majority of financial institutions was the poor credit management of such organizations (Ezekiel Nibenong et.el, 2020).

Generally credit management has three basic steps credit analysis, credit approval and follow-up. The first two are pre-disbursement process while the last one is a post disbarment process. Credit management of banks simply put in the framework of the above category includes the following:-

Credit Application

The credit application is the primary step in the credit management process. A credit application is filled out by a borrower and submitted to a lender to request a loan or other financing. The application documents contain detail information about the applicant name of the applicant, address, residential address, age, telephone number, marital status, number of dependants, 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.

The information included in a credit report helps the lender determine whether the borrower is a good candidate for a loan .It is the content of this document which financial institutions 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. As a result, current loan application forms should be evaluated to ensure that they are properly structured to protect the credit (Abdou, H. A., &Pointon, J. 2011)

Credit Assessment

This is the process for gathering the data needed to undertake a risk assessment exercise on a potential borrower and project to identify the risk that is involved. Financial institutions carefully consider this before making any loans. Jahin, S. Y. (2018) discussed an appropriate estimation of a customer's financial position decides the customer's financial situation and also aids in determining

the customer's ability to repay the loan when it is due. This is also done to determine whether the proposed project can actually be carried out. Additionally, this aids in examining the project's financial, technical, and economic viability. The risk associated with the loan can be reduced by doing the above. Credit risk simply means the risk of default as a result of a borrowers" failure to repay the loan taken from a financial institution.

Therefore, financial institution should attach all the seriousness to the credit assessment process in order to reduce the credit risk associated with credit since loans are the largest assets of financial institution like Banks. Financial institutions, such as banks, have a hierarchical structure in place to authorize loans, with branches having a discretionary lending limit depending on their grades. Discretionary lending limit is a limit set for each branch depending on their grade that allows them to disburse loans in various sectors (Meti, 2021) appropriate assessment of a customer helps to assess the applicants' creditworthiness and helps to reduce the difficulties between borrowers as an agents and the financial institution as the principal.

Credit Monitoring

According to Krznar, M. I., &Morsink, M. J. (2014), Credit Monitoring essential aspect of the lending process financial institutions bear a significant amount of responsibility for maintaining asset quality and timely recovery of interest and principal. Credit Monitoring is an integral part of lending activity.

Financial institutions are under a lot of pressure to keep their assets in good condition and timely recover any outstanding interest and principal through appropriate safety measures are performed when evaluating and approving loans, a financial institution must be more watchful. Unless early warning signals are captured, a financial institution may not be able to take proper remedial measures to arrest and reduce bad debt in the institution. A financial institution must set up a very reliable and efficient credit monitoring system to keep track of the borrower's account from various perspectives and take quick action as necessary. Monitoring may be by visiting the borrowers' places of business to examine the general state of affairs.

2.2.5 Credit Risk Exposures in Banks

Generally, credit risk is related to the traditional bank lending activities, while it also comes from holding bonds, interbank transactions, trade financing, foreign exchange transactions, in the

extension of commitments and guarantees, and the settlement of transactions. Various financial instruments including bankers acceptances, interbank transactions, financial futures, guarantees, etc. also increase banks' credit risk. (Basel , 1999) reports that for most banks, loans are the largest and most obvious source of credit risk; however, throughout the activities of a bank, which include in the banking book as well as in the trading book, and both on and off the balance sheet, there are also other sources of credit risk.

2.2.5.1 On-Balance Sheet Exposures Loans

The primary risk associated with bank loans is Credit risk. Since the default risk is usually present to some degrees in all loans (Saunders & Cornett, 2006), the individual loan and loan portfolio management is undoubtedly crucial in banks' credit risk management.

According to (Akinlo & Emmanuel, 2014,) nonperforming loans are those not generating income, and loans are often treated as nonperforming when principal or interest is due and left unpaid for 90 days or more. Thus the nonperforming loan portfolio is a very important indication of the bank's credit risk exposure and lending decisions quality. Debt Securities Besides lending, credit risk also exists in banks. Debt securities are debt instruments in the form of bonds, notes, certificates of deposits, etc, which are issued by governments, quasi-government bodies or large corporations to raise capital. In general, the issuer promises to pay coupon on regular basis through the life of the instrument and the stated principal will be repaid at maturity time. However, the likelihood that the issuer will default always exists, resulting in the loss of interest or even the principal to banks, which can be a damaging impact

2.2.5.2 Off-Balance Sheet Exposures

Some of the off-balance sheet credit exposures are: Derivatives Contracts According to (Saunders & Cornett, 2006), banks can be dealers of derivatives that act as counterparties in trades with customers for a fee. Contingent credit risk is quite likely to be present when banks expand their positions in derivative contracts. Since the counterparty may default on payment obligations to current and future losses, risk will arise, which leaves the banks un-hedged and having to substitute the contract at today's interest rates and prices. While trading in options, futures or other similar contracts may expose banks to lower credit risk since contracts are held directly with the exchange and there are margining requirements. Guarantees and Acceptances Bank Guarantee is an

undertaking from the bank which ensures that the liabilities of a debtor will be met, while a bankers' acceptance is an obligation by a bank to pay the face value of a bill of exchange on maturity (Basel, 2008). It is also mentioned that since guarantees and acceptances are obligations to stand behind a third party, they should be treated as direct credit substitutes, whose credit risk is equivalent to that of a loan to the ultimate borrower or to the drawer of the instrument. In this sense, it is clear that there is a full risk exposure in these off balance sheet activities.

Interbank Transactions Banks send the bulk of the wholesale payments through wire transfer systems such as the Clearing House Interbank Payments System (CHIPS). The funds or payments messages sent on the CHIPS network within the day are provisional, which are only settled at the end of the day. Therefore, when a major fraud is discovered in a bank's book during the day, which may cause an immediate shutting down, its counterparty bank will not receive the promised payments and may not be able to meet the payment commitments to other banks, leaving a serious plight.

As pointed out by (Saunders & Cornett, 2006) the essential feature of the above kind of settlement risk in interbank transactions is that, "banks are exposed to a within-day, or intraday, credit risk that does not appear on its balance sheet", which needs to be carefully dealt with. Loan Commitments A loan commitment is a formal offer by a lending bank with the explicit terms under which it agrees to lend to a firm a certain maximum amount at given interest rate over a certain period of time. In this activity, contingent credit risk exists in setting the interest or formula rate on a loan commitment. According to (Saunders & Cornett, 2006) banks often add a risk premium based on its current assessment of the creditworthiness of the borrower, and then in the case that the borrowing firm gets into difficulty during the commitment period, the bank will be exposed to dramatic declines in borrower creditworthiness, since the premium is pre-set before the downgrade.

