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AN ASSESMENT OF CREDIT RISK MANAGENT POLICIES AND PRACTICES: IN THE CASE OF AWASH BANK

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Approval Sheet

This thesis by Abigael Surafel is accepted in its present form by the board of examiners as Satisfying the thesis requirement for the degree master of business administration.

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By my signature below, I declare and affirm that this thesis is my work and has not been submitted to another institution for the award of a degree, diploma or certificate. All Scholarly matter that is included in the thesis has been duly acknowledged.

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List of Acronyms and Abbreviations

CAR - Capital Adequacy Ratio

CIR - Cost to Income Ratio

CRM - Credit Risk Management

ECL - Expected Credit Loss

ESG - Environmental, Social and Governance

ETB - Ethiopian Birr

EWS - Early Warning System

GC – Gregorian Calendar

ICT - Information and Communication Technology

IFRS -International Financial Reporting Standards

LDR - Loan to Deposit Ratio

NBE - National Bank of Ethiopia

NPL –Non Performing Loan

ROE - Return on Equity

ROA- Return on Asset

UAE - United Arab Emirates

Abstract

Credit risk remains one of the main challenges faced by Banks as it directly affects the overall financial stability and profitability of the institution. This study assessed the credit risk management policies and practices of Awash Bank S.C and was conduct to evaluate whether the banks credit risk management practices aligns with the industry practice and current regulatory standards.

A descriptive research design with both quantitative and qualitative methods was used.The respondents were selected by using purposive sampling method because the study required information that could only be obtained from employees who are directly involved in credit

related functions within the bank. The primary data were collected through structured questionnaires which were distributed to fifty employees working directly in the credit appraisal and administration departments also interviews were conducted with senior credit officials. Secondary data were obtained from the Bank's audited annual reports covering the period 2019/20 to 2023/24, internal policy documents and relevant directives issued by National Bank of Ethiopia.

The findings reveled that although the bank has established formal credit risk management policies & procedures and maintained relatively strong credit performance during the study period gaps remain in post disbursement loan monitoring, early identification of credit risk indicators, management of nonperforming loans and consistent implementation of credit risk policies. Based on the findings the study recommends strengthening loan portfolio diversification, improving loan monitoring and follow up mechanisms, improving the use of early warning systems, maintaining accurate borrower information and accelerating the digitalization of credit risk management processes. Implementing these measures would improve the effectiveness of Awash banks credit risk management framework, improve financial stability and ensure the banks long term performance and stability.

Chapter One

Introduction

1.1 Background of the Study

The banking sector plays an important role in the country's economic development. The banking sector provides financial assistance to various industries such as construction, agriculture, textiles, manufacturing, etc. The banking institute helps to directly increase national income and their overall growth. In this way, banks help in economic financial growth (Sharma & Saharan, 2015; Singh & Sharma, 2018). Credit creation is the principal source of income for the bank worldwide from which banks are subjected to credit risk. Banking sector stability depends on their profitability and capital adequacy. (Naser, Ahmadi & Emami, 2013).

Financial institutions deal continuously with risks to earn profit however because of poor risk management most of them collapse.Managing credit for banks not only about disbursing loans it requires a close supervision and continuous monitoring to prevent or reduce nonperforming loans (NBE, 2010). Credit risk represents one of the most significant threats to the stability and profitability of commercial banks. Individual risk is related to a single borrower and results from that borrower's financial situation. It also pertains to the value and liquidity of the legal collateral securing a particular credit exposure. Aggregate portfolio risk is influenced not only by the total number of loans granted and their sizes but also by the degree of interdependence among individual loans. A high level of portfolio credit risk often results from a poor bank strategy and inadequate credit policy (Marccinkowaska, 2009).

Credit risk management encompasses all activities aimed at identifying the factors that determine credit risk, measuring its level, controlling it and mitigating its adverse effects. According to

Basel Committee on Banking Supervision (2025), effective credit risk management requires banks to establish a comprehensive framework that includes board approved policies, rigorous credit granting criteria, ongoing portfolio monitoring and robust controls to address both on and off balance sheet exposures.

Early detection of defaulters can ease credit risk management as there is inverse relationship between nonperforming assets and identification of defaulter. An early warning system to be set up for timely detection of credit risk, proper market information system and training of employees helps in reducing nonperforming assets. Availability of big data and use of artificial intelligence helps in segmentation, customization, fraud detection and risk evaluation. The huge data provided with the banks can be utilized with the help of machine learning and deep learning to assess credit risk. Credit behavior can be evaluated using data analytics for early detection of defaults (Chaushary&Sharma, 2011).

Risks which are poorly handled or misunderstood will cause serious financial trouble. As stated by National Bank of Ethiopia (2019) Risk should be only acceptable if it's understandable, measurable, manageable and aligned with company's capacity to absorb it. In the current rapid financial sector growth and rising competition in Ethiopia there is a need for a well-developed credit risk management system in Domestic banks. Awash Bank is the largest private bank in Ethiopia. This study assesses how effective Awash Banks policies and practices are in managing credit risk.

1.2 Statement of the Problem

Around the world banks face Credit risk, one of the biggest challenges in the banking industry. Ineffective management of credit risk can result in borrower defaults, rising non-performing loans, reduced profitability, liquidity challenges and financial instability. When borrowers fail to fulfill their obligations it doesn't only affect individual banks it can also undermine the entire financial system. Financial institutions need clear and well developed policies and procedures which will be used in every stage of the credit process from loan approval to monitoring and recovery (Basel Committee on Banking Supervision, 2000).

According to the National Bank of Ethiopia (NBE, 2024) and Feleke & Tafere (2025), the banking industry's non-performing loan ratio increased from 3.2% in 2019 G.C to 3.9% in 2024G.C. Although the ratio remained below the regulatory ceiling of 5%, the upward trend signals growing credit risk within the banking sector and indicates the need for effective credit risk management systems.

Awash Bank is one of the largest and most profitable private commercial banks in Ethiopia for the past several years. The bank has experienced substantial growth in its loan portfolio in the study period. Rapid growth in lending can increase a bank's exposure to credit risk if it is not supported by effective credit appraisal, monitoring and control mechanisms (IMF, 2005). While this growth reflects the bank's expanding market presence and lending capacity it also increases the importance of maintaining effective credit risk management practices to safeguard its portfolio quality and financial performance.

Although credit risk is a critical issue a review of the existing literature indicates that many studies conducted in Ethiopia have primarily examined the relationship between credit risk and

financial performance or the determinants of non-performing loans. Comparatively, limited attention has been given to assessing the effectiveness of credit risk assessment, credit administration, credit monitoring and regulatory compliance practices within individual banks, particularly Awash Bank.

Therefore, this study seeks to assess the credit risk management policies and practices of Awash Bank by examining the tools and techniques used throughout the credit process, the implementation of credit policies, the factors contributing to non-performing loans and the extent to which credit risk management contributes to the bank's financial performance and stability.

1.3 General and Specific Objective of the research

1.3.1 General Objective

The main objective of this study is to assess the credit risk management policies and practices of Awash Bank.

1.3.2 Specific objectives

- To assess the effectiveness of the bank's credit risk management policies and procedures.
- To examine the effectiveness of the bank's credit collection and monitoring practices.
- To identify the major factors contributing to bad debts and non-performing loans at the bank.
- To evaluate the measures implemented by the bank to manage and reduce non-performing loans over time.

1.4 Research questions

- To what extent are Awash Bank's credit risk management policies and procedures effective?
- How effective are the bank's credit collection and monitoring practices in managing credit risk?
- What are the major factors contributing to bad debts and non-performing loans at Awash Bank?
- What measures has the bank implemented to manage and reduce non-performing loans over time?

1.5 Scope of the Study

This study is limited to the assessment of credit risk management practice at awash bank and it was conducted at the banks head office because key credit related activities such as policy implementation, credit approval, monitoring and risk oversight are done centrally. In order to collect relevant and detailed data, it was collected from employees working in credit appraisal, administration, loan follow up and risk management. The study used a descriptive research design and both quantitative and qualitative methods were employed which helped to understand the credit process specifically the management of nonperforming loans.

Secondary data were gathered from Awash bank five years' annual reports which is from 2019 to 2024 GC, from internal policies and directives of the National Bank of Ethiopia. These sources

were used to understand the pattern in loan quality, nonperforming loans ratios, provisioning and the banks compliance with regulatory guidelines.

