

**ST. MARY'S UNIVERSITY COLLEGE**  
**BUSINESS FACULTY**  
**DEPARTMENT OF MANAGEMENT**

**AN ASSESSMENT OF CREDIT AND RISK**  
**MANAGEMENT IN WEGAGEN BANK**  
**MESKEL BRANCH**

**BY**  
**ROMAN AYALEW**

**JUNE 2011**  
**SMUC**  
**ADDIS - ABABA**

**AN ASSESSMENT OF CREDIT AND RISK  
MANAGEMENT IN WEGAGEN BANK  
MESKEL BRANCH**

**A SENIOR ESSAY SUBMITTED  
TO THE DEPARTMENT OF MANAGEMENT  
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## **DECLARATION**

I the undersigned, declare that this senior essay /project is my original work, prepared under the guidance of Ato Biruk G/Michael. All sources of materials used for the manuscript have been duly acknowledged.

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DATE OF SUBMISSION: JUNE ,2011

## **SUBMISSION APPROVAL SHEET**

The senior research paper has been submitted to the department of management in the partial fulfillment for the requirements of BA Degree in Management with my approval as an advisor.

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# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Background of the Study**

Commercial banks are the largest group of financial institutions that play a major role in the business world by handling transaction. That primarily deals with extension of loan and advances to business entities and individuals.

Their main function is lending funds to customers engaged in trade, agriculture and industry in the economy where the greater part of loan able fund comes from deposit made by the customers.

Banker being suppliers of mainly short and medium term working fund, the banks expect that the proceeds of loans be invested in the type of assets which through their normal uses, place the borrowers to repay the loans. It is also obvious that what has been provided to borrower of loan and advances should ultimately be collected.

It has frequently been said that a good banker collects a loan at the time it is made. In lending, it is not only deployment of funds that is emphasized on but follow up and collection aspect is equally of paramount importance.

Against the environment of growing competition in the banking industry , it is highly necessary to ensure that existing customers are kept satisfied and retained and new customers attend so as to enlarge the lending operation and achieve the set business goal this would be possible only when quick and timely credit decision are taken to assist the customer.

In the light of the situation, maintaining the quality of loan and advances become very significant, if it is termed that the banks survival depends on the quality of advances maintained in the existing economic condition of the country.

Wegagen Bank S.C. is the case to focus on; nine individuals and seven shareholders established this bank in 1997 with an initial subscribed capital of Birr 60 million and paid up capital of Birr 30 million.

June 30, 2010 the total capital of the bank which is comprised of paid-up capital, legal reserve, retained earnings and premium on share capital Birr 1.05 billion, showed an increase of Birr 215.3 million or 25.7% over the balance recorded during the preceding year (Birr 836.4 billion). The shareholder base also increased from 1222 to 1541.

At the close of fiscal year 2009/2010, the bank had a network of 50 branches, 23 of which were located in Addis Ababa. There is a coordination office for international money transfer partners that are operating under the bank's agency in Ethiopia, and a forex bureau at Bole International Airport.

Assets include cash and bank deposit balances, fixed assets, suspense accounts, deferred charges etc. Over the years, the assets of Wegagen Bank have been growing continuously and as at June 30, 2010, they were birr 5.7 billion. That was an increase by Birr 624 million or 12.2% when compared with the preceding fiscal year (Birr 5.1 billion.)

Wegagen Bank has implemented "smart Bank" computerization (software) That has networked Addis Ababa Branches, and some of the out-lying branches are also networked while the rest will soon be networked with those of Addis Ababa branches. In addition, the bank has been diversifying its services in due course of its operation in the banking industry.

Currently Wegagen Bank is providing Deposit (Saving, Lending, guarantee facilities and International Banking Services. This study is to see an assessment of credit and risk management procedure and effective way of customer service provide. In doing so, emphasis effectiveness of the bank's credit procedure, risk of liquidity

Position, credit risk management and interest rate risk are considered in the study.

## **1.2. Statement of the Problem**

It is obvious that banks are established with the aim of making profit. However, they provide different service, providing a loan contributes the lion share of a bank's income.

However to obtain sustainable profit of the bank from loans, a bank must be cost efficient. The student researcher hypothesized that cost inefficiency is the result of mismanagement of credit and risk mismanagements. As stipulated in the risk management manual of Wegagen Bank credit, liquidity and interest rate are most frequently observed areas of mismanagement that bring about great risk and cost inefficiency to a bank.

- A preliminary observation conducted by the student researcher revealed the following problem/gaps:-
  - Efficiency of the bank's Credit analysis in 2006 reveals that of the Commercial Bank, in this case, Wegagen Bank S.C. is 12% cost inefficient.
  - Risk of liquidity position on customer service inability to meet its payment obligations.
  - Credit risk management default of a borrower on credit obligation to the bank.
  - Interest rate risk fluctuation due to macroeconomic policy.
  - The methods of credit collection are not as such good in Wegagen Bank S.C.

## **1.3. Research Questions**

The following questions represent what this paper sets out to address

- What is the size and trend of interest rate, liquidity, and credit risks and do they pose threat to Wegagen Bank S.C.?
- What are the major risk management mechanisms of Wegagen Bank?

- What are the major credit and risk management problems that are contributing to existence and extent of cost inefficiency of the bank?
- What are the possible methods of improving existing credit and risk management of Wegagen Bank S.C.?

## **1.4. Objectives of the Study**

### **1.4.1. General Objectives**

The general objective of this study is to examine credit and risk Management practices of Wegagen Bank

### **1.4.2. Specific Objectives**

- To see the size and trend of interest rate, liquidity and credit risks and do they pose threat to Wegagen Bank S.C.
- To investigate the major risk management mechanisms of Wegagen bank.
- To measure the major credit and risk management problem those are contributing to existence and extent of cost inefficiency of the bank.
- To identify the possible methods of improving existing credit and risk management of Wegagen bank S.C
- To propose some ways out to improve i.e. to make the poor performance better, the bank's credit and risk management and in turn cost efficiency.

## **1.5. Significance of the Study**

The student researcher believes that the result of the study brings into the general and specific picture of the issue of credit and risk management of Wegagen Bank S.C. In addition, this study supposed to have the following specific significances:

- Provide information and data for further studies.
- Trace and bring into attention some credit and risk management problems that need to be addressed.

- Propose some solutions to the identified credit and risk management problems and cost efficiency.

## **1.6. Delimitation of the Study**

The study focuses on credit & risk management of Wegagen Bank S.C. at Meskel Branch credit department because all procedures of credit is the same in all branches as well as many transactions are performed with in this branch since it is main branch. The boundaries of the study were focused on the year between 2006 up to 2010 because the study was targeted based on the recent information & data.

## **1.7. Definition of terms**

**Credit:** is a medium of exchange with limited acceptance. Because of different potential losses and components, the credit manager or loan officer will not allow everyone to the credit programs. Credit facilitates the transfer of value from buyer to seller (*WB. credit manual, 2007, 4*)

**Liquidity Risk:** the current and prospective risk to earnings or capital arising from the bank's inability to meet its payment obligations [like customer withdrawals] as they come due or fund loan requests in a timely and cost effective manner. (*WB. risk manual, 2009, 5*)

**Interest Rate Risk:** the exposure of the bank's financial condition to adverse movements in interest rates. (*WB. risk management manual, 2009, 6*)

**Credit Risk:** is the potential for financial loss arising from default of a borrower on credit obligation to the bank (both on-and-off-balance sheet exposures). (*WB. risk management manual, 2009, 8*)



## **1.8. Research Design and Methodology**

### **1.8.1 Research Design**

The research design was descriptive survey as the research carried out using facts to describe credit and risk management in the organization.

### **1.8.2. Population and Sampling Technique**

#### **1.8.2.1. Population**

The population of the study comprised Wegagen Bank S.C. Meskel Branch, Departments of Credit employees of the department and customers of this bank were selected because it is convenient for the student researcher to follow up, get information and the branch mobilization of deposit is high. The number of employees in the department is 6. The target customers were 187. Since the number of employees is very low, the study addressed all 6 respondent through census and from the customers the representatives of the sample made by using purposive sampling technique which is 30% of the total population,  $187 \times 30\% = 56$

#### **1.8.2.2. Sampling Technique**

To avoid biases on selection of employees, census was used while purposive sampling method was used for the customers.