2.2.6 General Principles of Sound Credit Risk Management

Financial institutions are facing several problems due to lack of adequate credit risk management principles, proper implementation credit standards of borrower and counterparties and poor portfolio risk management or lack of attention to changes in economic or other circumstances that

can lead to worsening in the credit standing of a bank's counterparties. Sound principles of banks credit risk management will be covered on five areas as follows (Basel, 2000)

2.2.6.1 Establishing an Appropriate Credit Risk Environment

To establish an appropriate credit risk environment mainly depends on a clear identification of credit risk and the development of a comprehensive credit risk strategy as well as policies. To banks, the identification of existing and potential credit risk inherent in the products they offer and the activities they engage in is a basis for an effective credit risk management, which requires a careful understanding of both the credit risk characteristics and their credit-granting activities. Besides, the design of objective credit risk strategies and policies that guide all credit granting activities is also the cornerstone in bank credit risk management process. According to (NBE, 2010) Rm-guideline revised Credit policies need to contain, at a minimum: general areas of credit in which the bank is prepared to engage or is restricted from engaging; clearly defined and appropriate levels of delegation of approval, and provision or write off authorities; and sound and prudent portfolio concentration limits.

2.2.7 Operating under a sound credit granting process:

The (Basel, 2000) asserts that in order to maintain a sound credit portfolio, a bank must have an established formal transaction evaluation and approval process for the granting of credits. Approvals should be made in accordance with the bank's written guidelines and granted by the appropriate level of management. There should be a clear audit trail documenting that the approval process was complied with and identifying the individual(s) and/or committee(s) providing input as well as making the credit decision. A sound credit granting process requires the establishment of well-defined credit granting criteria as well as credit exposure limits in order to assess the creditworthiness of the obligors and to screen out the preferred ones. In this regard banks have traditionally focused on the principles of five Cs to estimate borrowers' creditworthiness.

1. Character: It is the degree to which the borrower's ability to repay the loan, according to Gatimu, E. M. (2014). The debt repayment potential is worthless unless the borrower is able to repay the loan. Character refers to the borrower's appearance in terms of achieving a well-defined

goal and having a responsible attitude toward using the borrowed funds. Responsibility, truthfulness, serious purpose, and intention to repay are important elements in evaluating character.

2. Capital: This refers to the financial condition of the borrower. Where the borrower has a reasonable amount of financial assets in excess of his financial liabilities, such a borrower is considered favourable for credit facility. Earning can be taken as a good indicator of loan repayment capacity. For instance, for a poor farmer, the capacity can be determined by looking the possible discretionary income he/she can have. That is income left after meeting essential requirements like food, and clothing. The average family size should be considered since it has a huge effect on discretionary income. Since the total income, which seems to be constant, is shared by a large number as the family size grows, a family with three members can have more discretionary income than a family with six members

3. Capacity: The ability to repay, which reflects the volatility of the borrower's earnings. The level of capital must be evaluated to ensure that the risk is borne by the party with ownership interest. In this context, considerations such as the customer's net worth, home equity, and other assets should be considered (Bodenhorn, H. (2012).

4. Collateral: In the event of default, a banker has claims on the collateral pledged by the borrower. Borrowers with a lot more assets to pledge as collateral are considered favourable for credit facility

5. Conditions: This refers to the economic situation or condition prevailing at the time of the loan application. Before the loan is granted, all conditions that will affect the borrower in the future should be assessed. Failure to recognize such things may lead in bankruptcy, particularly if the loan portfolio is concentrated in a certain regions.

2.2.7.1 Maintaining an appropriate credit administration, measurement and monitoring process:

Maintaining a bank's safety and soundness requires effective credit administration. It is the bank's job to see that a credit is properly maintained after it has been provided. This includes keeping the credit file up to date, obtaining current financial information, sending out notices and preparing various documents such as loan agreements, and follow-up and inspection reports (Basel, 2008).

According to **Wesley (2009),** credit administration can be extremely important to a bank's success since it influences the creation and maintenance of a secure credit environment and typically protects the organization from lending sins. Therefore, banks must always pay attention to how well their credit administration processes are doing.

2.2.8 Ensuring adequate controls over credit risk:

In order to ensure adequate controls over credit, **Ganesan (2009)** asserts that there must be credit limits set for each officer whose duties have something to do with credit granting. Material transactions with related parties should be subject to the approval of the board of directors (excluding board members with conflicts of interest), and in certain circumstances (e.g. a large loan to a major shareholder) reported to the banking supervisory authorities. The means for guaranteeing adequate controls over credit risk in banks lay in the establishment of different kinds of credit reviews. Regular credit reviews can verify the accordance between granted credits and the credit policies, and an independent judgment can be provided on the asset qualities (Basel, 2008)

2.2.9 Credit Risk Measurement

Credit risk measurement relies on the lenders analytics and risk measurement tools rather than the borrowers. It also has three goals the first one is to limit the credit risk exposure that the lender accepts when extending the debt. The second goal is to insure that adequate compensation is earned for risk undertaking. It is concerned with the revenue and profit margin earned on the products and services that lenders provide. The third goal is to mitigate the credit risk exposure by structuring transaction to protect against loss as well as in to asset classes that can be marketed to third party investor **Colquitt (2017).** The risk measurement concerns the actual measurement of the risk in a risk grade or on a total portfolio. The measurement quantifies the actual default risk (probability of default), the loss risk (loss given default) and the exposure risk (exposure at default).

2.2.10 Tools of Credit Risk Management

According to (Raghavan, 2003) the instruments and tools, through which credit risk management is carried out, are

a) Exposure Ceilings:- Capital Funds are connected to Prudential Limit – say 15% for individual borrower entity, 40% for a group with additional 10% for infrastructure projects undertaken by the group, Threshold limit is fixed at a level lower than Prudential Exposure; Substantial Exposure, which is the sum total of the exposures beyond threshold limit should not exceed 600% to 800% of the Capital Funds of the bank (i.e. six to eight times)
b) Review/Renewal:- Multi-tier Credit Approving Authority, constitution wise delegation distribution, higher powers distribution for better-rated customers; discriminatory time schedule for revision/renewal, Hurdle rates and Bench marks for fresh exposures and periodicity for renewal based on risk rating, etc. are formulated.
c) Risk Rating Model:- Set up comprehensive risk scoring system on a six to nine point scale. Clearly define rating thresholds and review the ratings periodically preferably at half yearly intervals. Rating migration is to be mapped to estimate the expected loss.
d) Risk based scientific pricing:- Link loan pricing to expected loss. High-risk category borrowers are to be priced high. Build historical data on default losses. Allocate capital to absorb the unexpected loss. Adopt the Risk Adjusted Return on Capital (RAROC) framework.
e) Portfolio Management The need for credit portfolio management emanates from the necessity to optimize the benefits associated with diversification and to reduce the potential adverse impact of concentration of exposures to a particular borrower, sector or industry. Stipulate quantitative ceiling on aggregate exposure on specific rating categories, distribution of borrowers in various industry, business group and conduct rapid portfolio reviews. The existing framework of tracking the non-performing loans around the balance sheet date does not signal the quality of the entire loan book. There should be a proper & regular on-going system for identification of credit weaknesses well in advance. Initiate steps to preserve the desired portfolio quality and integrate portfolio reviews with credit decision-making process.