1.6 Significance of the Study

For Awash bank credit and management staffs it provides a clear look into the existing credit risk management practice also it gives insight and may assist the bank on how to reduce bad loans, how to improve collection process of nonperforming loans, credit review and monitoring process. The study may also benefit policymakers and regulators like National Bank of Ethiopia by giving evidence on the implementation of credit risk management directives and guidelines & by showing areas that needs improvement. It contributes to the limited number of studies available on credit risk management in Ethiopia private banking sector also could be used as a reference for future researches.

1.7 Limitations of the Study

The study was conducted only on Awash Bank S.C. as a result the findings may not reflect the credit risk management practices of other commercial banks in Ethiopia. The study covered the five-year period covering from 2019/20 to 2023/24 G.C. therefore any changes that occurred before or after this period were not considered. In addition, the research used descriptive research design which helped to assess and describe the banks credit risk management practices but did not examine cause and effect relationships. The study only focuses and assessed one of the major risk faced by financial institutions and did not examine other types of risks such as operational

risk, market risk and liquidity risk which may influence the bank's profitability, stability and overall performance.

1.8 Organization of the Study

The thesis organized into five chapters. Chapter One introduces the study background, the problem, outlines the objectives, research questions, significance, scope and limitations of the study. Chaptertwodiscussesthe key theories, past studies, the company's and regulatory frameworks. Chapter Three present the research design, data sources, sampling strategies, data collection tools, analysis methods and ethical standards followed including the conceptual framework. Findings and analysis supported by tables and explanations presented in chapter four and Chapter Five summarize key findings, draw conclusions, offers recommendations and point out areas for future research.

Chapter Two

Literature Review

2.1 Credit Risk

Many systemic credit issues start from Poor credit risk practices in both developed and developing economies. Credit risk is considered as the chance of loss that will occur when the loan or any other line of credit by a particular debtor is not repaid (Campbell, 2007). The essence of credit risk lies in the possibility that a borrower or counterparty may not fulfill their obligations as agreed with a bank, posing potential financial losses. Effective credit risk management aims to optimize a bank's risk adjusted returns by keeping credit risk exposure at acceptable levels (NBE, 2013). Credit risk arises from a multitude of factors originating internally and externally. Deficiencies in credit policy, poor borrower financial assessments,excessive reliance on collateral and inadequate post sanction monitoring contribute significantly to credit risk andalso external factors such as changes in economic conditions, unemployment, inflation, interest rate and regulations(Ray Ball et al., 2015).

Mispricing credit risk, setting interest rates that do not reflect borrower risk levels will attract high risk borrowers. It’s relevant in Ethiopia where competition sometimes leads banks to

underprice risk (NBE 2023). Contingent liabilities like guarantees, overdrafts and other off balance sheet exposures are also other factors that can cause credit risk. Practices like over exposure to a single borrower, group or industry increase credit risk. Concentrating only in one or few sectors specifically in construction and trade have a risk to Domestic banks because of their sensitivity to economic shocks like inflation and currency devaluation (NBE, 2023). Risk indicators or measures like Probability of Default, Loss Given Default and Risk Adjusted Return on Capital helps to make accurate lending decisions also to forecast future outcomes (Jorion, 2007). Adoptingnew lending practices like unsecured digital loans and using untested credit scoring models exposes financial institution tocredit risk.

2.2 Credit Risk Mitigation

Diversification allows institutions to limit their losses in the event of a default. It is essential for institutions to balance diversification with concentration risk, ensuring that their portfolios are adequately diversified without overexposure to any single risk factor (Scott et al., 2024).Ogedengbe, et. al (2023) stated that collateralization provides lenders with a degree of protection against default as it reduces the loss severity in the event of default. The effectiveness of collateralization depends on the quality and liquidity of the collateral, as well as the accuracy of its valuation. In the event of a default, the lender can seize and sell the collateral to recover some or the entire outstanding loan amount. Collateral can take various forms, including real estate, inventory, equipment or financial securities. Financial institutions can reduce their exposure to credit risk and diversify their risk across a broader range of investors by transferring

credit risk to other parties such as insurance companies or to investors. Familoni & Shoetan (2024) identified that securitization and syndicated lending as common form of risk transfer mechanisms. Loans are pooled together in securitization and sold to investors as securities. In syndicated lending, multiple lenders participate in a loan to spread the risk.

Credit derivatives allow institutions to transfer or mitigate credit risk. One common type of credit derivative is a credit default swap, where one party or the protection buyer pays a premium to another party in exchange for protection against the default of a specified reference entity, the protection seller may default on its obligations (Scott et al., 2024). Credit insurance provides protection to lenders against the risk of non-payment by borrowers, In the event of a default; the insurer compensates the lender for some or all of the losses. (Olawale,et. al., 2024). It also enables lenders to expand their lending activities, improve their credit risk management practices and enhance their financial stability. The process can be costly and coverage may be limited to certain types of risks.

In addition, by using statistical models and algorithms credit scores to borrowers based on their credit history can be assigned to make informed lending decisions, identify high-risk borrowers and tailor loan terms and conditions to mitigate risk. (Scott et al, 2024). These institutions can also use stress testing to assess how adverse events, such as economic downturns or market shocks on their credit risk exposure. Through simulated stress scenarios banks are able to identify vulnerabilities in their portfolios, adjust their risk management strategies and build resilience against unexpected events (Ogundipe, Odejide & Edunjobi, 2024).

2.3 Credit Risk Management

Credit risk management is the process of evaluating, approving, monitoring and recovering loans. The main objectives of credit management are to reduce nonperforming loans, maintain stability and ensure enough capital to cover future risk which can be achieved by conducting careful due diligence, continuous monitoring and using recovery strategies (Saunders & Allen, 2020). The practices include: identifying a potential credit risk, measuring the intensity of the risk, assigning an appropriate treatment to the credit risk detected also monitoring and ensuring suitable control over credit risk. As stated by NBE (2010), Banks must keep improving their internal processes by adapting to changing market conditions, by strengthening their credit standards and supervision. Financial institutions also need well trained personnel, well-built systems and forward looking risk strategies to be efficient. The primary goal of credit risk management is to increase a bank's risk adjusted rate of return by managing credit risk exposure within acceptable structures. The sound practices seek to strive for integrated actions to specifically manage risk. (Eckles et al., 2014).

2.4 Theoretical Foundations of Credit Risk Management in Banking

2.4.1 Modern Portfolio Theory (Harry Markowitz)

The theory argues that any given investment's risk and return characteristics shouldn't be viewed alone but should be evaluated by how it affects the overall portfolio's risk and return. As an alternative, starting with a desired level of expected return, the investor can construct a portfolio

with the lowest possible risk that is capable of producing that return (Markowitz, 1952). Based on statistical measures such as variance and correlation, a single investment's performance is less important than how it impacts the entire portfolio. As a practical matter, risk aversion implies that most people should invest in multiple asset classes. The expected return of the portfolio is calculated as a weighted sum of the returns of the individual assets (Markowitz, 1952).

2.4.2 Asymmetric Information Theory (George Akerlof)

This theory emphasizes the importance of doing thorough research before approving loan and to have effective information management. It encourages financial institutions to establish strict credit appraisal, collateral requirements, strong monitoring system and borrower screening procedures. Economists like George Akerlof, Michael Spence and Joseph Stiglitz helped shape this theory, showing how hidden information can lead to problems like adverse selection, when a financial institution lend money to people who are actually high risk without knowing it and moral hazard which occurs after loan approval, when a borrowers engage in risky activities which affect repayment. (Akerlof, 1970).

2.4.3 Credit Rationing Theory (stiglitz &Weiss)

The theory demonstrates that banks need strong lending criteria and loan approval standards to protect themselves from this kind of risk. According to Stiglitz and Weiss (1987), in accordance with the model, when there is high interest rate in the credit market with imperfect information,

the expected return of the loan borrowers from successful projects will decline. This situation will primarily increase loan defaults and motivate borrowers to undertake riskier projects with potentially high returns but low probability of success or force them to use risky operation techniques. When interest rates are high, banks lower the credit demands for risky projects by selecting borrowers carefully, in other words, by making quantity rationing rather than raising interest rates.

2.4.4 Agency Theory (Jensen and Meckling)

Agency theory discusses about conflict of interest between managers and shareholders. The theory emphasizes the important of corporate governance, internal control, supervision and accountability within financial institutions. It recommends strong Risk management framework, policies, auditing system and performance monitoring systems which will help to ensure employees and management to follow organization objective and policies (Jensen & Meckling, 1976). Agency theory focuses on relationships in which the principal, who delegates decision making authority, relies on the agent, who undertakes actions on the principal's behalf. Parties are assumed to be, self-interested, prioritizing personal gain, bounded rational, with limited capacity to foresee all contingencies and differentiated in their risk preferences, reflecting varying attitudes towards uncertainty. They also often pursue partially conflicting goals, leading to misalignment between principal and agent objectives.