### **1.8.3 Types of Data collected**

Primary and secondary data collected in order to address the research. Primary data taken through questionnaire, observation and interview, Also secondary data by referring manuals and circular of the bank, directives of the National Bank of Ethiopia credit policy and from annual report of the bank.

### **1.8.4 Methods of Data Collection**

Data collected through questionnaire, observation, interview and examination of company annual report.

### **1.8.5 Data Analysis Methods**

The data analysis method included table and percentage (%) to interpret the credit and risk management of the Wegagen Bank S. C.

### **1.9. Limitation of the Study**

Record of data and information cannot be found to evaluate the bank's time efficiency to provide credit service. Data and information on NPLs by sector, fixed deposit interest rate and volume of deposits cannot be found to the satisfaction of the researcher.

### **1.10. Organization of the Study**

The paper has four chapters. The first chapter deals with statement of the problem and delimitation, objectives, significance, research design & methodology and data sources, limitation of the study and background of the organization. In the second chapter various related literatures are revised. In the third chapter data and information is organized, analyzed and results (findings) interpreted. The fourth chapter encompasses conclusions, summary and recommendations. Lastly list of questionnaire, Table and references were attached.

## CHAPTER TWO

### REVIEW OF RELATED LITERATURE

#### 2.1. Definition of Credit

Credit is a medium of exchange with limited acceptance. Because of different potential losses and components, the credit manager or loan officer will not allow everyone to use credit programs. Credit personnel conduct investigations and assess the risk a particular client portrays before accepting a promise to pay. Credit is a privilege that must be earned and protected by those who wish to use this form of exchange. (*WB. Credit manual, 1998, 1*)

Credit is medium of exchanges to the extent that it facilitates the transfer of value from buyer to seller (borrower to lender) but it is not available to every one credit personnel conduct investigations and assess the risk of a particular client portrays before accepting a promise to pay credit is a privilege that must be earned (*Cole & Mishely, 1998,6*)

According to Thomson's Dictionary of Banking "Loan is a thing that is lent specially a sum of money The action of lending something or the state of being lent for each lender a loan is an investment comparable to bonds stocks or other assets. On the other hand, for each borrower, a loan is debt, an obligation to repay the borrowed money plus interest" (*Thomson's Dictionary of Banking*) Banks Grants loans to borrowers assuming that they will pay the agreed interest and principal amount according to their contractual agreement.

However, the borrower may fail to do. This results in nonperforming loans (NPL).

NPL is those loans which are past their due dates. They are classified in to:-

1. **Sub-Standard:-** Non-performing loans or advances past due 90 days or more but less than 180 days.
2. **Doubtful:** - Non-performing loans or advances past due 180 days or more but less than 360 days.

3. **Loss:** - Non-performing loans or advances past due 360 days or more will be classified as loss.

### **2.1.1. Classification of Credit**

Credit transactions occur in many different forms. The classification of credit types is based on the purpose for the credit and the method of payment.

The two main classifications of credit are private and public credit.

*Private credit* is credit used by individual and business in order to carry on exchange in the private sector of the economy.

*Public credit* is credit extended, or sued. Directly by a level of government such as state local or federal. Governments borrow money primarily through the sale of Bonds and other securities if tax revenues are not sufficient to cover current spending needs (*WB. Credit manual, 1998, 3*).

### **2.1.2. The Credit Management Function**

The development of credit management has been stimulated by the need to find more effective ways of granting and controlling credit as the nature of credit trading has become more complex. Credit terms now often stand alongside price and delivery as key factors in winning orders. The ever-increasing level of business failures coupled with decreasing profit margins has meant that no firm can afford to neglect credit control.

Successful credit management requires the operation of tight financial controls coupled with a positive approach to the achievement of profitable sales.

Once the design to establish a credit department has been made attention must be directed to ward the responsibilities, duties and goals of the credit manager credit managers are individuals within business organizations responsible for evaluating customer's application for credit and who hold the power to commit business resources in credit transactions.

All the credit managers are used in many business credit situations, this definition also applies to many others whose titles might be credit or Loan officers. Credit managers who decide, based on information provided in

customers will be allowed with credit facilities the common link is the challenge to evaluate risk & decide if credit relation ship is possible between creditors and the applicants (*Edwards, 1990,69*)

Credit managers and Loan officers, make the basic credit decision to grant, reject, or qualify loans. In the event of collection difficulties they are held responsible for ultimate settlement and recovery of the loans therefore, the need to have sound credit policy and procedure, credit management structure and assignment of proficient loan officers can not be over emphasized.

### **2.1.3. The Credit Management Process**

The credit management process is a series of steps that involves promoting credit, analyzing the risk of credit applicant, and collecting the payment after the dept is created.

Financial statement Analysis involves the calculation of various financial ratios, and other computations, using number drawn from financial statement the results are used to evaluate the liquidity, profitability, and financial health of the firm applying for credit.

A credit investigation involves a series of steps of steps undertaken to verify information on the credit application. And determine how the customer has handled past financial obligations the credit investigation involves many activities to gather the information needed to make a sound decision. Usually the credit manager will verify the in come and financial statement health of the applicant the credit manager will contact commercialized reporting agencies during the stage of the credit management processes because, these agencies collect, retain and sell information about the credit histories of consumes and businesses.

The credit investigation stage will also involve direct inquiry, that is, the process of contracting credit grantors who can verify facts and provide information about the applicant's willingness and ability to pay.

**Credit decision:** - is a judgment made by the credit manager to accept or reject an application for a credit the ability to make a good decision is based on a combination of art and science. The science often involves the ability to analyze the financial health of the applicant. The art involves with experience and include the ability to ask the right questions to predict payment results.

**Control functions:** - are used to monitor a credit control activities involve “watching” the disbursed credits to verify that payments are being. Made as planned and that the relationship between the customer and the credit grantor continues to be productive.

**Collection activities:** - include any effort to get credit be paid back in a timely manner this is one of the most important aspects of effective credit management. Research Shows that the longer a credit goes with out payment, the more difficult it becomes to collect a loan account. *(Cole & Mishely, 1998, 6)*

#### **2.1.4. The Effect of Credit on Profits**

Extended credit is frequently used to promote sales and rightly so. But unless the real cost of credit is recognized and included in the calculation of profit, the careless granting of long credit can easily have the opposite effect to that intended.

The higher the financing cost, the greater the effect on profit and the more doubtful the value of boosting sales by long credit. A company which has to borrow money to finance an increasing debtor level can easily. Seen its profit wiped out by interest changes.

This danger is present even with out granting long credit. In times of dear or scarce money, it is normal to find companies looking for the cheapest form of finance extended credit which is not agreed but just taken *(Edwards, 1990, 68)*

An over whelming percentage of the funds banks manage is subject at all times to the claims of the depositors. The successful management of commercial banks funds, therefore, requires careful consideration.

### **2.1.5. Organization of Credit Management**

The size and structure of credit department will be largely determined by the size and nature of the business, and the amount of money made available.

Is the credit function to be centralized or local? There are several arguments in favor of decentralization.

Assuming of course, that the company already has Branches loan committee (BLC) on a branch basis credit problems are always best solved by direct contract with the customer and a branch loan officer has distinct advantage over “the man in Head office. In being physically closer to his customers and in being familiar with local conditions.

On the other hand there are strong benefits form centralization control over both credit granting and collections is easier to maintain and the problem of ensuring up-to date information at branches is over come. Records are easier up to date information at branches is over come. Records are easier to maintain when kept in a central office than is scattered over a number of branches. Ultimately, the deciding factor will probably be the size and nature of the business.