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

2.2.11 Other Techniques for mitigating Credit Risk

The last step for any kind of risk management is to mitigate and transfer the risk in order to avoid or reduce losses. Credit Risk Mitigation is a strategy employed by many financial institutions to reduce the amount of exposure to credit risk that the institution continues to hold. Credit risk mitigation means reduction of credit risk in an exposure by a safety net of tangible and realizable securities including third-party approved guarantees/insurance (Raghavan, 2003).

Banks use a number of techniques to mitigate the credit risks to which they are exposed. Exposures may be collateralized by first priority claims, in whole or in part with cash or securities, a loan exposure may be guaranteed by a third-party, or a bank may buy a credit derivative to offset various forms of credit risk. Additionally banks may also net the loans owned to them against deposits from the same counter-party. The various credit risk mitigation tools laid down by (Basel, 2000) are as follows:

1. Collateral (tangible, marketable) securities: to support various lending agreements for reducing credit risk.

2. Guarantees: a transaction in which security is offered for abstract payment undertakings. It creates a non-accessorial, abstract obligation to the beneficiary.

3. Credit derivatives: Credit derivative is an instrument designed to segregate market risk from credit risk and to allow separate trading of credit risk. Credit derivatives allow a more efficient allocation and pricing of credit risk. Credit derivatives are privately negotiated bilateral contracts

that allow users to manage their exposure to credit risk. For example, a bank concerned that one of its customers may not be able to repay a loan can protect itself against loss by transferring the credit risk to another party while keeping the loan on its books. This mechanism can be used for any debt instrument or a basket of instruments for which an objective default price can be determined.

4. On-balance-sheet netting: A netting agreement nets the amounts to be exchanged between counterparties, which reduce the credit exposure. For banks, netting agreements are mostly applied to interbank transactions, including bilateral payments netting, multilateral payment systems with net settlement and master derivative agreements.

2.3 Empirical Literature

There are many researches regarding credit management and financing policy locally as well as internationally. This section presents evidence which identify the major factors affecting credit management. Many researchers have conducted a lot of study on determinants of credit management due to its significance for the bank's failure.

(Wang, 2013) find out that the key principles in credit risk management are establishment of a clear structure, allocation of responsibility and accountability, processes have to be prioritized and disciplined, responsibilities should be clearly communicated and accountability assigned on his research title Credit Risk Management in Rural Commercial Banks in China.

(Atiklt Hailu Asfaw[1]& P. Veni, 2015) in this study find out that Credit risk, liquidity risk and operational risk are the three important types of risks the banks mostly facing. The three widely used Risk identification method were identified and ranked as Financial Statement Analysis firstly and followed by audit and physical inspection and then internal communication. The study further confirmed that four aspects of Basel's Credit risk management principles explain a significant level of variation on Credit risk management practice of Ethiopian commercial banks. Furthermore, Establishing an appropriate Credit risk environment and Ensuring adequate Controls over credit risk were found to be the most influential variables on level of Credit risk management practice.

Bank Performance and Credit Risk Management in Qatar were studied by (Achou & Tenguh, 2008) in their study the researchers' intention was to see the relationship between bank performance and credit risk management, by taking data from Qatar Central Bank (QCB). They used regression model to show the result of ROE and TL. In addition, tables and charts were used by the researchers for proper analysis of the data obtained. Lastly, their study result shows that there is a significant relationship between bank profitability and credit risk management (in terms of loan performance). Better credit risk management results in better bank performance.

When it comes to Ethiopia, (Alebachew, 2015) in his paper entitled "Assessment of Credit Risk Management Policies and Practices in NIB International Bank" has conclude The Bank has a clearly-established process in place for approving amendment, renewal and re-financing of existing credits and the also the Bank requires to established a credit follow up system which control consistency of all credit approvals made as per the Bank's written guidelines and granted by appropriate organ level of the Bank's management.

(Girma, 2011) Studied Credit Risk Management and Its Impact on Performance on Ethiopian commercial Banks; the researcher used empirical data analysis technique to investigate credit risk management on banks performance. He uses six private commercial banks as reference and used their annual report for reference; the researcher used quantitative research method and interpreted the output sing regression. From the research he has arrived at there is a significant relationship between bank performance (in terms of ROA) and credit risk management (in terms of loan performance). Better credit risk management results in better bank performance.

(Flagot, 2021) Assessment of credit risk management practice on the case of Awash bank s.co the researcher using descriptive statistical tools to examine credit risk practice in the bank study targeted credit and loan department employees who currently work at the head office of the bank and collected primary data. The primary data were collected through questionnaires & expressed in the form of frequency, percentage, mean and standard deviation. the findings showed that there is a well-designed credit risk strategy and policy that clearly indicate and recognizes areas of credit engagement and the risks inherent in these engagements. The findings also indicated that respondent employees believed there is good level of credit appraisal and granting process at the bank.

(Meti, 2021) Assessment of credit management in the case of Oromia international bank sh,co researcher using both primary and secondary data was employed for thus study; primary data questionnaire, interview and yearly reports of the Bank 2016 to 2019, researcher using descriptive statistical tools to examine credit risk practice in the bank in this research can be concluded from the result of the study oromia international bank has a flexible credit management practice, periodic collection of repayments and follow up even if monitoring made over the Bank's collection mechanism was not sufficient.

(Singh, 2021) Credit Risk Management Practices in Dashen Bank of Mettu Branch in Ethiopia researcher using both primary (Questioner) and secondary data was employed for thus study the data was analysed using qualitative and descriptive statistics technique and frequency table in this research can be concluded that the bank has pitfalls such as absence of training for customers which results to loan diversion, absence of credit risk model that predict the risk level of the business and the priority sectors of the bank in terms of credit facility are highly exposed to credit risk which directly contribute to the increment of NPL.

2.4 Literature Gap

According to the literature mentioned above, credit risk management plays a significant part in the overall success of the bank's operations. A study carried out in Ethiopia revealed that effective credit risk management had a favourable impact on the business's overall performance.

Therefore, the researcher aims to close the gap and add knowledge by addressing issues with credit risk management practice in the Bank of Abyssinia. Moreover, previous researches did not consider Bank of Abyssinia, which is the technologically emerged well-structured financial service system latest recently up graded technology T-24 core banking system.