Information is asymmetric because agents typically know more about their attributes or actions than principals and information is treated as a purchasable commodity that can be acquirable at some cost. Under these conditions, governance turns on the design of contracts, monitoring and

incentives that align agent behavior with the principal's objectives (Bergen, Dutta & Walker, 1992).

2.5 Credit Risk Management Practices in Ethiopia and International Banks

The National Bank of Ethiopia introduced its own set of rules to improve the way local financial institutions manage risk in Ethiopia. The guidelines require financial institutions to follow global standards throughout the loan process especially when identifying, measuring and monitoring credit risk. However, domestic banks still face challenges in Implementation due to limited resource and weak enforcement of risk appetite limit (Habtamu, 2024). According to BIS (2000), International banks follow strong and structured credit risk management systems based on the Basel Accords. Basel committees outlined key principles to make sure banks work in a safe lending environment and everything is structured in a way banks fully understood it.

2.5.1 Risk Assessment

Global banks often use advanced models like Advanced Internal Rating Based (AIRB) approach. These models help predict if a person or business is capable to repay a loan and if they don't, how much will be the potential losses. These help banks to know how much money to keep aside in case of default (BIS, 2000). Financial institutions in Ethiopia are gradually adopting more organized methods like risk registers or scenario planning (Habtamu, 2024).

2.5.2 Risk Mitigation

Domestic banks limit how much credit is given to one customer and set up special departments to monitor risk however there is a gap in internal audits and lack of technology which makes the

credit risk management process complicated (Fekade selassie, 2015). The Bank for International settlements (2000, 2017) states financial institutions shouldn't depend solely on collaterals, it only be effective when the agreement is legally backed, instead it encourages prioritizing strong credit evaluation. Foreign banks in terms of controlling and reducing risk use a mix of strategies like asking for collateral, credit derivatives and diversification. In Ethiopia most banks require physical assets like buildings or vehicles as collateral to reduce credit risk (Alemayehu, 2021).

2.5.3 Institutional Capacity

As stated by Habtamu (2024), in domestic banks there is a lack of trained risk professionals sometimes the same person engaged in assessing loans and in approval, which can lead to conflicts of interest. According to Basel committee on banking supervision (2015) banks should have independent risk management compliance and internal audit functions. For effective credit risk management, financial institutions need skilled staff, digitalized systems and proper governance. In developed countries banks invest in computerized system to evaluate customers, to process loan and to identify risky loans early. Their internal structures also include independent risk committees, compliance officers and internal auditors to ensure smooth and accurate operation (Rose & Hudgins, 2013).

2.5.4 Regulatory Compliance and Basel Implementation

National Bank of Ethiopia enforces basic requirements like minimum capital levels and loan classification however currently domestic banks only comply with Basel I or the first pillar of Basel II when it comes to risk management (Awash Bank, 2019/2020,2020/2021,2021/2022,2022/2023,2023/2024). Internationally the Basel II and III

frameworks help banks to ensure they have enough capital to absorb losses and to remain stable. Basel III improves financial safety by requiring banks to maintain minimum liquidity levels and to set aside extra capital during good economic times to protect them from future losses or economic downturn (BIS, 2011).

2.6 Non-Performing Loans (NPLs)

The non-performing loansrefer to loans which are not repaid for 90 days or more. It's a key indicator of how much credit risk a bank carries and the quality of its asset. High level of unpaid loans weakens a bank's performance and affect banks' ability to manage cash flow. When loans go unpaid banks lose expected income from both interest and principal repayments. Financial institutions put aside loan loss provision to cover these unpaid loans. If this situation continues banks will loss public confidence and their investment (IMF, 2020). Basel committee guidelines emphasize the importance of adequate provisioning and careful loan classification practice to minimize future risks. Regulatory bodies set ceilings for acceptable nonperforming loansRatios. According to NBE 2021, the National Bank of Ethiopia requires banks to keep their nonperforming loans ratio below 5%. National Bank of Ethiopia monitors compliance with this requirement by conducting regular audits and off site analysis However if nonperforming loans ratio exceeds the 5% limit the NBE will take corrective action by increasing provision and restricting dividend.

2.7 Loan Write-Offs and Write-Backs

When a bank determines a loan is uncollectable it removes it from its balance sheet through a write-off (Greuning & Bratanovic, 2020). Under IFRS 9 a write-off is reasonable after the financial institutions has used all recovery options but not succeed and recognized the loss as part of its loss recognition process under Stage 3 assets. According to NBE (2021) the decision should be internally approved and reported to the National Bank of Ethiopia. Loan can also be recorded as write back when it's recovered in part or in full even if it was recorded as write off previously which involves reversing earlier loan loss provisions and recognizing the recovered amount as income.

2.8 NBE Directives on Credit Risk

The National Bank of Ethiopia asset classification and provisioning directive (2024)require Ethiopian banks to follow global standards like Basel II/III and IFRS 9. Banks now classify loans as substandard, doubtful or loss and must move problem loans to nonaccrual status even if they have collateral. Restructuring is limited three times for short medium term and four times for long term to prevent repeated restructuring (NBE, 2024). The National Bank of Ethiopia requires each bank's board to approve its credit policy and to ensure clear separation of duties from loan originators to those responsible for recovery and banks must use internal credit rating systems, review loan portfolios and to report exposures regularly (NBE, 2024; Basel Committee, 2006).

For overdue loans domestic banks must set aside provisions based on the category, 20% for substandard, 50% for doubtful and 100% for loss. If any loan in a group defaults by 20% all associated loans are seen as nonperforming loans and unrecoverable loans must be written off

with National Bank of Ethiopia approval. The National Bank of Ethiopia provides flexible provisioning for key sectors like agriculture and SMEs. To align with Basel standards, it requires banks to hold capital based on their risk weighted assets, to share credit data with national bureaus and encourages loans diversification.

2.9 Awash Bank's Lending Process

Awash banks' lending process starts when a borrower submits loan request with the necessary documents such as accurate financial statements, valid ID and other required documents then a credit officer will meet with the borrower and visit the business site to verify the information. Credit officers will conduct a full appraisal that covers finances, the industry and management strength. Other than its value, collateral must be liquid and legally clean. After the assessment and evaluation all findings will go into a credit recommendation report for the credit committee (Awash Bank, 2017).

Approval stage is done by analysts with limits to the loan's size and risk. If a loan is high risk it goes through additional committee reviews for tighter control. Funds are released only after all stages and process are completed and checked to be legal and in compliance with the low and regulations. Disbursement can be a lump sum or installments to ensure appropriate utilization of fund and continuous monitoring throughout the process. The bank establishes lending limit for specific sectors, products or regions to minimize loan concentration risk (Awash Bank, 2017).

According to Awash bank annual reports and manual, the bank regularly monitors borrower's financial performance, payment pattern and utilization of fund to identify potential risk at early

stage, before loans become nonperforming. A separate and special team will be dedicated to regularly evaluate borrowers risk profile to ensure compliance with lending policies, adequacy of collateral and loan portfolio diversification (Awash Bank, 2017). Collateral is checked and revalued regularly to ensure, adequate coverage of outstanding loan considering market and legal changes. Guarantees and letters of credit although not recorded on balance sheet as direct loans, will be regularly monitored to avoid hidden risks and to stay within bank's risk appetite. The bank regularly rates borrowers from A which means very low risk to E very high risk by using updated financial information and behavior, which helps to decide loan terms, interest rates and risk limits (Awash Bank, 2017).