Once these two questions are settled the credit manager can plan his organization and staffing. The number of staff need and their employment will be directed principally by the volume of active customer and by the spread of business between those customers. Every position in a credit department should be discussed and the qualities and qualifications required for it examined. Accredit management who does this is forced to think clearly and critically about his organization. It is staff will work better if they have a proper under standing of their responsibilities and authority. (*Edwards, 1990, 6*)

Depending upon own policies, every bank can establish several credit management structures. Some banks prefer to form loan committees at all branches, management credit committee at the head office level, Board credit sub-committee etc other may lay the responsibilities to administer loans and

advances solely to Loan officers and Branch managers at branches level and management credit committee at head office level etc.

### **2.1.6. Credit Management Techniques**

To minimize credit losses, a variety of credit management techniques have been deployed. The decisions addressed by these techniques fall in to two categories.

Many advantages accrue though the use of quantitative methods for credit management. First there are obvious benefits from optimally making the decisions specified above. More credit worthy applicants are granted credit or additional credit, Thus, increasing profit, more non- credit worthy applicants are denied credit, (or given reduced credit), thus decreasing losses and optimal collections polices minimize the cost of administrating collections ore maximizing the amount recovered from the delinquent account there are indirect advantage, including application can be processed quickly, the decisions are objective and not base up on human biases or prejudices, fewer people are needed to administer credit granting, and the more experienced people can concentrate on difficult cases.

Most of the techniques used in practice utilized a “score” computed for each applicant or existing account to determine the decision there fore, much of the credit literature deal with” application scoring” (for the first category of decisions) or “behavior scoring” (for the second category). The intent of applicant scoring to fore cast the future behavior of a new credit applicant, behavior scoring tries to predict the future payment behavior of an existing account.

Credit management is currently as much of an art as a science while the accept reject decision for a new applicant is will defined and must amenable to quantitative analysis, the other decisions are not as easily to formulate and subjective Judgment rather than empirical model appears to be the norm.

Scoring system utilize information relating to the traditional of 5 Cs of credit

1. Character (the willingness to repay debt)
2. Capacity (the financial ability to repay debt)



3-4 capital & collateral (possession or equities) from which payment might be made, and

5. Conditions (reflecting the general economic environment or special conditions applying to the borrower or the type of credit)

The data for scoring systems are obtained through questions on e.g. the length time at current address or with current employer, present salary, number of dependents, other Loan commitments, and occupations in addition behavior scoring typically utilized information on delinquency during the performance period, account activity during the performance, period, account balance during the performance period, amount past due score returned cheques, age of account, new applicant score. (*Rosenbery, 1993, Internet*)

All involved in administration of loans, are primarily concerned to ensure the likelihood that the customer will repay the loan in accordance with stipulated terms there fore, careful consideration of the time honored” Cs of credit” character capacity, capital collateral and conditions as basis of decision is equally of paramount importance.

### **2.1.7. Operation in Credit Management**

Identification of potential Borrowers for effective management of credit, banks and other credit institutions do not extend their credit service to all credit requests but they analyze the request from different angles the firm needs not follow the policy of treating all customers equally for the purpose of extending credit. It requires adequate information system at a regular interval for ensuring the selection of potential customers who are capable of repaying the credit and service change and safeguarding bank interest against uncollectible risk. To identify these potential customers, it is necessary to collect credit information, analyze it, and reach the final decision (*Pandey 1999, 861*) the first condition which should be met when an applicant places formula written request for a loan is the provision of full information on the credit worthless of the applicant.

### **2.1.8. Credit Granting Decision**

Once the bank has assessed the credit worthiness of customers, it has to decide whether or not credit should be granted. All credit decisions are based primarily on the lender's assessment of the credit likelihood of payment. In deciding to provide credit to customer, the credit manager must evaluate the chance of no payment and estimate the benefit of extending credit.

The lender also uses the concept of the net present value (NPV) to assess the cost benefit of extending credit before making credit decision using the result of NPV is positive. Setting a maximum of the amount of credit offered to a customer limits the exposure of the lender to the risk that the customer won't pay.

If lender decide not to grant any credit, the lender avoids the possibility of any loss but also loses the opportunity of increasing its profitability (*Ibid*, 856).

The final decision as to whether the loan request should be approved or rejected is reached by comparing statement made by the applicant with the information derived through the investigation process and by analyzing the various credit factors (5Cs) and track record for repayment and others.

#### **2.1.8.1. Collateral**

Loans are generally granted by the banks and financial agencies against the security of tangible assets pledged by the borrower in favor of the lender. Firms whose credit ratings are not sufficiently high to qualify them for unsecured loan or commercial papers are often required to pledge a portion of their assets to the lender as security for loan. The advantage for the lender is that if the firm is liquidated, the lender has first claim against the assets pledged. This serves the lender as a protection against loss if the borrower firm gets into trouble.

Collateral is the security a bank has in assets owned and pledged by the borrower against a debt in the event of default. Bank look to collateral as a secondary source of repayment when primary cash flows are insufficient to meet debt service requirement. Bank can lower the risk of loss on a loan by requiring back up support beyond normal cash flow. This can take the form of assets held

by the borrower or an explicit guarantee by a related firm or key individuals (Lawrence DS, 1991, 706).

Collateral is only meant to serve as a full back position in case things go wrong and should not be considered the prime source of repayment. As the motive of banks depends on profit, the fundamental principle is to lend to sound investment projects that meet this objective. No matter how good the security is, don't lend unless the profit is viable should strictly be complied with.

### **2.1.9. Collection Policy and Procedures**

Though collection procedures should be firmly established, individual cases should be dealt with in their merits. Collection power is needed because all customers do not pay in time. Some customers are slow payers and reducing bad debt losses. The collecting policy should ensure prompt and regular collection.

Prompt collection is needed for fast turn over of working capital, keeping collection costs and bad debts within limits and maintaining collection efficiency. Regularity in collection keeps debtors alert, and they tend to pay their due promptly.

The collection policy should lay down clear-cut collection procedures. The collection procedures for past due or delinquent accounts should also be established in unambiguous terms. The slow paying customers are to be handled very tactfully. The collection process initiated quickly, without giving any chance to them, may antagonize them and the firm may lose them to competitors (Pandey Im, 1999, 863)

It is also obvious that what has been provided to various sectors by way of loans should be collected. Debtors tend to forget their obligations whereas lenders are inclined to remember it. It is said that lenders have better memories than debtors.

### **2.1.10. Measures on Problem Credit**

When a customer has not paid his account within the allowed credit period, there should be an automatic follow-up procedure until it is paid. The firm should follow a well laid down collection policy and procedures to collect

dues from its customers, as a first means, when the normal credit period to customer is over, a polite letter reminding that the amount is overdue should be sent.

If a customer doesn't respond, the lender may send progressively strong worded letter. If receivable still remains uncollectible, reminders may be followed by telephone, telegram and a personal visit of the lender's representatives if the payment is still not made, the lender may initiate a legal action the lender should examine the customer's financial conditions. Under such situation it is better to be patient and wait, or accept reduced payment in settlement of the account  
(Wright M.G, 1987, 37)

### **2.1.11. The Main Types of Credit Facilities of the Bank**

- **Term Loan financing policy**

Short term loans (which can be extended up to maximum period of one year beginning the date the loan contract is signed).

Medium term loans (which have duration of over one year but not exceeding a period of five years or 60 months with periodic installments)

Long term loan (which have a duration exceeding five years)

- **Overdraft financing policy**

Overdrafts are credit facilities by which customers may be allowed to draw beyond the deposit balances maintained in the current accounts. They are normally availed to individuals/business organizations whose financial position is strong with voluminous business transactions, and that they are aware of handling all transactions through their overdraft accounts. Such customers are also believed to be well known for their best integrity and credit worthiness. With these understandings, overdraft facilities are a bridging finance availed for limited durations normally for six months and in exceptional cases for one year.

- **Merchandise Loan**

A form of credit facility, which is availed at a certain percentage portion of the value of the merchandise to be pledged as security (WB, loan manual, 2005, 12)

## **2.2. Risk management**

### **2.2.1. Definition of Risk**

There is no single definition of risk, Economists, Behavioral Scientists, Risk theorists, Staticians and actuaries each have their own concepts of risk. Therefore the research will try to give different authors' view for the word Risk. According to Williams Jr., Risk is a potential Variation in outcomes and the exposure to a potential loss. It can also be defined as uncertainty about economic losses due to the occurrence of an event. Economic losses are caused by perils such as crimes, fire and accidents; it is the possibility of an adverse deviation from the desired outcome that is expected. (*Williams Jr, L.smiht and others, 1998:15*).