Chapter 3: RESERCH METHDOLOGY

3.1 Research Design

A research design constitutes the blueprint for collecting, measuring and analysing of data. This research has used descriptive research design. As stated by (J K Muiruri & J M Ngari,, 2014), In descriptive research, data that describe occurrences are gathered, organised, tabulated, depicted, and described. With the help of this study design, the researcher is able to describe the phenomenon of interest from the perspectives of individuals or organisations. Additionally, the purpose of this study design is to add knowledge about a topic by defining the form or characteristics of a phenomenon and addressing important research questions, such as "what is going on" in a certain circumstance. Accordingly, this study has found this research design to be more appropriate to collect data from the sources and then analyses it in order to evaluate and describe the current practises of credit risk management at Bank of Abyssinia S.C

3.2 Research Approach

The study mainly employed quantitative research approach. A quantitative approach is employed in the study to analyse quantitative data from structured questioners created using a 5-point Likert scale. Qualitative approach was used to analyse the data from the interview conducted. According to Kothari (2004) mixed research method is defined as the class of research welfare the researcher mixes or combines quantitative and qualitative research techniques, methods, approaches, concepts or language in to a single study. The quantitative method entails the collection of quantitative data that may be subjected to rigorous quantitative analysis in a formal and rigid manner. The goal of the qualitative research method is to evaluate attitudes, views, and behaviour on a subjective basis. By means of employing this mixed approach, the research tried to obtain the advantage of both quantitative and qualitative approaches and can overcome their limitations.

3.3 Target population

Bank of Abyssinia has more than 810 branches with in the country and 215 branches in Addis Ababa. The population for this study consists of workers in the credit and lending division at the head office, which is in the Leghar area. The study focuses on the head office because the establishment of credit rules polices, credit assessments, and the approval process for credit are

under the authority of, or pass through, the approval of, the head office level. According to the preliminary survey, there are more than 1,375 employees working at different departments at the head office. Of this employees at the head office only those workers who have a clear link and association with credit processing and administration activities have been approached for the purposes of this report 115 employees are currently working at the credit and risk management department. Consequently, the target populations of the study are the 115 employees currently working at the credit and risk management department at the head office.

3.4 Sample Procedure and Sample Size

To make the sample size more manageable, the study use a simple random sampling technique. There are several approaches to determine the sample size, this include using a census for small populations, imitating a sample size of similar studies using published tables and applying formula to calculate a sample size. The study uses a formula developed by Yamane (1967) to determine the sample size assuming 95% confidence level and 5% margin of error.

Formula n= N/(1+N*e2)

Where n =sample size,

N =population size

e = margin of error

n= 115 /**1**+115(**0.05**)2= 89

The target populations of the study were the 115 employees currently working at the credit and risk management department at the head office. As a result of the total sample size selected and number of participants in the study will be 89 employees working at the credit and risk management department selected randomly.

3.5 Data collection Instruments

This study used primary data. The key data for the study will be gathered through a self-administered questionnaire and an interview with the department's head of credit management. The items of the questionnaire were adopted from the prior literature (Sahlemichael2009) (Basel,

2000), (Flagot, 2021). The adopted items were slightly modified according to the context of the study. The questionnaire used in the study has two parts. Each respondent's demographic data gathered in the first section of the survey. The second part contains information to assess variables and is prepared on five point Liker scale ranged from "1=Strongly Disagree" to "5=Strongly Agree". In addition to this, the study interviewed the department head at the head office to obtain responses on open ended questions prepared.

The interview questions are used to get more details about the bank's credit risk management procedures. The head of credit department is chosen for an interview since it is directly involved with credit management. This research conducted an Interview as it affords a follow up questions to respondents for clarity.

3.6 Method of Data Analysis

The study analysed the data collected from respondents through questionnaire by using SPSS software. The study uses descriptive statistics and tables to present data from primary sources that are expressed as frequency, percentage, mean, and standard deviation. To analyse the information from the conducted interview, narration was employed.

3.7 Ethical consideration

The study is ethically clear since the research uses the data from respondent which is collected through questionnaire, permission will obtain from the respondent, to maintain the confidentiality of the information provided by the respondents, they instruct not to write their names on the questionnaire and assure of that the response used only for academic purpose and kept confidential. Brief description of the central objective of the study and the potential benefits of the research outcome to respondents will be clearly given in the introductory part of the questioner.

Chapter 4: RESULTS AND DISCUSSION

This study's main goal was to evaluate Bank of Abyssinia's credit risk management practice. To achieve the objective of the study, data from primary source was collected through questionnaires distributed to employees working in the credit department at the head office of Bank of Abyssinia. In this chapter data presentation, interpretation and discussion are presented. The data of the respondents is analysed by using descriptive statistical tools. The response rate and demographic information about respondents are covered in the first section of this chapter, and the analysis and application of the study's findings are covered in the second section.

4.1 Response rate and Demographic Characteristics of Respondents

4.1.1 Response rate

As stated in the previous chapter the study took a sample size of 89 employees who work in credit department of the bank. Thus, eighty nine questionnaires were given to the relevant employees of the organization. A response rate of 89% was achieved with 80 correctly completed and returned questionnaires. This response rate was sufficient for the study's conclusions.

4.1.2 Demographic Characteristics of the Respondents

The demographic data of respondents is displayed in the next section. These include gender, age and work experience of respondents. The respondents were questioned about their demographics and their responses are shown below.

Table 4.1 the graph below was created to show the respondent's gender distribution. As it is presented in table 4.1 below, 71.3% of the respondents are male and 28.7% are female. The majority of responses are men. This result shows that there are higher numbers of male employees working in the credit department of the bank

Table 4-1 Demographic characteristics of respondents

	Frequency(n)	Percentage (%)
Gender		
Male	57	71.3
Female	23	28.7
Total	**80**	**100**
Age		
25 to 30 years	5	6.3
31 to 35 years	20	25
36 to 40 years	40	50
Above 40	15	18.8
Total	**80**	**100**
Level of education		
Diploma	8	10
Bachelor's Degree	38	47.5
Master's Degree	34	42.5
Total	80	100
Work Experience		
Below 5 years	10	12,5
6 to 10 years	20	25
11 to 15 years	38	47.5

Above 15	12	15
Total	**80**	**100**

Source: Own survey (2023)

As it is shown on table 4.1 above, 6.3% of the respondents are in the age group between 25 to 30 years, 25% of the of the respondent indicated they are in the age group between 31 to 35 years, 50% of the respondents were in the age group 36 to 40 years, whereas the remaining 18.8% of the respondents indicated that they are above 40 years old. This implies that the bank human resource especially in credit related staffs are younger aged. Young people are active and simple to customise with technology, and this conduct could be advantageous to the bank In addition, respondents were asked to state their highest degree of education in the study. The findings presented above revealed that 10% of the respondent indicated their highest level as Diploma, 47.5% of the respondent indicated their highest level as Bachelor’s Degree, and the remaining 42.5% of the respondents indicated their highest level of education as Master’s Degree. It is identified that most of the respondents included in the study had Bachelor’s Degree. This result shows that majority of the employees (90%) who are currently working in the credit department of the bank have Bachelor’s Degree or above. The people working in the credit industry have academically trained this result indicates that the respondents are well prepared to understand and respond to the questionnaire items.