Table 2.1 Grading Borrower Risk

Grade	Risk level	Description	Credit management implication
A	Very low risk	solid financials, collateral and capacity	Prefers pricing, extended terms
B	Low risk	Good financial stability, acceptable repayment	Standard Terms, regular monitoring
C	Moderate Risk	Risk can be managed	continuous review, Higher pricing
D	High risk	financial hardship or poor character	additional collateral required

E	Very High Risk/Default	NPLs	Credit recovery, close Follow-up

2.10 Empirical Literature Review

Al-Tamimi, H. A., & Al-Mazrooei, F. M. (2007) carried out comparative study of bank's risk management between national and foreign banks in the United Arab of Emirates through survey. The survey questionnaire mainly composed seven items clustered under Risk management practice (independent variable) and thirty-three items under Understanding risk and Risk management, Risk identification, Risk assessment & analysis, Risk monitoring and Credit risk analysis (independent variables). The regression result revealed that risk identification and risk assessment and analysis had significant positive impact on Risk management practice while other variables had insignificant positive Impact. The researcher also found that Risk identification and Risk assessment and analysis were the most influential variables for Risk management practice of nationally owned bank. It also further concluded that there was a significant difference between nationally owned and foreign banks in the aspect of Understanding risk, Risk management, Risk assessment and analysis and Monitoring and Controlling aspects also with practice of Risk identification, Risk management practice and Credit risk analysis. The study generally reported foreign banks were more effective in Risk management practice than nationally incorporated bank due to quality of staffs and regulatory requirement.

One of the most comprehensive studies in Ethiopia was conducted by Asfaw (2015), who examined the credit risk management practices of Ethiopian commercial banks using the Basel Committee's credit risk management principles as an evaluation framework. The study found that establishing an appropriate credit risk environment, implementing a sound credit granting process, maintaining effective credit administration and monitoring systems also ensuring adequate internal controls significantly influence the effectiveness of credit risk management practices. The findings revealed that financial statement analysis was the most frequently used credit risk identification technique, followed by audit, physical inspection and internal communication systems. More importantly, the study concluded that a strong credit risk environment and effective internal control mechanisms were the most influential factors in reducing credit risk exposure. The study demonstrated that the quality of policy implementation is more important than the mere existence of credit policies.

Similarly, Shahida and Reddy (2018) assessed credit risk management practices in the Ethiopian banking sector by comparing existing practices with Basel credit risk management principles. Their findings indicated that banks with clearly defined credit policies, rigorous borrower assessment procedures, comprehensive loan monitoring systems and effective recovery mechanisms were better able to manage non-performing loans. The study further revealed that excessive dependence on collateral as the primary lending criterion exposes banks to higher credit risk because collateral does not guarantee repayment capacity. The researchers argued that effective credit risk management should focus on the borrower's cash flow, repayment ability, business viability and financial strength rather than relying solely on collateral security. The

study concluded that continuous monitoring after loan disbursement is equally important as the initial credit appraisal process.

Aschis study the effect of credit risk management on profitability of commercial banks of Ethiopia over the period of 2008-2018 GC. The findings show, capital adequacy, loan to deposit ratio and loan provision ratio has positive and statistically significant effect on profitability of selected commercial banks. In the opposite side NPL ratio, loan to total asset ratio and cost per loan have statistically negative effect on the banks profitability. The study recommended Ethiopian banks to prioritize the enhancement of credit risk management practices with a specific focus on strategies to address nonperforming loans. Strengthening credit analysis framework and refining loan administration were also recommended. Policy makers and industry stakeholders were encouraged to collaborate in developing and implementing robust risk management.

AL Zaidanin (2021) investigated the effect of credit risk management on the financial performance of commercial banks in the United Arab Emirates. The findings reveal NPL ratio and cost to income ratio have a significant negative impact on the profitability of commercial banks in the UAE Whereas, the capital adequacy, liquidity and the LDR have weak positive relationship with ROA.The study concluded that these ratios are not determinants of bank profitability due to their insignificance statistical impact. To improve financial performance and reduce the risk of nonperforming loans in the future, the study recommended prior to approving loan applications, banks must closely monitor the performance of loans and analyze clients credit

histories and ability to repay debts. In addition, the study recommended banks to continuously improve their asset utilization, liquidity and techniques for managing operating costs.

Chapter Three

Research Methodology

3.1 Research Design

A descriptive research design was used by combining both quantitative and qualitative data. The descriptive design was best to examine Awash Banks credit risk management. By using numerical findings from structured questionnaires combined with insights gathered through interviews, the study offered a deep understanding of how the bank's credit assessment, administration & monitoring processes help to reduce nonperforming loansand itscompliance with regulatory standards. This method was useful to show the operational challenges the bank faces and to develop realistic recommendations.

3.2 Sources of Data

The study used both Primary and secondary source of data. Primary data were collected by distributing structured questionnaires for employees who works in credit related units. Interviews were conducted with senior officers in these units, which helped to collect additional information

on regulatory compliance, credit quality and managerial responses to risk. Secondary data were collected from the Bank's audited annual reports covering the period 2019 to 2024, credit policy manual and relevant directives issued by the National Bank of Ethiopia was also used. Additional academic literatures and journal reviews were used to support the literature review.

3.3 Population and Sampling Technique

The study used purposive sampling method because it required information that could only be obtained from employees who are directly involved in credit related functions within the bank. The selected participants work in departments responsible for credit appraisal, credit administration, credit monitoring and follow-up. These employees have firsthand knowledge of the policies, methods and practices used to identify assess monitor and control credit risk.

Since the questionnaires and interview questions focused on technical and operational aspect of credit risk management only employees actively engaged in these functions and those who participate in credit related decision making processes were considered suitable respondents. Accordingly, fifty employees from the relevant departments were purposively selected to participate in the questionnaire survey and interviews.

3.4 Method of Data Analysis

The study used both qualitative and quantitative data analysis. The data collected from questionnaires were organized and assessed by using excel. Percentages, frequencies and tables

were used to summarize responses, to identify patterns on credit assessment, monitoring and compliance practices and to present results. Data collected from interviews and open ended responses were interpreted thematically by pointing out main issues related to credit risk management practices, operational challenges, compliance issues and institutional capacity.

3.5 Validity and Reliability

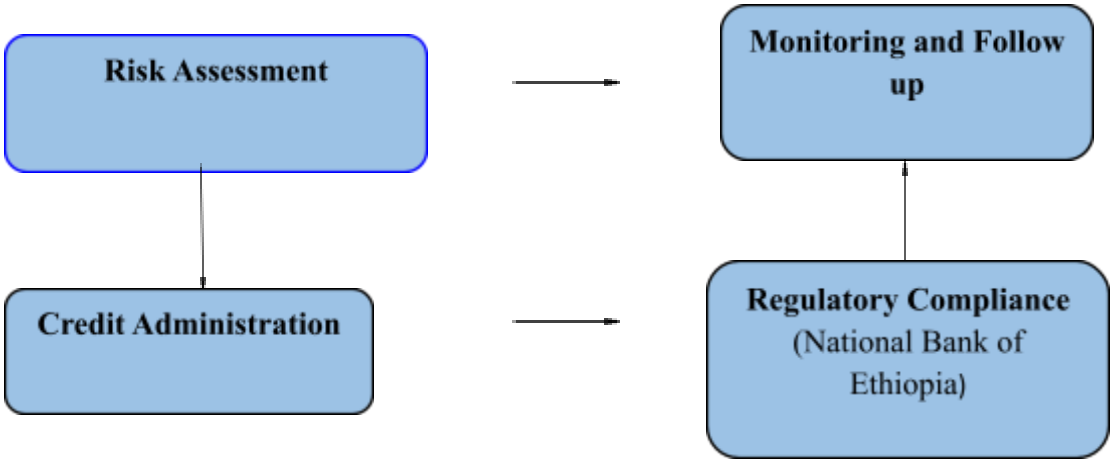
Before the data was collected, feedback was obtained to make sure the questions were clear and relevant and some correction was made. The study uses multiple data sources which strength the accuracy and minimizes potential bias. In this process there was consistent data collection and combinations of findings from questionnaires, interviews and document analysis which makes the study more reliable.

3.6 Ethical Considerations

In this study Participation was voluntary, participants were informed about the purpose and scope of the study and were assured the information they provide will be used only for the research and would be treated confidentially also identifying information wasn't recorded or used for other purposes.

3.7 Conceptual Framework

These Four dimensions' influence loan performances and the management of non-performing loans also helped to guide the data collection process, analysis and interpretation of the findings in the study.



Credit risk assessment focuses on evaluating borrowers risk using criteria's such as Character, Capacity, Capital, Collateral and Condition. Credit administrationinvolves proper documentation, disbursement procedures and internal controls. Credit Monitoring refers to continuous review of borrower performance, repayment behavior after loan is disbursed. Compliance concerns about the alignment of all these processes with regulators such as National Bank of Ethiopia directives and requirements.

The effectiveness of credit risk management system also influenced by internal factors including staff capacity, information systems and policy implementation practices as well as external factors such as economic condition, inflation and sector specific risks. The outcomes of these factors are reflected through loan portfolio growth, nonperforming loan ratios and repayment

performance. These factors serve as a key criterion for assessing the effectiveness of credit risk management policies and practices at Awash Bank.