According to Trieschman, Risk can be defined as uncertainty concerning losses. The risk surrounding a potential loss creates significant economic burdens for businesses, governments, and individuals. Billions of dollars are spent each year on strategies for financial potential losses. But when losses are not planned for advance, they may cost even more. Businesses as well ass individuals may try either to avoid risk as much as possible or reduce its negative consequences. Overall, an entity's cost of risk is the sum of outlays to reduce risk, the opportunity cost of activities forgone due to risk considerations, expenses of strategies to finance potential losses and cost of un reimbursed losses. (*Trieschmann, James and Gustavson, Sandra G, 1998:5*)

Credit risk is the risk of loss due to the financial weakness of the Ban's customer. Generally, the customers will not be able to settle their transaction due to bankruptcy or some other liquidity crises. (*Myland Paul, 1991, 35.*)

It is the risk that borrowers will be unable to meet its obligation. A Bank reflects and aims to profit from taking credit risk by charging higher interest margins on loans to those customers that are considered at present a higher risk. (*Burt Edwards, 1976, 60.*)

- Risk is a condition in which there is a possibility of an adverse deviation from a desired outcome that is expected on hopped for.

- Risk is the objectified uncertainty as to the occurrence of an undesired event.
- Risk is the dispersion of actual from expected result (*Hailu Zeleke 1985,2*)

### **2.2.2. Classification of Risk**

- **Financial Vs Non-Financial Risk**

This way of classification is self-explanatory. Financial risks result in losses that can be expressed in financial terms. Non- financial risk does not have financial implication.

- **Static Vs Dynamic Risks**

Dynamic risks originate from changes in the over all economy which are associated with such as human wants, improvements in technology and organization Static risks, on the other hand, refer to those losses that can take place even through there were no changes in the over all economy measures.

- **Fundamental Vs Particular Risks**

Fundamental risks are essentially group risks; the conditions, which cause them, have no relation to any particular individual. Most fundamental risks are economic, political or social.

Particular risks are those due to particular and specific conditions, which obtain in particular cases. They affect each individual separately.

- **Objective Vs Subjective Risk**

Objective risk has been defined as “the variation that exists in nature and is the same for all persons facing the same situation”. The estimate of the objective risk which depends on the person’s psychological belief is the subjective risk.

- **Pure Vs Speculative Risks**

Pure risks refer to the situation in which only a loss would occur. There are only two distinct outcomes: loss or no loss

- **Property risk**

This refers to losses associated with ownership of property such as destruction of property by fire.

- **Personal risk**

This refers to the possibility of loss to a person such as death, disability. Loss of earning power, etc.

- **Liability Risk**

The term liability is used in various ways in our present language. In general usage, the term has become synonymous with “responsibility” and involves the concept of penalty when a responsibility may not have been met (*Hailu Zeleke 1985, 6*)

### **2.2.3. Risk Management**

Risk management is the identification, measurement, and treatment of exposures to potential accidental losses. Most accidental losses are not dramatic, but many lesser incidents each day threaten the survival of some businesses, cause their earnings to dip below acceptable levels, interrupt their growth. Proper risk management enables a business to handle its exposures to accidental losses in the most economic effective way. Management policy of Wegagen Bank, 2009 (*W.B. risk manual, 2009, 7*)

### **2.2.4. Objectives of Risk Management**

The possible objectives of risk management can be derived from the possible contributions of risk management. The possible objectives are:-

- Mere survival, peace of mind, lower risk management cost and thus higher profits.

Fairly stable earnings, little or non interruption of operations, continued growth. (*W.B.Risk Manual, 2009,9*)

### **2.2.5. An Approach to Risk Management**

A firm often uses the following three steps approach to risk management.

- **Identifying the risk faced by the firm**

The risk Manager must identify the potential risk faced by his or her firm.

- **Measure the potential impact of the risk identified**

Some risks are so small as to be immaterial, where as others have the potential to doom the company. It is useful to segregate risks by potential impact and then to focus risk management recourses on most serious threats (*WB Risk manual, 2009, 10*)

### **2.2.6. Risk Related to Financial Institutions**

- **Credit Risk**

Credit risk, the most frequently addressed risk for Bank's, is the risk to earnings or capital due to borrowers' late and non payment of loan obligations.

- **Transaction Risk**

Transaction risk refers to the risk within individual icons. Banks mitigate transaction risk through borrower screening techniques, underwriting criteria, and quality procedures for loan disbursement, monitoring and collection.

- **Portfolio Risk**

Portfolio Risk refers to the inherent in the composition of the overall loan portfolio. Policies on diversification (avoiding concentration in a particular sector or area), maximum loan size, types of loans, and loan structures lessen portfolio risk.

Management must continuously review the entire portfolio to assess the nature of the portfolio's delinquency, looking for geographic trends and concentration by sector.

Product and branch. By monitoring the overall delinquency in the portfolio, management can assure that the Bank has adequate reserves to cover potential loan losses. (*W.B. Manual 2007, 12*).

### **2.2.7. Effective Approaches to Managing Credit Risk in Banks include:**

Well-designed borrower screening, careful loan structuring, close monitoring, clear collection procedures, and active oversight by senior management,



Delinquency is understood and addressed promptly to avoid its rapid spread and potential.

The importance of a “credit culture” in minimizing problems and increasing operational efficiencies cannot be overstated. Bank senior managers need to set up systems that compel and offer incentives to loan officer incentives to loan officers to prevent, disclose, and respond to problem loans quickly, so as to limit potential credit-related losses.

- **Liquidity Risk**

Liquidity risk is the possibility of negative effects on the interests of owners, customers and other stakeholders of the financial institutions resulting from the inability to meet current cash obligations in a timely and cost-efficient manner.

Liquidity risk usually arises from management’s inability to adequately anticipate and plan for changes in funding sources and cash needs. Efficient liquidity management.

Requires maintaining sufficient cash reserves on hand (to meet client withdrawals, disburse loans and fund unexpected cash shortages) while also investing as many funds as possible to maximize earning (putting cash to work in loans or market investments).

Liquid management is not a one-time activity in which the Bank determines the optimal level of cash it should hold. Liquidity management is an ongoing effort to strike a balance between having too much cash and too little cash. If the Bank holds too much cash, it may not be able to make sufficient returns to cover the costs of its operations, resulting in the need to increase interest rates above competitive levels. If the Bank holds too little cash, it could face a crisis of confidence and lose clients who no longer trust the institution to have funds available when needed. Effective liquidity management protects the Bank from cash shortages while also ensuring a sufficient return on investments. Cash Management refers to the mechanics of consolidating cash at the head office and investing it at the local bank in interest bearing accounts.

Effective liquidity risk management requires a good understanding of the impact of changing market conditions and the ability to quickly liquidate assets to meet increased demand for loans or withdrawals from savings. Some principles of liquidity management that Banks use include:-

- Maintaining detailed estimates of projected cash inflows and outflows for the next few weeks or month so that net cash requirements can be identified.
- Using branch procedures to limit unexpected increases in cash needs. Some Banks have put limits on the amount of withdrawals that customers can make from savings in an effort to increase the Banks ability to better manage its liquidity.
- Maintaining investment accounts that can be easily liquidated into cash, or lines of credit with local bank to meet unexpected needs.
- Anticipating the potential cash requirements or new product introductions or seasonal variations in deposits or withdrawal (*GTZ, 2002,11*)

- **Interest Rate Risk**

Interest rate risk arises from the possible of change in the value of assets and liabilities in response to change in market interest rates. Also known as asset and liability management risk, interest rate risk is a critical treasury function, in which financial institutions match the maturity schedules and risk profiles of their funding sources (liabilities) to the terms of the loans they are funding (assets). The savings and loan crises in the 1980s in the United States resulted largely from the mismatching of assets and liabilities. The savings and loan institutions (S&Ls) had financed themselves primarily with short-term deposits while investing in long-term, fixed interest rate

Mortgages. When the cost of short-term funding rose quickly, the S&Ls were not able to restructure their asset base fast enough to avoid significant losses.