Moreover, as presented on table 4.1 above, the study requested respondents to indicate their work experience. Their responses’ revealed that 12.5% of the respondents have a work experience of less than five years, 25% of the respondents had a work experience ranging 6 to 10 years, 47.5% of the respondent indicated that they had worked for a period ranging between 11 to 20 years. And 15% who has worked above 20 years .This implies that most of the employees (87.5%) have above 5 years of experiences accumulated. As a result the researcher believes that the respondents have a good work experience. Due to their experience respondents came across many credit risk exposures this might have helped them to clearly understand the current credit management practice of the Bank and they can easily pinpoint the Bank's strengths and weaknesses in these areas

4.1.3 Presentation and Analysis of the Findings of the Study

This study was conducted with the main objective of assessing the credit risk management practice at Bank of Abyssinia (BOA).This study evaluated the Bank of Abyssinia current credit policies and standards, client evaluation and credit-granting practises, credit measurement and monitoring procedures, and the methods used to manage and reduce credit risk. According to the research methodology, a Likert scale was employed to gauge respondents' opinions of the bank's practise of credit risk management. The data collected is analysed by using descriptive statistics such as minimum, maximum, mean and standard deviation. The mean value findings from the Likert scale measures were evaluated according to the neutral (average) value which is 3. A result which is above 3 shows high and a result which is less than 3 shows below average. Additionally, interview findings from discussions with the department head are included and presented.

4.2.1 Credit Policies and Guidelines

Banks must operate with in sound, well-defined credit-granting criteria. These criteria should include a clear indication of the bank's target market and a thorough understanding of the borrower or counterparty, as well as the purpose and structure of the credit, and its source of repayment (Basel, 2000).having this in mind, the study's initial goal was to determine how respondents felt about the bank's current credit policies and criteria. In order to achieve this, the study asked respondents a series of questions linked to the problem, and the responses are provided in table 4.2 below.

Table 4-2 Employees opinions towards credit policy and guidelines at the bank

No		Min	Max	Mean	Std. D.
1	The bank has well-designed and comprehensive credit risk Strategy and policy	1	5	3.75	1.428
2	There is credit policy and procedure with clearly stetted eligible criteria	1	5	3.37	1.504

3	The existing credit policy of the Bank explicitly indicate general areas of credit in which the bank is prepared to engage	1	5	3.66	1.359
4	The existing credit policy of the bank incorporates credit risks inherent in all products and activities on which the Bank engages in	1	5	3.49	1.359
5	The existing credit policy of the Bank incorporate sound and prudent credit portfolio concentration limits	2	5	3.61	1.142
6	The credit policy of the Bank clearly defined appropriate levels of delegation of approval, and provision or write- off authorities	1	5	3.70	1.267
7	The Bank has credit risk policy that clearly set out how bad credits are to be managed	1	5	3.51	1.331
	Average			3.58	1.341

Source: Own survey & SPSS output (2023)

As presented in table 4.2 above, employees were initially questioned how they felt about the bank having a well-designed credit risk strategy and policy. The mean value for the item was 3.75. This shows that respondents think that the credit risk strategy and policy at the bank is comprehensive and well designed. Question 2 , 3 and 4 in table 4.2 above inquired the opinion of the respondents regarding the existence of a credit policy outlining areas of involvement and the capacity of the credit strategy to take into account risks inherent in activities on which the Bank engages. The mean scores regarding these items were 3.37, 3.66 and 3.49 respectively. According to this outcome, respondents think that the credit policy and strategy at Bank of Abyssinia indicates and recognizes areas of credit in which the bank engage in and the risks associated with all product & activities the bank engages in. According to table 4.2 above, Question.5 respondents agreed with regard to the presence of credit policy at the bank that incorporates sound and acceptable credit portfolio concentration limits. This is reflected in the mean score value of 3.61 which shows agreement with the stated statement.

This result shows that the credit policy and strategy of the bank aware the concentration limits of the risk the bank takes in. Moreover, respondents were asked whether the bank's credit policy and procedures clearly define appropriate levels of delegation with regard to approval and provision of credit. The mean score for the above item Question 6 was 3.70. This shows respondents think the Bank's current credit policy is very clear about delegation of loan approval. This makes it easier to identify who is in charge of performing credit-related tasks. Furthermore, as shown in table 4.2, Question 7 respondents also agreed with the statement the Bank has credit risk policy that clearly set out how bad credits are to be managed. This was reflected in the 3.51 mean score. This suggests that the bank's credit policy has a plan for how to handle poor loans when they arise. In addition, the overall mean score for the above items, which inquire about the credit policies and guidelines of the bank, is 3.58. In general, from this and the results presented in table 4.2 above, it can be implied that the bank's current credit policy has the essential components for maintaining sound credit management.

It is argued in the literature that A proper credit risk environment mostly depends on the creation of comprehensive credit risk strategies and policies that may handle the detection of present and potential credit risk, the activities the bank engages in, and credit portfolio concentration limit and also identify and manage in all products and activities and also is stated in (NBE, 2010) The bank's credit policy contain general areas prepare to engage or restrict, clearly define appropriate level of delegation and prudent concentration limit.

The above result and discussion shows that the bank's current credit strategy and policy complies with these standards. Furthermore, in order to grasp the overall risk status of the bank, in the interview carried out with the credit department head, it was questioned regarding the bank's default rate and nonperforming loan trends over the previous five years.

From the interview response revealed that the NPL ratio for the last five (2018-2022) years has up and down mainly within 5 precent interval because of the bank use different mechanism like strong contact with borrowers, refinancing, amendment asset quality improvement over the period. It was also mentioned that this non-performing loans ratio of the bank with in the acceptable limit as per NBE limit 5%.