Chapter Four

Data Presentation, Analysis and Interpretation

4.1 Questionnaire Respondents

All of the information collected from fifty employees who have firsthand knowledge of how the bank handles credit also these respondents are closely involved in applying the credit policies and procedures of the bank. 84% of them were senior officers which show most of the feedback came from employees who involve in credit decision and risk management processes.

Tables 4.1 Demographic Characteristics of Respondents

Variable	Category	%
Gender	Male	56
	Female	44
Education level	Bachelor's degree	56
	Masters or above	44
Job level	Senior officers	84
	Mid-levels officers	16
Experience	2-5 years	6
	6-10 years	22

	More than 10 years	72

Demographic Characteristics of Respondents

The responses show that the study gathered information from employees who are well educated and in senior positions within the bank. This suggests that many of the respondents have developed a strong understanding of lending operations, borrower behavior, credit monitoring and risk management practices through years of professional experience. Therefore, their responses will provide useful insights into how credit risk management policies and practices are applied within the bank.

Table 4.2 CRM Awareness and Effectiveness

Variable	Category	%
CRM policy Awareness	Yes	84
	No	16
Policy effectiveness	Highly effective(5)	44
	Effective(4)	16
	Moderate(3)	4
	No response/other	36

Awareness and Effectiveness

The finding shows that most respondents were aware of the existence of the policy. This suggests that the policy is actively used to support lending and risk management activities within the bank.

At the same time, a notable number of respondents were unable to clearly evaluate the effectiveness of the policy even if the study was conducted on departments that are directly involved in credit operation & decision making. This may be because employees have different levels of involvement in policy implementation. However, this finding highlights the need for continuous communication, awareness creation and regular policy discussions across departments.

Table 4.3 Challenges Affecting Credit Risk Management and Credit Scoring

Variable	Category	%	Variable	Category	%
Key challenges in credit risk management	Economic factors	22	Use of credit scoring	Yes	60
	Lack of borrower info	6		No	20
	Poor collateral valuation	4		No response	20

Challenges Affecting Credit Risk Management

The findings suggest that Awash Bank faces several challenges that influence the effectiveness of its credit risk management activities. Respondents identified internal issues such as data quality limitations, weaknesses in monitoring processes and shortages of experienced staff as major concerns. Externally, respondents highlighted economic conditions and borrower related factors

as significant challenges which includes changes in economic performance, business disruptions and reduced borrower repayment capacity.

Use of credit scoring

Based on the finding credit scoring is used as part of credit assessment process, suggesting that lending decisions are supported by a structured approach to evaluating borrower risk. However, the differing views show that the application or awareness of credit scoring may not be fully consistent.

The results suggest that while credit scoring plays an important role in the bank's credit risk management framework, there is room to improve its uniform implementation and understanding throughout the organization.

Table 4.4 Credit Risk Monitoring and Loan review frequency

Variable	Category	%	Variable	Category	%
Loan review frequency	Monthly	4	Risk monitoring methods	Financial analysis	38
	Quarterly	56		Borrower visits	28
	Semi annually	22		Credit scoring	16

	Annually	6		Automated systems	10
	Not specified	12		Other specified	8

Credit Risk Monitoring

The responses show there is regular reviews of loan performance and the difference in the responses indicate there is lack of uniform knowledge between staff. Among the monitoring methods used by the bank, financial statement analysis and borrower visits were reported most frequently by respondents. This suggests that the bank depends heavily on historical methods which means technology based monitoring tools are not utilized as traditional methods.

As loan portfolios become larger depending on manual monitoring alone will limit the bank's ability to identify warning signs quickly. The results therefore suggest that the bank has a functioning monitoring framework however there is a need for advanced technology to improve the speed, accuracy and effectiveness of credit risk monitoring activities also the bank need to work on providing relevant training so there will be a uniform knowledge.

Table 4.5 Adequacy of Collateral Valuation & Challenges in Loan Recovery

Variable	Category	%
Adequacy of collateral valuation	Very adequate	24
	Adequate	36
	Moderately adequate	20
	Inadequate	10

	No response	10
Challenge in loan recovery	Ineffective monitoring	30
	Borrower insolvency	22
	Economic downturn	14
	Legal regulatory barriers	12
	Internal process delays	8
	Not specified other	14

Adequacy of Collateral Valuation

Most participants viewed the valuation process as satisfactory however the responses also indicate that there is room for improvement in ensuring consistency and reliability across the valuation process. The presence of respondents who expressed reservations about the adequacy of collateral valuation may show concerns regarding valuation accuracy, periodic reassessment, differences in implementation across lending units or knowledge gap.

Challenges in Loan Recovery

Many respondents pointed out challenges related to monitoring and borrower repayment capacity, suggesting that difficulties often arise when potential repayment problems are not identified and addressed at an early stage. The findings also suggest that economic conditions, legal processes and internal operational issues can affect recovery performance and these factors may delay recovery efforts and reduce the effectiveness of existing collection mechanisms.

Table 4.6 Early Warning Systems & Training Capacity

Variable	Category	%
EWS use for credit risk detection	Yes	56
	No	24
	Not sure/no response	20`
Training program rating	Excellent	18
	Good	48
	Fair	20
	Poor	6
	No response	8

Use of Early Warning Systems for Credit Risk Detection

The responses indicate that early warning mechanisms are recognized as part of the bank's credit risk management process however the differing views shows that awareness and application of these systems may not be consistent across all areas of the bank. Some employees appear to have limited exposure to these practices. These finding points to the need for integration and awareness of early warning mechanisms to ensure their benefits are fully utilized throughout the organization.

Training and Capacity

The findings generally show that investment in staff development remains important in the bank however the training outcomes are not perceived uniformly by all employees. Some participants expressed less favorable views suggesting that improvements may be needed in areas such as training frequency, content relevance or accessibility.

Table 4.7 Credit Risk Mitigation Practices

Variable	Category	%
Risk mitigation effectiveness	Very effective	28
	Effective	44
	Moderately effective	20
	Ineffective	6
	No response	2
Risk mitigation techniques	Collateral requirements	70
	Guarantees/ cosigners	16
	Credit insurance	6
	Loan covenants	4
	Other/not specified	4

Credit Risk Mitigation Practices

The findings show that collateral remains the primary credit risk mitigation tool used by Awash Bank. the bank's heavy dependence on collateral will exposeto valuation and liquidity risks especially during the periods of economic instability when the value of the collateral is reducing. Most respondents considered the existing mitigation measures to be effective in reducing credit

losses even if the current mitigation practices appear to be effective, expanding the use of other risk mitigation tools could strengthen the overall quality of the bank's credit portfolio.

Table 4.8 Credit Risk Policy and CRM

Variable	Category	%	Variable	Category	%
Policy update frequency	Annually	18	Impact of CRM on profitability	Very positive	32
	Every 3 years	50		Positive	44
	Every 2 years	22		Neutral	14
	More than 3 years	10		Negative	6
				Very negative	4

Frequency of Credit Risk Policy Updates

The responses show that Awash Bank reviews and updates its credit risk management policy periodically rather than on a frequent basis. Most respondents indicated that policy revisions are carried out after a number of years andthe differences in perceptions regarding how often policy updates occur. Such variations may reflect differences in employee's involvement in policy related activities or levels of awareness regarding policy revision processes. Based on the

continuous changes in economic conditions, regulatory requirements and risk exposures there may be a need for periodic policy reviews to ensure the credit risk management framework remains relevant and effective.

Impact of Credit Risk Management on Profitability

Based on the response, employees generally recognize sound risk management help reduce loan losses, improve asset quality and support sustainable profitability at the same time a small number of respondents expressed more neutral or less positive views, suggesting that some employees may be concerned about the costs, complexity or operational challenges associated with implementing risk management measures.

Table 4.9 Credit Risk Reporting and credit risk Policy Implementation

Variable	Category	%	Variable	Category	%
Frequency of risk reporting	Monthly	36	Implementation challenges	Lack of skilled personnel	26
	Quarterly	50		Resistance policy enforcement	18
	Semi annually	10		Inadequate training	14
	Annually	4		Poor coordination between units	12
				Other/not specified	8

Frequency of Credit Risk Reporting to Management

The responses show that credit risk information is reported to management on a regular basis. On The response there is a difference in reporting frequency which may affect the speed at which potential issues or risks are identified and addressed. More frequent reporting can improve responsiveness and create an opportunity for early action, while longer reporting intervals may delay corrective action and this shows there might be a need in maintaining timely and effective reporting systems to support proactive risk management.