Below are two common approaches to interest rate risk management among financial institutions:-

- To reduce the mismatch between short-term variable rate liabilities (e.g. savings deposits) and long-term fixed rate loans, managers may refinance

some of the short-term borrowings with long-term fixed rate borrowings. This might include offering one and two-years term deposits as a product and borrowing five to ten years funds from other sources. Such a step reduces interest rate risk and liquidity risk, even if Bank pays a slightly higher rate on those funding sources.

- The boost profitability, Banks may purposely “mismatch” assets and liabilities in anticipation of changes in interest rates. If the asset liability managers think interest rates will fall in the near future, they may decide to make the Banks liabilities. *(GTZ,2002,12)*

- **Operating Risk**

Operating risk refers to the risk of losses of unexpected expenses associated with fraud, inefficiency, mismanagement, human errors and unforeseen contingencies. Clear and transparent operational guidelines and policies help to reduce various types of operating risk, including errors. Unforeseen contingencies can be minimized through experience.

The decentralized nature of credit decisions and lack of necessary bureaucracy in the service delivery technology create opportunities for fraud.

- Weak information system exposes the institution to fraudulent practices. If a Bank cannot detect instances of delinquency at the loan officer level, it could have significant problems with fraud; Weak or nonexistent internal control procedure create an environment in which fraud can be prevalent;
- High employee turnover at management, administrative, or loan officer levels *(GTZ, 2002, 12)*.

## CHAPTER THREE

### DATA PRESENTATION ANALYSIS AND INTERPRETATION

This chapter deals with data collected through questionnaires, observation and interview. The information gathered was presented analyzed and interpreted.

#### 3.1. Analysis of Responses Given by the lone Department Staff

The lone department staffs have played a great role in the finalization of this paper by answering questions forwarded in the form of questionnaire and interview. Their responses for the presented questions are analyzed as follows:-

**Table 1. Background of Respondents**

Items	Responses	Number of staff	Percentage
Sex	Male	5	83.83%
	Female	1	16.67%
	Total	6	100%
Level of Education	Certificate	-	-
	Diploma	-	-
	Degree	6	100%
	Total	6	100%
Position	Loan Section Head	1	16.67%
	Loan Officer	4	66.67%
	Loan clerk	1	16.67%
	Total	6	100%
Work Experience	1-2 years	1	16.67%
	3-5 years	1	16.67%
	6-9 years	4	66.67%
	Above 10	-	-
	Total	6	100%

**Source of data: collected through the questionnaire**

As it is shown in table of item 1 of the total respondents 83.33% were male where as 16.67% were females. This informs most of the staff was male.

Regarding their educational level in item 2, it shows all of them (100%) were degree holders. It indicates the bank has qualified staff members.

The position of respondents can be seen in Item 3, of the table 16.67% was the loan section head 66.67% was loan officers and 16.67% was loan clerk. This informs most of the work is handled by loan officers. The head supervises the work done by them.

Work experience of the staff is include in item 4, of the same table 16.67 of the respondent has worked in the bank between 1-2 years. This shows that they are not experienced enough to have developed work knowledge. 16.67% of them have experience ranging from 3-5 years. This group is experienced in acquiring their job responsibility. Majority of the staff (66.67%) are more experienced in carrying out their duties.

**Table 2. Credit and risk management policy**

<b>How do you evaluate the bank credit &amp; risk management policy of the work?</b>	<b>Response</b>	
	<b>Number</b>	<b>Percentage</b>
Very small	-	-
Small	-	-
Medium	4	66.66%
Weak	2	33.33%
Very week	-	-
Total	6	100%

**Source of data: collected through the questionnaire**

As it can be seen form table 2, credit and risk management policy of the bank is evaluated by the respondents as being “weak” according to 33.33% and 66.66% evaluated it “medium”. This indicates that the policy requires an improvement, i.e., it should be designed to create a good relationship between the bank and the borrowers in connection with loan and risk processing.

**Table 3. The bank's profit**

How much profit does the bank expected from the credit?	Response	
	Number	Percentage
Small amount	-	-
Medium	1	16.67%
High amount	5	83.33%
Total	6	100%

**Source of data: Collected through the questionnaire**

As presented in Table 3, 16.67% of the respondents inform the bank expects to have “medium” profit from the credit where as 83.33% of them identify the profit expected as “high amount”. It shows that the amount of profit is depending on various situations which means if the bank works very hard on the credit then it may get more profit.

**Table 4. Collection of credit**

Do you think that all types of credit granted to the customer are collected on time?	Response	
	Number	Percentage
Yes	2	33.33%
No	4	66.66%
Total	6	100%

**Source: data collected through questionnaire**

In the above table 4, 33.33% of the respondents said “yes” to the collection of credit on time but 66.66% said “No” it is not collected on time. This indicates that most of the credits granted to the customers are not collected on time.

**Table 5. Mechanisms of evaluating borrowers**

In what mechanism does the bank evaluate the borrower before approving the credit?	Response	
	Number	Percentage
Interviewing the borrower	5	50%
Considering the collateral	1	16.67%
Evaluate the capacity of the borrower	1	16.67%
Purpose of the Loan	1	16.67%
Total	6	100%

**Source data: Collected through questionnaire**

As it can be seen from table 5, 50% of the respondents revealed the mechanism of examining is interviewing the borrowers, 16.67% of the responded believed that the mechanism is evaluating the capacity of the borrowers, 16.67% of the respondent responded that the mechanism “Considering the collateral”, 16.67% responded that the mechanism of examining consider the purpose of the loan and to examine the borrowers.

Majority believed that interviewing the borrowers is an appropriate way of examining the borrowers before the loan is approved. This indicates that all the other come after the interviewing.

**Table 6. The time taken to process the credit**

How long it takes to process a credit?	Response	
	Number	Percentage
15 days	4	66.67%
A month	2	33.33%
More than a month	-	-
Total	6	100%

**Source: data collected through questionnaire**

According to the information provided in Table 6, 66.67% of the respondents believe that it takes “15 days” to process credit while 33.33% of them believe the

credit process takes “a month”. The above table shows most of the respondents believe the time taken to process credit is 15 days which is convenient for borrowers to get the credit with in a short period of time.

**Table7. Implementation of Bank Operation Manual**

Is the bank credit operation manual Properly implemented?	Response	
	Number	Percent
Yes	5	83.33%
No	1	16.67%
Total	6	100%

**Source data: collected through questionnaire**

As it can be seen from table 7, 83.33% of the respondent “yes” to the bank’s credit operation manual being properly implemented but 16.67% of them said “No” it is not properly implemented. This indicates the bank properly uses its manual to implement its operation.

**Table 8. Organs of Credit Facility Request**

What organs of the bank involve in deciding credit facility request of prospective borrowers?	Response	
	Number	Percentage
Loan Officer	-	-
Management credit commit	4	66.67%
Board Credit Commit	1	16.67%
Branch Credit commits	1	16.67%
Total	6	100%

**Source data: collected through the questionnaire**

Table 8. Explains about decision makers of the organs of credit facility request of prospective borrowers, 66.67% of the respondents are from management credit committee, 16.67% of them are from Board Credit committee and 16.67% are



from Branch credit committee this implies that most of the time loan disbursement is made by the management credit committee. Board credit committee and Branch credit committee do not have much influence on the decision making.

**Table 9. Credit Pre-Requests for Collateral**

<b>Are collateral considered pre-requests for qualification of credit requests?</b>	<b>Response</b>	
	<b>Number</b>	<b>Percentage</b>
Yes	4	66.67%
No	2	33.33%
Total	6	100%

**Source data: collected through questionnaire**

From the data on Table 9, 66.67% of the respondent “yes” to pre-request for collateral qualification and 33.33% of them said “No”. From the above response those who responded “yes” believe collateral is the major pre-request of the credit. But those who said “No” believe priority is given to the borrower source of payment rather than collateral.