Table 4-3 Bank of Abyssinia NPL ratio for the last 5 years

S.no	Year	Loan	NPL ratio
1	2018	17,524,450.00	1.30%
2	2019	22,732,950.00	3.77%
3	2020	35,175,250.00	4.41%
4	2021	72,696,640.00	3.78%
5	2022	102,815,530.00	3.60%

Source: Report of the Bank and own computation, 2023

4.2.1 The Credit Appraisal and Granting Process at Bank of Abyssinia S. CO.

Assessing the credit worthiness of the obligors is necessary for a solid credit-granting procedure in order to screen out the favoured ones and reject unfit creditors. In this regard the study asked respondents questions related with the credit appraisal and granting process at Bank of Abyssinia and responses are summarized and presented in table 4.3 below.

Table 4-4 Employees opinion towards credit appraisal and granting process at the bank

No		Min	Max	Mean	Std. D.
1	The Bank conducts comprehensive Credit worthiness analysis properly before granting loan	1	5	3.70	1.287
2	The bank checks the borrower history before granting loans	2	5	3.68	0.976
3	The bank properly assessed the customer financial ability to meet obligation	2	5	3.48	1.414
4	The bank has a clear established process for approving a new credits as well as amendment, renewal and re-financing of existing credits	1	5	3.79	1.456

5	Adequacy, marketability and enforceability of collateral requirement is properly evaluated and measured by professional personnel or expertise	1	5	3.49	1.331
6	The banks credit granting and approval process establishes accountability of the decision maker	1	4	3.11	1.125
	Average			3.54	1.265

Source: Own survey & SPSS output (2023)

Table 4.3 above shows results of respondents' opinion regarding the credit appraisal and granting process of the bank. In this regard, as presented in table 4.3 above, the first question asked respondents if they believe the bank appropriately assesses credit worthiness before giving loans. The mean value of the item was 3.70 according to respondents It implies that the bank appropriately undertakes a credit worthiness before giving a loan. Item 2 in table 4.3 above inquired the opinion of the respondents if the bank checks the borrower history before granting loans. The mean score regarding this was 3.68 which is above average and implies the majority of respondents agree that the bank investigates borrowers' histories before approving loans. Similarly, question 3 and 4 in table 4.3 above which have a mean value of 3.48 and 3.79 respectively, is shows before making loans, the bank accurately evaluates the customer's financial capability and collateral needs. According to table 4.3 above, the mean score was 3.79, with regard to the existence of a clear established, transparent framework for the amendment, renewal, and refinancing of existing credits. This finding for item no. 5 the mean value 3.49 shows that respondents' opinion is relatively positive regarding the presence of adequately evaluated and measured by professional expertise. The average value for the final row in table 4.3, however, was 3.11 this result shows that, respondents agree that the process for granting and approving credit makes the decision-makers accountable. Furthermore, the average mean score of the set of statements regarding the credit appraisal and granting process of the bank, as presented in table 4.3 above, was 3.54 this outcome together with the above explanation shows that the bank considers main aspects like; history, financial standing, and available collateral of the borrower before making a loan.

Several studies (Flagot, 2021), (Basel, 2008); Basu and Rolfes, 1995) made with regard to credit appraisal & granting process before making a loan disbursement, banks take into account the customer's present financial situation, credit history, which reveals the nature of the customer's ability to fulfil obligations, and collateral value. The above results show Bank of Abyssinia follows most these principles of a sound credit appraisal and granting practices before granting loans.

Moreover, in the interview conducted, the department head has pointed out that about major challenges faced in lone appraisal and granting process our country has no centralized information regarding the borrower there are occasions where some customers don’t provide genuine documents and full financial information creating difficulties on appraising their loan requests.

4.2.3 Credit Risk Control and Monitoring Practices at Bank of Abyssinia S. CO

Once a credit is granted, it is the responsibility of the bank to ensure that credit is properly maintained. According to (Basel, 2000) this includes keeping the credit file up to date, obtaining current financial information, sending out notices and follow-up and inspection. As a result, the study attempted to evaluate the bank's credit monitoring procedure, and the findings are reported in the following part.

Table 4-5 Employees opinions towards the credit risk control and monitoring

No		Min	Max	Mean	Std. D.
1	The Bank has a well-structured documentation tracking system for credit and collateral files.	1	5	3.49	1.35
2	The Bank monitors the business of clients after granting credits on regular interval basis	1	5	3.30	1.56
3	The Bank regularly asses value and existence of Collateral coverage	1	4	2.54	1.32
4	The bank periodically prepare credit quality reports for signalling credit quality	1	4	2.46	1.32
5	The bank sends timely notices notifying customers their obligation	2	5	3.41	1.03

	Average			3.04	1.31

Source; own survey & SPSS output (2023)

As it is presented in table 4.4 above, the first item asked respondents' opinion about the presence of a well-structured documentation tracking system for credit and collateral files at the bank. The mean value of the item was 3.49; this suggests that respondents accept that the bank has a well-structured documentation tracking system for credit and collateral files. Similarly, the second item presented to the respondents was to learn whether or not the bank regularly assesses loan terms and conditions. Respondents rated their agreement with mean value of 3.30 shows that the bank makes an ongoing effort to determine whether borrowers are complying with the terms and conditions of their loan. In contrast, table 4.4 shows that, respondents don't agreed that the bank regularly asses value and existence of collateral coverage the bank and prepares credit quality reports on a regular basis to indicate signalling credit quality; this was reflected with the mean results of 2.54, 2.46 for item 3, 4 respectively. This result shows that the banks effort to assess the value of the existing collateral situation & credit quality report during the loan term to be below average. The final question asked to respondent the bank sends timely notice to notify customers about their obligation the mean value of this answer 3.41 this indicate most of the respondent agree the bank give notice letter to the borrowers. In addition, as presented in table 4.4 above, the average mean result of the set of statements was 3.04. This indicates that according to the respondents, the status of credit monitoring practice at Bank of Abyssinia is considered to be average. Generally speaking, it is said that an efficient and solid credit risk management strategy develops sound monitoring procedures designed to ensure credit is used responsibly and fully returned. These includes maintaining up to date information on loan terms and conditions, regular reviews of customers' financial health, inspections on collaterals tied with loans and effective communication with clients (Basel, 2000).The result in table 4.4 above showed credit monitoring activities at Bank of Abyssinia s.co is considered to be average.

Therefore, it can be implied that there is a room for improvement regarding the activities undertaken to monitor the status of the credit provisions provided by the bank. In addition, in the interview carried out with the department head, it was asked about the challenges faced to monitor

credit. The manager pointed out the main difficulties encountered during the banks' attempt of examination were clients' unwillingness to reveal financial conditions.

4.2.4 Credit Risk Mitigation Strategies at Bank of Abyssinia

Credit risk mitigation strategies attempt by lenders through the application of various safeguards to minimize the risk of losing investment due to borrowers defaulting in their interest and principal.it is stated that banks should use techniques and scientific analytical tools that enable management to measure the credit risk inherent and reduce adverse outcomes. These mitigation strategies and tools should provide adequate information on the composition of the credit portfolio, including identification of any concentration of risk (Koch & MacDonald, 2013).In this regard the study asked respondents questions related with the Credit risk mitigation strategies at the Bank and responses are summarized and presented in table 4.5 below.