Obstacles to credit risk Policy Implementation

Participants frequently pointed to issues related to staff capacity, policy enforcement and coordination. These findings imply that strengthening employee skills, supporting consistent policy implementation and improving coordination among departments could improve policy implementation which will help to ensure credit risk management policies achieve their intended objectives and contribute more effectively to risk control efforts.

Table 4.10 Use of Tech in credit Risk Monitoring& Challenges

Variable	Category	%
Tech use in credit risk monitoring	Limited use	30
	No use	20
Challenges in monitoring	Data quality issues	30
	Lack of real time info	24

	Inadequate staff training	20
	Limited IT infrastructure	16
	Coordination problem	10

Use of Tech in credit Risk Monitoring

Some participants believe that technological tools are supporting monitoring activities, others stated technology adoption is limited. This suggests that the bank is still in the process of integrating technology more into its credit risk management operations. As credit portfolio continuously increasing in the bank each year, technology can play a major role in supporting data analysis, early risk identification and decision making processes.

Challenges in Monitoring Credit Risk

Issues related to data quality, access to timely information, staff capability and technological limitations were frequently highlighted. these findings suggest that there is a need for continuous investment in data management, staff development and technological infrastructure. improving these areas will improve the quality of risk information available to management and support more effective monitoring of the credit portfolio.

4.2 Qualitative Analysis of Interview Data

Table 4.11 Interview participants

Position	Number of participants
Credit analysts	8
Senior credit follows up officers	6

senior/principal credit risk management officers	4
Senior portfolio management officers	2
Total	20

4.2.1 Credit Collection Challenges

One of the most common and critical issues pointed out was the difficulty in maintaining accurate and current contact information from borrowers also technical problems, relationship dynamics and behavioral factors has made the credit collection process more challenging. There is lack of up to date contact details of borrowers which makes it harder to follow up or communicate on time which will create a gap for loans to become nonperforming loans. Another issue is the poor relationship between some borrowers and the bank, making it difficult for staff to maintain open and honest discussions that are essential for resolving loan problems early.

4.2.2 Bad Debts

The bank uses two methods to manage bad debts, the first one is by offering loan rescheduling, refinancing, arrears capitalizationand by offering grace period it helps borrowers to get back on track and after trying many times to resolve the issue through letters and discussions if these methodsdon’twork the bank takes legal steps which involves taking back collateral, going to court or starting foreclosure procedures.

4.2.3 Credit Policy

Recently the Bank has made some changes to its credit policies because of new rules from the National Bank of Ethiopia and because of changes in the market which includes strict regulations for high risk borrowers, better systems to monitor loan quality and a shift in direction toward short term loans. These changes helped to improve the overall quality of loan portfolio and to reduce risk however interviewees stated there should be more work to monitor borrowers after they receive the loan also recommended real time data and behavior analysis.

4.2.4 Credit Risk Management

One of the key suggestion was to make credit policies flexible so that it quickly can adjust when the economy changes. They also advised to take immediate action when a loan starts showing signs of trouble, if needed legal steps should follow right away to recover the funds. All interviews agreed that following the rules set by the National Bank of Ethiopia is very important. They also emphasized the bank should strength its borrower monitoring practice and assessing thoroughly their past credit history. In addition, improving the bank's legal process, being careful on taking too much risk, setting the right loan prices and actively manage the loan portfolio was outlined by interviewees.

4.3 Findings from internal documents and five year annual reports

4.3.1 Financial and Credit Risk Performance for the Year 2019/20

Financial Performance

Awash Bank increased its total loans and advances to ETB 57.3 billion which is a 21.1% jump from the previous year. The Loan to Deposit Ratio was at 77.1% indicating the bank was actively lending but still kept enough cash to handle customer withdrawals. The bank kept its nonperforming loans ratio at just 1.1%, far below the 5% maximum allowed by regulators which signifies the lending and monitoring systems were effective. 587 million Birr was set aside as loan loss provisions that is 60.2% NPL coverage ratio, the bank was financially ready if more loans become nonperforming loans. In terms of profits, ROA was 2.9% and ROE was 21.6%. The bank made 2.59 billion Birr in net income, 77% of its total income came from interest of loans.

Loan Quality

In this period loan portfolio was stable because most of it were backed by collateral also borrowers were evaluated regularly. From the total loan amount 24%of it went to trade and services, 22% to construction and 19% to exports. Lending to exporter business helped the bank to manage its foreign currency issues also the loan disbursed to construction and trade helped to increase economic activity.

Challenges and Gaps

The bank did notused tools like stress testing or scenario analysis to see how its portfolio will perform in a stress which was a big gap in risk planning. The banks monitoring system was manual and did not have the tools to predict problems or risks early. There was lack of clear reporting which was another challenge and there was not a clear report on how loans were distributed across industries.

4.3.2 Financial and Credit Risk Performance for the year 2020/21

Financial Performance

In 2020/2021total loan portfolio increases from 57.3 billion Birr to 87.5 billion Birr and recorded 2.72% of Return on asset and 27.1% of Return on equity which shows there was effective management of assets and investors funds.

The Loan to deposit ratio was 81%there was healthy balance between lending and liquidity. NPL ratio was 2% indicates good loan quality and as a provision 1.72% of its total loans was set aside. The cost to income ratio was 60% suggesting there should be better management in managing cost. From the total earning 82.5% was interest income, the capital adequacy ratio was 12.5% which means the bank was financially stable and its prepared to absorb risks.

Loan quality

From the total loan amount, 91.9 % were classified as low risk (Stage 1), 6.3% had increased risk (Stage 2), while only 1.8% were considered risky or impaired (Stage 3). Provision held was 1.51 billion Birr and from this amount only 24% was for Stage 3 loans. The bank is working on strengthening its credit policy, expanding loan recovery teams and also pushed for more collateral backed loans which improved the recovery processes. The nonperforming loans ratio was 2%that implies there was strict credit control and improved loan quality. However, since 6.3% of loans had increased risk (Stage 2) and only limited provisions were made for Stage 3 loans, the bank needs to remain alert.

Challenges& Gaps

There still is a gap on setting limits on how much it could lend to specific sector or industries, did not use risk based pricing and instead of using forward looking models or tools it relies too much on past data.

4.3.3 Financial and Credit Risk Performance for the year 2021/22

Financial Performance

In this period the loan portfolio increased to 129.2 billion Birr and profit before tax was 7.45 billion Birr that means the bank controls and manages its expenses and earned a lot from its lending activities. More loans were granted also more liquid assets were held for safety that's why total asset increased to 183.4 billion Birr. The LDR increases to 85% indicting that the bank utilized a large portion of its deposits for lending; the NPL ratio was low at 1.2% showing that the bank maintained good loan quality and effective credit risk management and nonperforming loans coverage ratio was 196.3% presenting sufficient loan loss provision. ROA was 4.06% and ROE was 40.2%. There were investments in expanding and to upgrade technology which leads to cost to income ratio to increase to 62.8%.

Interest income still made up 76.5% of total income. CAR remains at 11.01%. The bank set aside 1.19 billion Birr in total provisions of which 606.3 million Birr was for Stage 3 loans it shows relatively low coverage for the riskiest loans. From total loan distributed 22.6% were for Domestic trade and services while construction decreases to 17.6%. The reallocation helped the

bank to spread risk and to protect earnings because some sectors were more vulnerable to market changes on that year.

Developments& Gaps

The financial reporting was in line with global standards in this year because the bank fully adopted IFRS nine; employees were trained on better loan assessment and worked closely with legal teams to recover bad debts also demanded stronger collateral from borrowers to protect its asset from defaults. There were no fixed limits for lending to specific industries still which can lead to overexposure and there were no fully developed tools to test how loans might perform under future economic stress.

4.3.4 Financial and Credit Risk Performance for the Year 2022/23

Financial Performance

Total loans grew to 161.95 billion birr a 25.4% increase from the previous year. Customer deposits also increase by 27.7%. The ROE was 29.5% and ROA was 3.1%. The LDR was 86%. Its capital adequacy ratio stood at 10.64%. The percentage of NPLs was 1.1%.