**Table 10. Credit Processing of NBE (National Bank of Ethiopia)**

<b>Do directive on credit activity adopted by NBE affect smooth processing of credit?</b>	<b>Response</b>	
	<b>Number</b>	<b>Percentage</b>
Yes	6	100%
No	-	-
Total	6	100%

**Source data: collected through questionnaire**

According to table 10, it informs that directives on credit activity adopted by National Bank of Ethiopia affect smooth processing of credit positively. The table clearly shows all of the respondents (100%) have agreed to this.

**Table 11. Interest Fluctuation**

How do you see the rate of interest fluctuation compare to other similar bank?	Response	
	Number	Percentage
Very high	-	-
High	-	-
Medium	2	33.33%
Low	4	66.67%
Very Low	-	-
Total	6	100%

**Source: data collected through questionnaire**

From the data on table 11. 66.67% of the respondents the rate of interest fluctuation is “low” and 33.33% of the respondents said rate of interest fluctuation is “medium”. This indicates the Wegagen Bank’s of fluctuation is low when compared to other similar banks.

**Table 12. The cause for liquidity risk**

What is the cause for liquidity risk?	Response	
	Number	Percentage
Not Collecting Loan	2	33.33%
Weak follow up	-	-
Inadequate deposit	3	50%
Other	1	16.67%
Total	6	100%

**Source: Data collected through questionnaire**

From table 12, we can see that 33.33% of respondents replied to the cause of liquidity risk saying not collecting loan on time 50% of the respondents show the other cause for liquidity risk is inadequate risk and 16.67% responded “Other” reasons.

We can understand from the above table that the majority respondents chose inadequate deposit for the cause of liquidity. Some of them responded saying

reason could be not collecting loan on time. Respondents who said “other” claim “market risk” is the cause for liquidity risks.

**Table 13. Factors contributing for credit risk**

<b>What are the major contributing factors for problem credit risk?</b>	<b>Response</b>
	<b>Percentage</b>
- Lack of Financial discipline of borrowers	20%
- Character problems on the part of the bank	20%
- Capacity problem the part of the borrower	40%
- Force major	20%
- Other	-
Total	100%

**Source: data collected through questionnaire**

From Table 13. The respondents select major contributing factors for problem in credit risk, 40% of the respondents select capacity problem on the part of the lenders, 20% of them select character problem on the part of the bank, 20% of them select lack of financial discipline of borrowers, 20% of them select forced measure and 20% of them responded “other”. “Other” indicates the collateral marker risk. The table shows that a factor for problem in credit risk capacity problem on the part of the lenders is the major credit risk.

### **3.2. Analysis of Data on Questioners Collected From Customers**

Some selected credit customers of the Bank of Wegagen have also given the opportunity to express their attitude towards the credit facility that the Bank of Wegagen renders to them their response is analyzed as follows.

**Table14. Background of the Customers**

<b>Items</b>	<b>Responses</b>	<b>Number of customer</b>	<b>Percentage</b>
Sex	Male	40	71.42%
	Female	16	28.57%
	Total	56	100%
Age group	18-20	-	-
	20-30	5	8.92%
	30-40	15	26.78%
	40-50	29	51.78%
	Total	56	100%
Duration of the customer	Below a year	10	17.85%
	5-10 years	40	71.42%
	Above 10 years	6	10.71%
	Total	56	100%

**Source: data collected through questionnaire**

As it is shown in item 1 of Table 14, out of the total respondent 71.42% are male where as the remaining 28.57% are female. This indicates that majorities of the bank customers are male.

Item 2 indicates the age group of the respondent, 8.92 % is 20-30 Age, 26.78% are the age group 30-40, 51.78% are 40-50 age group and 12.50% of the respondent are above 50 age group. Most of the customers are in the age group ranging from 30-40.

Item 3 shows the duration of the customers below a year 17.85%, 71.42% of the respondents are 5-10 years and the last 10.75% of the respondent are above 10 years. This indicates that duration of customers ranging from 5-10 year occupies the larger portion.

**Table 15. Types of Credit**

What kind of credited have you taken from the bank?	Response	
	Number	Percentage
Short term loan	30	53.57%
Medium term loan	14	25%
Long term loan	2	3.57%
Over draft	10	17.85%
Total	56	100%

**Source: data collected through questionnaire**

From the information collected above on the Table 15, 53.57% respondents said types of credit they take from the bank is “short term loan, 25% of the respondents said “medium term loan”, 3.57% of the respondents said “long term loan” and 17.85% of the respondents are the ones who are treated specially in taking “over draft”. This shows half of the respondents have taken short term loan.

**Table 16. Bank Credit Policy**

Do you think that the bank credit policy is Encouraging for borrowing?	Response	
	Number	Percentage
Yes	42	75%
No	14	25%
Total	56	100%

**Source: data collected through questionnaire**

Table 16. Shows that 75 % the respondent believe that the bank credit policy is encouraging for borrowers the rest 25% the bank credit policy is not encourage for borrower. This indicates that the bank credit policy is encouraging for borrowers.

**Table 17. Amount of Credit**

Do you get the amount of credit you ask for from the bank on time	Response	
	Number	Percentage
Yes	40	71%
No	16	29%
Total	56	100%

**Source: data collected through questionnaire**

Table 17. Indicates that 71% of the respondents get the amount of credit they ask for from the bank on time. Said “yes”, 29% of the respondents stated they do not get the amount of credit they ask for from the bank on time. This shows majority of the respondents get the credit on time.

**Table 18. Prerequisite for Advancing Credit to Borrower**

Do you think that the prerequisite set for advancing credit to a borrower by the bank is reasonable?	Response	
	Number	Percentage
Yes	38	67.86%
No	18	32.14%
I don't know	-	-
Total	56	100%

**Source: data collected through questionnaire**

Table 18, Shows that 67.86% of the respondents believe the prerequisite set for advancing credit to a borrower by bank is reasonable but the rest 32.14% of the respondents don't agree. The table states most of the borrowers think the prerequisite set for advancing credit to them is reasonable.

**Table 19. Customer Service Satisfaction**

How much are you satisfied with you get from the bank service?	Response	
	Number	Percentage
Very high	6	10.71%
High	12	21.43%
Fair	30	53.57%
Low	8	14.29%
Very low	-	-
Total	56	100%

**Source: data collected through questionnaire**

From the above table 19, regarding customer service satisfaction of the bank, 10.71% of the respondents said it is “very high”, 21.43% of the respondents said customer service satisfaction is “high”, 53.57% of the respondents said customer service satisfaction shows “Fair” and the rest of them 14.29% said customer service satisfaction is low. Most of the customers said the bank’s customer service satisfaction is fair.

**Table 20. Duration of Taking Credit Service**

How long it takes to get credit from the time a loan requested up to the cash disbursement?	Response	
	Number	Percentage
15 days	10	17.88%
A month	21	37.5%
More than a month	25	44.64%
Total	56	100%

**Source: data collected through questionnaire**

Table 20, Indicated that duration of taking credit service is 15 days according to 17.88% of the respondents those who said “a month” are 37.5% and 44.64% of the respondents said it takes “more than a month”. This shows that it takes

more than a month to get credit from the time a loan is requested up to the cash disbursement.

**Table 21. Procedure Accomplished to get a loan**

<b>Do you think that the procedure that should be accomplished to get a loan is clear and easy to borrowers which do not open loopholes for other considerations?</b>	<b>Response</b>	
	<b>Number</b>	<b>Percentage</b>
Very Clear	16	28.57%
Clear	40	71.43%
Not clear	-	-
Total	56	100%

**Source: data collected through questionnaire**

As we have seen from table 21, 28.57% of the respondents said procedure that should be accomplished to get a loan is “very clear” and 71.43% said procedure accomplished to get a loan is “clear” Majority of the respondents stated procedure accomplished to get a loan is clear.

**Table 22. The Collateral Requirement**

<b>How do you find the collateral requirement of the bank for credit compared to other commercial bank?</b>	<b>Response</b>	
	<b>Number</b>	<b>Percentage</b>
Very high	-	-
High	12	21.43%
Fair	38	67.86%
Low	6	10.71%
Very low	-	-
Total	56	100%

**Source: data collected through questionnaire**

As presented in table 22, collateral requirement for credit as compared to other commercial banks is “high” according to 21.43% of the respondents, 67.86% of the respondents regarding collateral requirement said it is “fair” and 10.71% of



the respondents said it is “low”. This indicates the collateral requirement of the bank for credit as compared to other commercial banks is fair.