Table 4-6 Employees opinions towards the credit risk mitigation strategies

No		Min	Max	Mean	Std. D.
1	There is independent risk management policy and procedure from credit policy and procedure in the bank	1	5	3.60	1.25
2	The bank has appropriate internal risk scoring system that distinguishes high and low risk areas.	1	5	3.68	1.32
3	The Bank employs risk based scientific pricing	1	4	3.07	1.15
4	Proper credit limit is established by the Bank for particular economic sector, geographic region specific products, and a group of associated borrowers	1	4	3.15	1.12
5	Adequate measures are put in place to recover non-performing loans	1	4	3.30	1.02
6	The bank offers training for employees on credit risk management	1	4	2.46	1.32
7	The bank offers customers sufficient training on loans usage	1	4	2.36	1.30

	Average			3.09	1.21

Source; own survey & SPSS output (2023)

Table 4.5 above shows opinions of respondents about the credit risk mitigation strategies and tools employed at the bank. The average mean score of the above statements was 3.09. This result reflects respondent employees believe the credit risk mitigation strategies and tools employed at the bank considered to be average. As presented in table 4.5, the first item asked employees' opinion if there is independent risk management policy in the bank. The mean result of the item was 3.60 which show acceptance with the stated statement. Similarly, item 2 of the above table respondents believe that the bank has appropriate internal risk scoring system that distinguishes high and low risk engagement areas. The mean score value of 3.68 for these results implied that in order to distinguish between areas with high and low risk, BOA has an independent risk management function and uses an internal risk rating system. Respondent employees also agreed that the bank employs risk based scientific pricing and credit limit is established by the bank for different sectors, as it was indicated in the mean value of 3.07 and 3.15 respectively for the items. In addition, respondent employees believe that there are adequate measures in place to deal with non-performing loans, as shown with a mean value of 3.30 for the item. These results imply that according to respondent employees, for the purpose of reducing the risk that the bank faces, Bank of Abyssinia uses a risk rating system and risk-based pricing. And according to (Raghavan, 2003) and (Thiupathi & Manoj, 2013) utilizing a suitable risk scoring system, setting ceilings on aggregate exposure and maintaining effective framework for tracking and recovering on-performing loans are effective measure used to reduce credit risk. In contrast, according to table 4.5, the statements regarding the existence of employee credit risk management training and customer loan usage training had mean scores below 3 in both cases.

This finding shows that respondents' employees don't think both staff and consumers receive enough training on credit risk management and loan utilization. Moreover, according to the response from the interview carried out, it was mentioned that the bank use different technologies (software) to cope with the increasing internal and external changes that are taking place continuously. According to the bank credit policy manual the primary protection against losses is ability and willingness of the customer to repay their lone and also the policy state based on risk

associated with the manager mentioned that the bank use latest recently up graded technology T-24 core banking system to its credit management practice accordingly the system automatically alert borrower by their cell phone on due date to pay by mentioning the total amount.

Chapter 5: SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of findings

This study was collect necessary information with the main objective of assessing the credit risk management practice of Bank of Abyssinia (BOA). This study has assessed existing credit policies and guidelines, client appraisal and credit granting process, credit measurement and monitoring practice and the methods employed control and mitigate credit risk at Bank of Abyssinia. The study used descriptive research design and the study was carried out through collecting data by questionnaires from the employees at the head office and interview with a department head, banks annual reports and credit policy manual that was done at bank's head office credit department. The necessary data of the study distributed 89 questionnaires to be filled by the sampled employees of the bank. Among the distributed questionnaires 80 were correctly filled and returned.

Based on the findings from the questionnaire results obtained,

Majority of the employees (90%) at credit department of BOA hold Bachelor's degree or above. we can say majority of employee is well educated in credit department. Moreover, the information gathered using the questionnaires showed that most of the employees (87.5%) have gained more than five years of work experience so they are very rich in credit experience by working above 5 years.

The findings in the study revealed that the majority of the employees agreed that there is a well-designed credit risk strategy and policy at the bank mean 3.75. The results in the study also showed that employees agree that the credit policy and strategy at BOA clearly stated and eligible criteria with the mean 3.37 and the credit policy of the bank incorporates credit risks inherent in all products and activities on which the Bank engages in mean 3.49.The respondent also rank above the average question related credit policy incorporate concentration limit, Appropriate level of delegation and also how to manage bad credits.

This research used descriptive research design, which was used to describe the bank's credit risk management practice. According to the findings; respondents' employees felt that the bank appropriately assesses a borrower's credit worthiness before approving a loan and also borrower history Mean 3.70, & 3.68 respectively. The bank properly assesses the customer financial ability

before granting loan and clear established, amended process mean 3.48 and 3.79 respectively finally checks for collateral requirements before granting loans Mean 3.49. However, the study's findings showed that respondents' opinions about the existence of a credit-granting and approval process that establishes accountability for the decision-makers mean score of 3.11 and as per credit policy of the bank state all credit performers engaged in credit processing accountable and responsible practicing with credit policy and procedure of the bank.

When we come to credit monitoring and controlling practices of the bank, results in the study showed that respondents agreed the bank has a well-structured documentation tracking system for credit and collateral files mean 3.49 and that the bank regularly assesses their clients' after granting credit on regular interval mean 3.30. In contrast, results in the study showed that respondents disagreed that the bank regularly asses' value and existence of collateral coverage mean 2.54 and the bank periodically prepare credit quality report Mean 2.46. But the respondents agreed that the bank give timely notice to notify customers to pay their obligation mean 3.41

Questioners regarding credit risk mitigation strategies the response in relation to independent credit management policy mean 3.60 and respondent employees believe that the bank uses appropriate internal risk scoring system mean 3.68 which means bank categorize individual lone based on credit analysis & local market condition. The results presented in the study also showed that and that the bank employs risk based scientific pricing mean 3.07 which means that the bank offer different interest rate based of the estimated risk and respondent answered about proper credit limit mean 3.15. respondent also ask is there educate measure put to recover non performing lone mean 3.30 and finally Gives trainings for employees on credit risk management mean 2.46 and provides advice for customers on loans usage mean 2.36 in contrast as per the bank manual the bank may appoint external consultants to advice or support lending officers and also the bank should build appropriate level of competency in dealing with customers such as advising customers

5.2 Conclusions

Literature makes an argument for credit risk environment mainly depends on a development of a comprehensive credit risk strategies and policies that can address the identification of existing and potential credit risk, the activities the bank engages in and credit portfolio concentration limits (Basel, 2000). According to the study's conclusions, the bank's current credit policy has all of the necessary components to support sound credit management.