Loan quality

The share of Stage one loans those considered low risk was 96.18% which means most of the loans are performing well. Stage two loans that are riskier but not yet in default were 2.7%. Stage three loans those already considered bad loan were1.1% of the total loan amount. Awash bank increased its loan portfolio by 32.8 billion birr reaching a total of 161.95 billion birr. The largest

portions of loans went to trade and services (30%), construction (25%) and manufacturing (20%) respectively. Areas like agriculture and exports received much less attention.

Challenges& Gaps

In these year loan granted to just few industries, agriculture and export business received very less compared to other industries. There was delayed communication and also too much workload on credit staff, these were challenges.

4.3.5 Financial and Credit Risk Performance for the Year 2023/24

Financial Performance

Total loan reached to183.52 billion Birr, deposits increase to 232.44 billion Birr, total assets reached 282.41 billion Birr and Equity also increased to 38.1 billion Birr in this year. Paid up capital increase by 39% that improved the Bank's financial strength and revenues for the year totaled 36.58 billion Birr, most of the revenue earned from interest on loans. There was a reversal of 102 million Birr in provisions that means the bank is expecting to recover some previously doubtful loans. NPL was 1.25% also loan to deposit ratio was 79% which is below the NBE limit of 85%.

The bank was using its resources well because Return on asset was 3.14% and Return on equity was 23.26%. The CAR was above the minimum requirement, 12.86% which shows the Bank is financially strong. The Cost to Income Ratio increased to 70.4% this might be because of continuous spending on new branches and technology.

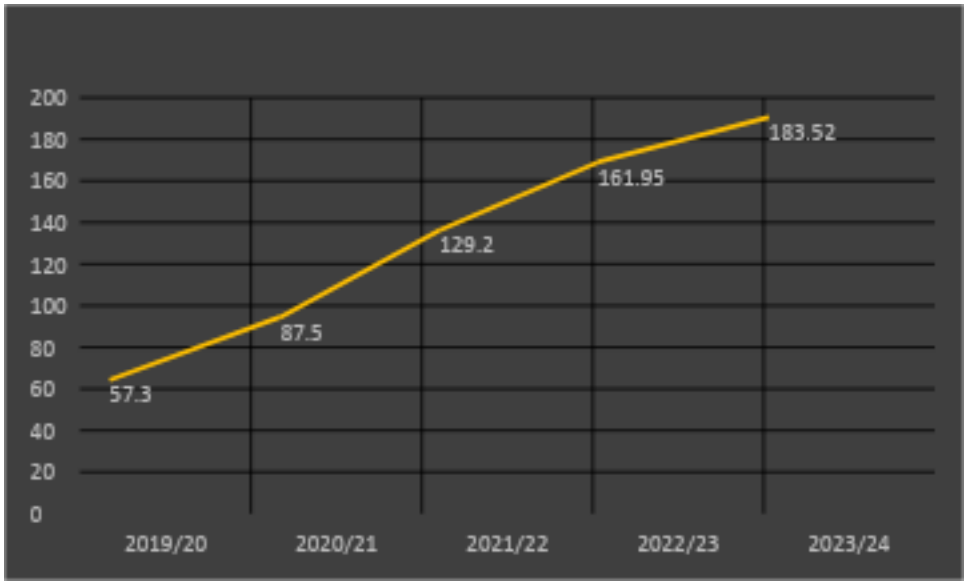
Credit Quality

91.4% of the loan were in stage one which means most of the granted loans were performingwell, from the total loan amount 6.8% were in stage two this could be because of inflation and foreign currency shortages and only 1.8% were in stage three. The bank was also focusing on business that bring foreign currencies, from the total loan amount 24.5% was given to trade and services, 16.6% to export and 16.4% to construction.

Challenges and Gaps

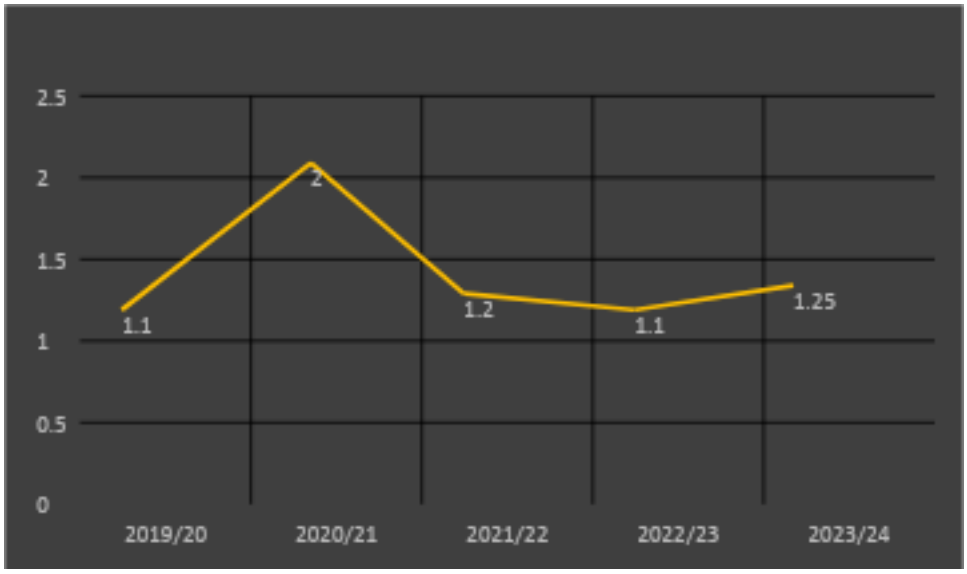
There is still a gapin restructuring distressed loans and using predictive tools to plan for potential defaults also only focusing on a few key sectors and risk monitoring systems still not fully being automated are the other gaps. In trade related sectors it become more difficult for borrowers to repay their loan because of inflation and shortage in foreign currency.

4.1Total Loan Growth Trend for the period covering from 2019/2020 to 2023/2024



The graph shows a continuous increase in Awash Bank's total loan portfolio over the study period. Total loans grew from 57.3 billion birr in 2019/20 to 183.52 billion birr in 2023/24 which shows substantial growth in lending activities. The most significant increase occurred between 2020/21 and 2021/22, when the loan portfolio increased from ETB 87.5 billion to ETB 129.2 billion.

4.2The Non-Performing Loan Ratio Trend for the period covering from 2019/2020 to 2023/2024

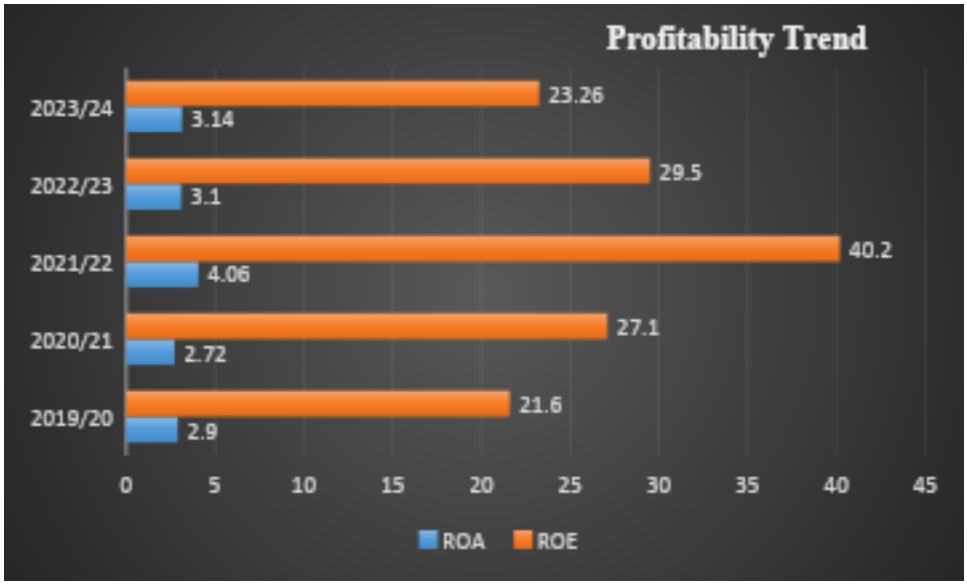


The graph presents the trend of the Non-Performing Loan ratio over the five-year period. The NPL ratio increased from 1.1% in 2019/20 to 2.0% in 2020/21, before declining to 1.2% in 2021/22 and 1.1% in 2022/23. It slightly increased to 1.25% in 2023/24.

The NPL ratio remained significantly below the National Bank of Ethiopia's maximum benchmark of 5% during this five years, indicating strong asset quality and effective management of credit risk. The temporary increase in 2020/21 may be associated with economic

disruptions and borrower repayment challenges. Overall, the stability of the NPL ratio despite substantial loan growth reflects the effectiveness of Awash Bank's credit appraisal, administration and monitoring practices.