**Table 23. Credit Payment**

Do you pay your credit regularly?	Response	
	Number	Percentage
Yes	28	50%
No	28	50%
I don't know	-	-
Total	56	100%

**Source: data collected through questionnaire**

Table 23 shows if customers pay credit regularly. 50% of the respondents say “yes”, 50% of the respondents do not their credit regularly. This indicates half of them pay regularly where as the other half do not.

**Table 24. Default of credit payment**

Have you ever had defaulted your credit payment?	Response	
	Number	Percentage
Yes	16	28.57%
No	40	71.43%
I don't know	-	-
Total	56	100%

**Source: data collected through of questionnaire**

Table 24 informs 28.57% of the respondents have defaulted their credit payment and 71.43% of the respondents have not defaulted. This table shows more than half of the respondents have not defaulted their credit payment.

**Table 25. Willingness to Help Borrowers**

<b>Do you think that the bank is willing to help borrowers in cases where a client is not able to meet his obligation as specified in the terms and conditions of borrowing due to unforeseen circumstances?</b>	<b>Response</b>	
	<b>Number</b>	<b>Percentage</b>
Willing	42	75%
Not willing	14	25%
Total	56	100%

**Source: data collected through questionnaire**

Table 25 shows willingness of the bank to help borrowers during unforeseeable circumstances. 75% of the respondents said the bank is willing to help them where as 25% of them said the bank is not willing. The table indicates that more than half of the respondents said the bank is willing to help them during unforeseeable circumstances.

### **Interview Questions**

1. What is the main reason risks of credit and risk management settle?

According to the manager: - the customer's back ground must be studied before loan is given, The customer's intention has to be clearly stated so as to know the purpose of the credit, series of follow up has to be done and Financial statement of the customer must be known

2. What measure should be taken to become equilibrant fluctuation of interest rate?

Managers suggest that basically interest rate of banks is based on the country's economic condition & banks loan policies and Stable kind of country's economy should exist

3. What are the main reasons for delay of credit collection?

Loan section head says, customers don't take into consideration the time the credit is to be collected the market fluctuation, Bank has to investigate the customer's business condition, time limit the business takes and when customers misuse the credit for another purpose than the one they stated

4. What are the challenges of which can face credit risk management?

Loan section head says, in order to lessen credit risk Businessmen should have an organized and workable, financial statements have to be up to date and Organized and permanent follow up policy has to designed regarding customers

5. What actions are taken to solve risk of liquidity problem?

Managers suggest banks must find ways to win society's trust to deposit money in banks and encourage the society to buy shares to help the growth of the capital of banks

6. What is the effort of your organization to implement computer technology?

The manager explained how the latest computer technology which is owned by Indians called Omni Enterprise is implemented to assist the core banking system and the bank is user of the ATM Technology

7. Are the set credit policy and procedures of the bank complete to handle day to day activities of credit operations?

Yes, loan section head stresses the fact that the bank's credit policies and procedures coincide with the National Bank of Ethiopia.

## CHAPTER FOUR

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

#### 4.1. Summary

The research summary is designed to assess the credit and risk management of Wegagen Bank S.C. This chapter presents the summary, conclusions and recommendations

The main concern of this study is to collect necessary information about credit and risk management of the Wegagen Bank S.C. and to seek solution for the problems that are related with credit and risk.

The researcher used descriptive research method to describe the credit and risk management of the Wegagen Bank. To make the study complete all relevant primary and secondary data were collected through interview and questionnaire. Loan section Head and the manager of the Wegagen Bank were interviewed. The questionnaires were given to customers and the staff. Based on the information gathered, analysis and interpretation were provided. Finally recommendation was suggested.

The following are the major findings of the study regarding the *STAFF* of Wegagen Bank

- 83.83% of the respondents are male and 16.67% of them are female.
- All of the respondents are degree holders.
- 66.67% of the respondents have work experience of 6-9 years and the rest are below this level.
- 66.66% of the respondents said the bank's credit and risk management policy is moderate.
- 83.33% of the respondents agree the bank expects high amount of profit
- 66.66% of the respondents inform credit is not collected on time.
- 50% of the respondents believe interviewing the borrowers is appropriate way of examining before the loan is approved.

- 66.66% of the respondents confirm as the time is concerned it is one factor of processing of loans advance and at least it takes 15 days to process the loan.
- 83.33% of the respondents believe the bank's existing loan policy and procedure manual is properly used.
- 66.67% of the respondents implied credit facility request is decided by management credit committee.
- 66.67% of respondents consider collateral is the major pre-request of the credit.
- All the respondents believe credit related directive issued by the National Bank of Ethiopia do not affect smooth processing of loan and advance.
- 66.67% of the respondents indicate the Wegagen Bank's interest function is low when compared to other similar banks.
- 50% of the respondents think the major cause of liquidity risk is inadequate deposit.
- 40% of the respondents select capacity problem on the part of borrower is major contributing factor for credit risk.
- The bank uses the latest computer technology which is the network system and Automated Teller Machine (ATM).

The following responses involve *CUSTOMERS* of the bank

- 53.57% of the respondents take short term loan from the bank.
- 75% of the respondents agreed the bank's credit policy is encouraging.
- 71% of the respondents claim they get the amount of credit on time.
- 67.86% of the respondents believe the prerequisite set for advancing credit to a borrower by the bank is reasonable.
- 53.57% of the respondents are satisfied with the service they get from the bank.
- 44.64% of the respondents said it takes more than a month to get credit from the time a loan is requested up to the cash disbursement.
- 71.43% of the respondents think the procedure that should be accomplished to get a loan is clear and easy to borrowers.

- 67.86% of the respondents indicate collateral requirement for credit as compared to other commercial bank is fair.
- 50% of the respondents pay their credit regularly.
- 71.43% of the respondents have not defaulted their credit payment.
- 75% of the respondents think the bank is willing to help them in cases where they may not be able to meet their obligation as specified in the terms and condition of borrowing due to unforeseen circumstances.

## **4.2. Conclusions**

The bank can generate its profits from different services that provide like local section. International Banking Department and others but majority of the profit is gained from the loan.

Policy strengthens the follow up and it also reinforces the performance of the workers. Credit and risk management policy of the bank is designed to create a good relationship between the bank and the borrower.

The time is very sensitive and one factor to attract the borrowers and to compete with the other competitors. However, from the time taken to process the loan and advance is taken more than one month and this time is long and the customer may be dissatisfied due to this reason.

Bank use different mechanisms to process the loan before the loan and advance is processed among this preliminary interviewing of the borrower, background of financial statement of the borrowers, capacity and condition of the borrowers are some of them. However, the bank's loan and advance facilities are moderate. The mechanism doesn't make the bank to be flexible and borrowers don't get enough funds as they need. Because of this reason the bank may lose its customers. Besides that before the loan advance is processed interviewing the borrower is an appropriate way of examining. This helps the bank to get full information and the right customers.

Based on the research it was discovered that recovery of loans from sales of collateral borrowers appeared essential step for security to safeguard the bank against risk, customer also tend to give high emphasis to securities held as collaterals for loans to obtain credit facility privileges.

Credit related directives issued by the National Bank of Ethiopia do not affect smooth processing of loan given by Wegagen Bank interest fluctuation is the exposure of the bank's financial condition to adverse movements in interest rates, customers are encouraged to use services of the bank because interest rate doesn't fluctuate.

Liquidity risk is the current and prospective risk to earnings or capital arising from the bank's inability to meet its payment obligations as they come due or fund loan request in a timely and cost effective manner. There is the presence of inadequate deposit which affects the bank's customers from getting loan.

Credit risk is the potential for financial loss arising from default of a borrower and credit obligation to the bank. One of the major contributing factors for problem of credit risk is the capacity problem on the part of the borrower.