The findings shows that there is a well-designed credit risk strategy and policy that recognises and clearly identifies many credit engagement areas as well as the associated risks. It is stated that bank's should follow a thorough credit evaluation process to assess whether clients are credit worthy or not before granting loans. Banks should be able to assess the potential borrower's repayment capacity in order to correctly analyse loan requests. For this, it's necessary to evaluate the company, the possible client's financial situation, and the state of the economy as a whole. In connection with this, the study's findings shows that the bank takes into account crucial factors such as the history, financial situation, and collateral of the borrower.

Another way of a sound credit risk management process is a sound monitoring and controlling procedure designed to guarantee that debt is repaid in full and on time. This involves monitoring of the portfolio performance, conducting site visits, regular contact with clients and the reviewing of clients' files and documents. Findings from the study indicated that there is space for improvement with regard to the monitoring and controlling operations carried out by Bank of Abyssinia in this regard like assessing value and existence of collateral coverage and prepare credit quality report.

According to the bank Credit policy manual article 3 sub article 3 the bank build competency in dealing with customer in advising various financial and non-financial factors that leads business success or failures. Building a capability to transfer and mitigate the risk in order to minimise losses is another component of credit risk management. To achieve this risk management objective banks use tools and strategies through which credit risk is mitigated (Raghavan, 2003). With this regard the findings in the study ravelled that Bank of Abyssinia uses appropriate internal risk scoring system, employs risk based scientific pricing and has an independent risk management function and proper credit limit. But results also indicated a lack of trainings to develop current employees' capacity and also lack of advisory service to its borrowers.

5.3 Recommendations

On the basis of the findings, the study suggests the following Point

The existence of a well-established continuous monitoring mechanism is very necessary after credit is given and it is the main portion of the monitoring role in a bank. One method of carrying out this monitoring process is by assessing the value and existence of collateral coverage and makes report to concerned party to know early indicators of warning Bank of Abyssinia may stand to improve in this area. The study advises the bank to develop a credit quality report by frequently assess the worth of its assets this can be accomplished by timely analysing the financial accounts of loan clients and contrasting them with the projections accepted at the time of the credit facility appraisal. This enables the bank to timely identify accounts exhibiting signs of stress and put them under continuous observation.

The bank has space is not give training for employees in credit department it is important to provide a sufficient professional training programme to upgrade performance and skill of employee.

The Bank is advisable to give advisory role for loan usage about various factors that leads to business success or failures it improve the borrower business and repay their loans timely.

5.4 Suggestion for further research

For the purpose of gathering this data, the current study largely uses a questionnaire and interviews. The researcher can't say completely this instrument is bias-free future research can employ by alternative techniques to fully describe the phenomenon under evaluation. It is possible to evaluate the credit risk management for instance by using financial statement (secondary data) and calculating credit risk ratios.

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List of appendices

ST.MAERY'S UNIVERSITY

Department of Accounting and Finance

Dear respondents

I am Birhane Tsegaye, a post graduate student at St. Mary University. This questionnaire is prepared in order to conduct a study for the partial fulfilment of the requirements for the Award of a Master's Degree in Accounting and Finance at the University. The title of the research work is, "Assessment of Credit Risk Management Practices in The Case of Bank of Abyssinia S.Co.'' Hence, to gather information, I kindly request your assistance in responding to the questions listed below. Any information you give will be kept absolutely confidential and will only be used for academic purpose. Your cooperation and response will be highly appreciated.

NB • Writing your name is not necessary

• Please put "X" for your choice in the box.

Part one: - General background information

1. Sex/Gender/: Male (_____) Female (______)
2. Age (in year): 25 to 30 (____), 31to 35 (____), 36 to 40 (___), above 40 (____)
3. Level of education: TVET certificate (__), Diploma (___), Bachelor's Degree (__), Master's Degree (_____) or others specify___________________________
4. Work experience; Below 5 yrs (_______),6-10 yrs (______), 11-20yrs (_______), Above 20 yrs (_______)

Part two:

Questions related to the study Answer the following questions and put "X" in the box

that is given in each of the cell below The values of scales are

5= strongly agree, 4= Agree, 3= Neutral, 2= Disagree, 1= strongly disagree

No	Question	1	2	3	4	5
Questions related to existing credit policies and guidelines						
1	The bank has well-designed credit risk Strategy and policy					
2	There is credit policy and procedure with clearly stetted eligible criteria					
3	The existing credit policy of the Bank explicitly indicate general areas of credit in which the bank is prepared to engage					
4	The existing credit policy of the bank incorporates credit risks inherent in all products and activities on which the Bank engages in					
5	The existing credit policy of the Bank incorporate sound and careful credit portfolio concentration limits					
6	The credit policy of the Bank clearly defined appropriate levels of delegation of approval, and provision or write- off authorities					
7	The Bank has credit risk policy that clearly set out how bad credits are to be manage					
Questions related to client appraisal and credit granting process						
8	The Bank conducts comprehensive Credit worthiness analysis properly before granting loan					
9	The bank checks the borrower history before granting loans					
10	The bank properly assessed the customer financial ability to meet obligation					
11	The bank has a clear established process for approving a new credits as well as amendment, renewal and re-financing of existing credits					
12	Adequacy, marketability and enforceability of collateral requirement is properly evaluated and measured by professional personnel or expertise					
13	The banks credit granting and approval process establishes accountability of the decision maker					
Questions related to credit risk control and monitoring						

14	The Bank has a well-structured documentation tracking system for credit and collateral files.					
15	The Bank monitors the business of clients after granting credits on regular interval basis					
16	The Bank regularly asses value and existence of Collateral coverage					
17	The bank periodically prepare credit quality reports for signalling credit quality					
18	The bank sends timely notices notifying customers their obligation					
	Questions related to overall credit risk mitigation strategies					
19	There is independent risk management policy and procedure from credit policy and procedure in the bank					
20	The bank has appropriate internal risk scoring system that distinguishes high and low risk areas.					
21	The Bank employs risk based scientific pricing					
22	Proper credit limit is established by the Bank for particular economic sector, geographic region specific products, and a group of associated borrowers					
23	Adequate measures are put in place to recover non-performing loans					
24	The bank offers training for employees on credit risk management					
25	The bank offers customers sufficient training on loans usage					

St. Mary University

School of Postgraduate Studies

Interview Questions

1. What trend is exhibited with regard to non-performing loan and default rate?
2. What major challenges are faced in loan appraisal and granting process?
3. What are the main concerns regarding loan monitoring activities of the bank?
4. Does the bank utilize technological infrastructure that can help its risk mitigation Strategies?