4.3The Profitability Trend for the period covering from 2019/2020 to 2023/2024



The graph shows the trend of Return on Assets and Return on Equity from 2019/20 to 2023/24. ROA fluctuated between 2.72% and 4.06%, reaching its highest level in 2021/22. Similarly, ROE increased from 21.6% in 2019/20 to a peak of 40.2% in 2021/22 before gradually declining to 23.26% in 2023/24.

The high levels of both ROA and ROE indicate the Bank maintained strong profitability throughout the study period. The peak profitability observed in 2021/22 suggests efficient utilization of assets and shareholders' equity. Although profitability declined slightly after 2021/22, the ratios remained strong compared to industry standards. Therefore, the bank's ability

to sustain profitability while expanding its loan portfolio reflects the effectiveness of its risk management framework.

Chapter Five

Summary, Conclusions and Recommendation

5.1 Summary

The banking sector plays an important role in the country's economic development. Since credit covers a substantial portion of bank asset and serves as the primary source of income banks are highly exposed to credit risk. Ineffective management of credit not only affects the profitability of individual bank but can also undermine the country's financial system. Therefore, this study focuses on examining the credit risk management and practice of the leading private bank. This research assesses Awash Banks credit risk management focusing on its practices and the effectiveness of its policies. The study used a descriptive research design with both quantitative and qualitative methods. Data was collected from staff working directly in the credit appraisal and administration departments by distributing structured questionnaires and by conducting Interviews. Additional data were also gathered from the Bank's five years audited annual reports, internal policy documents and relevant directives from the National Bank of Ethiopia.

During this five years 'period (2019-2024), Ethiopia faced several economic challenges, includingCovid19, high inflation, foreign currency shortage and political instability. These conditions caused the economic environment to be unstable which affects negatively borrower's

behavior and increased credit risk. In 2019/2020, the bank had a loan portfolio with a low NPL rate of 1.7% which is below the industry average. Provisions set aside were used to cover over half of defaulted loans. However, the bank didn't yet use modern models to predict future loan problems which limit how well it could prepare for future risks. In 2020/21 the bank increased its loan portfolio by 53% but still managed to keep its NPL ratio at2%. Provision for bad loans increased significantly because of the uncertain economy. During this year Profitability also improved However, the bank's risk management tools were still basic. Instead of using more advanced and forward looking models the bank still relied heavily on past data.

In 2021/22, the bank kept improving with nonperforming loans declining to 1.2% and high provision was held. Loan growth and profitability remained strong. The bank was still slow to adopt new data driven risk management methods. In 2022/23 the non-performing loans ratio decline to 1.1% because most loans werehealthy and provisionalso decreased. loan growth slowed to 13.3%, loan to deposit ratio was 79% and NPL was 1.25% In 2023/24 alsothe bank reversed loan loss provisions by 102 million birr which will rise a question about its risk forecasts if it was accurate or not. Profit remained good but cost to income ratio increased because of investments in technology and branch upgrades. There is still a gap that needs improvement, in restructuring non-performing loans and in the use of predictive tools to plan for potential loan defaults or risks. The risk monitoring systems not being fully automated and relying on few sectors is another gap that the bank needs to improve.

From the information and responses collected from interviews and surveys, the study found that predicting potential losses or risks early is a problem because of lack of formal early warning

systems, lack of advanced risk models or sector specific risk limits. The bank lends most of the fund to a few sectors such as trade, construction, manufacturing and real estate which will be a risk if these sectors challenged. The bank has a formal credit risk procedure but still there are gaps in loan monitoring after disbursement, in the management of nonperforming loans and in the implementation of policy. The bank relies too much on collateral which means there is limited risk mitigation strategies. Incomplete borrower information, repayment difficulties because of social and economic problems and lack of trust from some borrowers was pointed out by employees as challenge.

Despite the challenges and gaps mixing loan restructuring with legal steps helped to protect itself from unnecessary risks while maintaining good customer relationship. The banks overall risk management culture was effective supported by staff and clear policies but still major gaps exist in the use of technology, staff training and operational systems.

5.2 Conclusions

Based on the information collected and analysis done on the annual reports, the bank controlled its defaulted loans, maintains good capital reserve and stays profitable for the five years' period from 2019 to 2024also its loan portfolio quality was generally high with 90% of loans performing well which indicates that its risk management practices was strong and comply with internal policies and regulatory rules. The bank was lending huge amount of fund to just a few sectors which could be risky also the early warning tools were not updated also incomplete

borrower information, limited use of technology and inadequate staff training affected the banks' ability to manage risk efficiently. Even if the bank has made changes in strengthening its risk management practices there is still a need for more improvements to increase efficiency, predictive ability and to reduce future credit risk exposure.

5.3 Recommendations

Awash bank should focus on improving its loan portfolio diversification strategy to reduce the possibility of substantial loss, by focusing more on less risky areas like farming and manufacturing and by creating opportunity for small businesses and startups to get credit will help to increase customer base and also to reduce high dependence on large borrowers.

The bank should use modern data based models that measure and predict loan problems more accurately and before time also should regularly conduct scenario analysis and stress tests to see how loans might perform during tough challenging economic situations or in future possible events.

Other than using centralized systems to gather accurate data the bank can consider other sources like utility payments or mobile money history to collect updated and complete information about customers. These methods can be used to collect reliable and accurate information on customers who don't have formal credit records and also regular update is necessary.

In order to make credit risk management processes quicker and accurate the bank must invest more on updated technologies continuously. Using updated technologies and software's will help to cut unnecessary steps that will save money, energy and time. Integrating with the best tech companies and using cloud systems could be the solution to solve this big gap.

All trainings given for employees should align with specific needs of each staff and department, it should be designed adequately otherwise it will be waste of time and money. Partnering with universities and professionals can be a good option to create relevant and strong training system in the bank.

Future Research

Credit risk is always changing, studying and doing research on how this risk connects with and affected by other types of risks such as liquidity, market and operational risk is worth exploring.

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Appendix

Questionnaire on Credit Risk Management and Loan Collection at Awash Bank.

Thank you for taking the time to complete this questionnaire. Your insights will help in understanding Awash Banks credit risk management, loan recovery challenges and improvements. Please answer all questions as accurately as possible.

1. What is your job title?

2. How many years have you worked in the banking sector?

Less than 2 years

2-5 years

6-10 years

More than 10 years

3. What is your role in credit risk management unit?

4. Does Awash Bank has a formal credit risk management policy?

Yes

No

Not sure

5. How frequently are the credit risk policies updated?

Annually

Every two years

When needed

Never updated

6. How effective do you think the bank's current credit risk policies are? (Rate from 1-5, 1 = Not Effective, 5 = Highly Effective)

7. What are the major challenges you face in managing credit risk? (Please explain)

Lack of borrower information

Poor collateral valuation

Weak monitoring system

External economic factors

Others:

8. Does the bank use any credit scoring models to assess borrowers?

   Yes

   No

   If yes, how effective are these models in predicting loan repayment ability?

9. What are the main challenges the bank faces in collecting loans from borrowers?

   Poor financial capacity of borrowers

   Lack of strict follow-up

   Inadequate collateral assessment

   Economic downturn

   Others:

10. How does the bank handle non-performing loans?

    Immediate legal action

    Loan restructuring

    Extended repayment period

    Others:

11. What is the most common cause of bad loans? (explain)

    Business failure of the borrower

    Poor credit risk assessment

    Lack of follow-up by the bank

    Others:

12. What should be done to improve loan recovery and to minimize risks?

    More careful borrower screening

    Financial education for customers

    Taking strong legal steps

    Flexible repayment options

    Others:

13. What should be done to balance loan profitability and risk?

    Stricter lending criteria

    Different loan products with flexible terms

    Closely monitoring loan performance

    Increasing interest rate to cover potential losses

14. What additional strategies should be implemented to improve credit risk management?
15. What improvements can be made to reduce bad debts?

Interview Questions

1. What do you think are the major challenges in credit collection?
2. What are the most common reasons why customers default?
3. How does the bank deal with bad debts and NPLs?
4. What specific strategies does the bank use to recover loans from defaulters?
5. Have the bank's credit policies changed in recent years to address credit risks? How?

6. How do you evaluate the effectiveness of the current credit risk policies?

7. In your opinion, how can Awash Bank balance loan profitability and risk minimization?