Short term loan can be extended up to maximum period one year beginning the date the loan contract is signed. Using short term loan reduces the banks risk of collecting on time.

Using computer technology increases efficiency, lessens accuracy, interconnects all the branches of the bank. There fore, customers are served effectively and are satisfied with the service.

### **4.3. Recommendations**

Based on the finding of the study and conclusion, the study researcher has preparing the following recommendations.

- Most of the bank's borrowers are male. The bank should find means of creating awareness to increase female participation in using the bank's services.
- The time taken to process the loan and advance is long and this is not attractive to the borrowers. Therefore, the bank should try to minimize the time taken.
- Before the credit is processed the bank should give enough advice to the borrowers and screen out them by using interviewing method and helps the bank to identify easily the right customer at the same time the borrowers can get full of awareness about the loan.
- There is a major cause liquidity risk which is in adequate deposit; in order to lessen liquidity risk bank has to promote its deposit capacity by advising its customers to save money in banks.
- Capacity problem is the major contributing factor for credit risk. According to the bank's pre-requisite procedures, the borrower has to be obligated to settle the loan and serious follow up should be conducted to make the borrower pay his debt
- Few numbers of the customers are not satisfied with the services of the bank. This problem should be solved by the bank.
- It takes more than a month to get credit from the time a loan is requested up to the cash disbursement. The bank should minimize processing time not to lose its customers.
- Half of the borrowers do not pay their credit regularly. The bank should collect the credit on time by serious follow up.
- For timely and speedy execution of decision of loans and advances, the existing credit organization hierarchy and the discretionary lending limit of the deciding body's need to be reviewed
- The credit policy is encouraging in general but the bank has to try to minimize some bureaucratic procedures.



## APPENDIX – I

### St. Mary's University College Faculty of Business Department of Management Questionnaire of Credit and Risk Management

#### Dear Participants.

This questionnaire should be filled only by the staff of credit department of Wegagen Bank S.C.

The aim of this questionnaire is to collect data to assess credits risk management of the bank and to recommend necessary point that should be considered before the credit is approved. I would like to say thank you in advance for your Co-operation. It is not necessary to write your name

#### Instruction

Dear respondent put  mark on the box which contain your choice of the answer to the questions and use the blank spaces for your answer.

#### I. Background of the respondents.

1. Sex

Male

Female

2. Educational Back ground

Certificate

Degree

up to 12

Diploma

above Degree

3. Work experience

1-2 years

3-5years

6-9 years

above 10

4. Number of year you have served in the organization

Less than 5 years

6-10 years

above 10 year

5. What is your present position (title)? \_\_\_\_\_

## II. Question related to credit and risk processing

6. How much profit does the bank expect from credit?

Small amount  Medium  high amount

7. Do you think that all types of credit granted to the customer are collected on time? Yes  No  I don't know

8. If your answer is No for question number 8? Please specify the reasons \_\_\_\_\_  
\_\_\_\_\_

9. In what mechanisms does the bank evaluate the borrower before approving the credit? (you can select more than one choice)

Interviewing the borrower  evaluating the capacity of

Considering the collateral  the borrower

Background of the borrower  Purpose of the loan

Financial statement of the bank  other \_\_\_\_\_

10. Do you think the credit approving procedures are simple & clear to customers?

Yes  No  I don't know

If No state the reason \_\_\_\_\_

11. Who is involved in deciding credit facility for prospective borrowers

1. \_\_\_\_\_

2. \_\_\_\_\_

3. \_\_\_\_\_

12. How long it takes to process a credit

15days  a month  more than a month

13. What internal factors prevail affecting fast and timely decision of credit \_\_\_\_\_  
\_\_\_\_\_

14. Is the bank credit operation manual properly implemented?

Yes  No  I don't know  If No state the reason behind-----  
-----

15. what organs of the bank involve in deciding credit facility request of prospective borrowers
- Loan officers  credit analysis
- Managers  management credit committee
- Board credit committee  Branch credit committee
16. Are collateral considered pre - requests for qualification of credit Requests? Yes  No  I don't know
- If No state the problem.-----  
-----
17. Do directive on credit /loan activities adopted by NBE affect smooth processing of credit. Yes  No  I don't know  If No state -----  
-----
18. How do see the rate of interest fluctuation compared to other similar banks?
- Very High  High  Medium  low  verylow
19. How 'do you evaluate the bank credit & risk management policy in dealing with none performing loan?
- Very small  Small  medium  Strong
- verystrong
20. What is the cause for liquidity risk?
- Not Collecting Loan  Inadequate deposited
- Weak of follow up  other-----
21. What are the major contributing factors for problem in credit risk? (you can select rank)
- Lack of financial discipline of borrowers
- Character problem on the part of the bank
- Capacity problem on the part of the lenders
- Force major
- Other-----

Thank you

## APPENDEX – II

### St. Mary's University College Faculty of Business Department of Management Questionnaire of Credit and Risk Management

#### Dear Participants.

This questionnaire should be filled only by the borrower of Wegagen Bank S.C.

The aim of this questionnaire is to collect data to assess credits risk management of the bank and to recommend necessary point that should be considered before the credit is approved. I would like to say thank you in advance for your Co-operation. It is not necessary to write your name

#### Instruction

Dear respondent put  mark on the box which contain choices to answer the questions and uses the blank spaces for your answer.

#### I. Background of the respondents.

- Sex Male  Female
- Age group 18-20  20-30  40-50   
30-40  above 50
- For how long have you been a customer to the bank?  
Below 5 years  5-10 years  above 10 years

#### II. Question Related to Credit and Risk Processing

- What kind of credited have you taken from the bank?  
Over draft  long term loan  short term  medium
- Do you think that the bank credit policy is encouraging for borrowing?  
Yes  No  I don't know

6. If your answer for question number 5 is No what do you think the reason is?

The services is poor  Cumbersome and Bureaucratic  
Interest rate is high  procedures   
Un balanced collateral requirement   
Other -----

7. Do you get the amount of credit you ask for from the bank on time?

Yes  No  I don't know

8. If your answer is No what do you think the cause maybe?(you can select more than one choice)

Liquidity problem of  the bank constrained by maximum  
The bank  limit policy of NBE   
Do not know  other -----

9. Do you think that the prerequisite set for advancing credited to a borrower by the bank is reasonable?

Yes  No  I don't know

10. If you say No what do you suggest to be improved?

---

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11. How much are you satisfied with you get from the bank service

Very high  High  Fair  Low  very low

12. How do you see the interest rate of our bank compared to other similar commercial bank? Very high  high

Fair  low  Very low

13. How long it takes to get a credit from the time a loan requested up to the cash disbursement

15 days  a month  more than a month

14. Do you think that the procedure that should be accomplished to get a loan is clear and easy to borrowers which do not open loopholes for other considerations?

Very Clear  clear  Not clear

15. How do you find the collateral requirement of the bank for credit compared to other commercial bank?

Very high  high  Fair  Low  Very Low

16. Do you pay your credit regularly?

Yes  No  I don't know

17. If your answer the equation is No number 16 is the reason do not pay? \_\_\_\_\_

18. Have you ever had defaulted your credit payment?

Yes  No  I don't know

19. If you answer yes number 18 what was the reaction of the bank

Sue at court  try to help you pay your credit by extending payment period other means

20. Do you think that the bank is willing to help borrowers in cases where a client is not able to meet its obligations as specified in the terms and conditions of borrowing due to unforeseen circumstances?

Willing  Not willing

Thank you

## APPENDEX – III

### Interview question

#### Interview will be made with branch manager & Loan section head

1. What is the main reason risks of credit and risk management settle?
2. What measure should be taken to be come equilibrant fluctuation of interest rate?
3. What are the main reasons for delay of credit collection?
4. What are the challenges of which can face credit risk management?
5. What actions are taken to solve risk of liquidity problem?
6. What is the effort of your organization to implement computer technology?
7. Is the head office management credit committee fully independent of the board of directors credit committee in deciding loans advance.  
Yes                       No                       I have no Idea
8. Are the set credit policy and procedures of the bank complete to handle day to day activities of Credit operations? If No state weaknesses that should be readdressed? -----  
-----

Thank you