



**Addis Ababa University**  
**College of Business and Economics**  
**Accounting and Finance Department**

**AN ASSESSMENT OF CREDIT RISK MANAGEMENT PRACTICE:  
THE CASE OF ABAY BANK S.C**

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Under Guidance of ABEBAW K. (PhD)

MAY, 2024 G.C

ADDIS ABABA ETHIOPIA

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THE CASE OF Abay BANK S.C**

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**Under Guidance of ABEBAW K. (PhD)**

May, 2024 GC

Addis Ababa, Ethiopia

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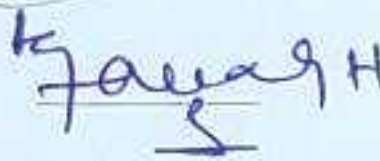
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## Statement of Declaration

I, WORKNEH LASHETEW, declare that this thesis work entitled “assessment of credit risk management practices: the case of Abay Bank S.C” is my own original work. I have carried out it independently with the guidance and suggestions of the research advisor. And it has not been presented in Addis Ababa University or any other University.

Declared by: - WORKNEH LASHETEW

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Date 03/07/2024

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## **Statement of Certification**

This is to certify that, WORKNEH LASHETEW carried out his research work on the topic entitled “ASSESMNET OF CREDIT RISK MANAGEMENT PRACTICE: THE CASE OF ABAY BANK S.C.” is original work and is suitable for submission for the award of Masters of Science degree in Accounting & Finance.

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## **Abstract**

*Credit risk is an essential factor that needs to be managed. Credit risk is the possibility that a borrower or counter party will fail to meet its obligations in accordance with agreed terms. Credit risk is one of the most vital risks for any commercial bank. Credit risk arises from non-performance by a borrower. Among the risks that face bank's credit risk is one of great concerns to bank authorities and banking regulators. This is because credit risk is that can easily and most likely prompts bank failure. Managing credit risk is not a simple task comprehensive consideration and practices are needed for identifying, granting, controlling and evaluating and monitoring credit risk. This research assesses the practice of credit risk management in Abay Bank S.C. Therefore, the main objective of undertaking this study is to assess the credit risk management practice of Abay Bank S.C. For the study primary data is used. Primary data is collected using questionnaire and interviews. Regarding to the nature of the study, the research design is descriptive and quantitative study approach is adopted to assess credit risk management practice of bank. The research found that, credit risk monitoring procedure is not reviewed and updated regularly, the bank's credit professionals do not conduct a formal meeting to discuss the customer's history and future plans and there is lack of adequate training to credit management staffs and there is lack of adequate staff in credit management department of the bank. Finally based on the findings of the study, the following recommendations are given. Credit monitoring procedure should be reviewed and updated on regular basis; the bank should be adequately staffed the credit management department and the bank should arrange short term and long-term training to update and enhance the employees understanding about credit risk management.*

*Key words; credit risks and credit management department*

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# ACRONYMS

A-Agree

CRA-Credit Risk Analysis

CRM-credit risk management

D-Disagree

EL-Expected loss

NBE-National bank of Ethiopia

N-Neutral

NPL-non performing loan

S.D-standard deviation

SA-Strongly Agree

SD-strongly Disagree

SMEs-small scale and medium enterprise

UL-Unexpected loss

## CHAPTER ONE

### 1. INTRODUCTION

#### 1.1. Background of the Study

A financial institution is the support of the financial sector of the economy, they provide financing to different groups, and different sectors in the economy namely, the contractors, real estate builders, traders, house-holds, and manufacturers. These credits will be used to reinvest in businesses for which the owners expect to earn a return. At the same time, lenders or financial intermediaries supply credit to earn a return when these companies borrow. This process of extending credit has a multiplier effect on the global money supply, so this is why credit is a powerful driver of our backward economy. This transformation from the supply to demand side is not without risk (Yaw, 2015).

Banks are established with the objective of providing various services to their clients; among the services credit facility took the lion's share in most banks. It is argued that the granting of credit remains the central and the vital role played by banks in any economy. The credit related function of banks is associated to inherent risks including borrowers' outright default, unwillingness or inability to meet credit commitment due to the vagaries of business activities or other environmental dynamics (Bidaniet. al., 2004).

Credit is that it is originated from the Latin word "Credo" which means "I believe". Credit is a matter of faith in the person and no less than in the security offered. Credit is purchasing power not derived from income, but by financial institutions either as an offset to idle by depositors in the banks, or as a net addition to the total amount of purchasing power. In fact, no economy can function without credit; all economic transactions are settled by means of credit instruments today. It is the very life blood of modern business and commercial system (Cole, 2000).

Credit creation is a major source of income for banks. Maximum bank loan and the most obvious source of credit risk. Credit risk continues to be dominant cause problems for the bank and can seriously jeopardize the smooth functioning of the bank work. Banks and their supervisors can therefore learn useful lessons from the past experience. Among the risks faced by banks, credit

risk is a major concern for most banks authorities and banking supervision. This is because credit risk is the easiest and most exposed risk likely to lead to bank failure (Conford A., 2000).

This high dependence on credit creation process and the availability of huge demand on credit exposes banks to different risks associated with such facility. Hence, credit risk management is needed for the success of any bank. Credit risk management (CRM) in a financial institution starts with the establishment of sound lending principles and an efficient framework for managing the risk. The goal of credit risk management is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters (Basel I, 2000).

Among the core activities of Banks, credit provision is one of their central businesses. Although credit creation is the main income generating activity for the banks, this activity involves huge risks to both the lender and the borrower. The risk of a trading partner not fulfilling his or her obligation as per the contract on due date or anytime thereafter can greatly jeopardize the smooth functioning of a bank's business (Pasha & Bayush, 2017).

On other side, this credit business operation of the bank is also the main cause for credit risk which is the probability that some of bank's assets, especially its loans, will decline in value and possibly become worthless. Among the risk that face banks" credit risk is one of the main concerns to most bank's stake holders and banking regulators. This is because credit risk is the risk that can easily and most likely prompts bank failure (Suresh & Paul, 2010). Since exposure to credit risk remains to be the main cause of problems in banks and can greatly put at risk the smooth operation of a bank's business, banks and their managements should be able to take useful lessons and give more attention to manage this risk properly.

Credit risk is one of the most significant risks that banks face, considering that granting credit is one of the main sources of income in commercial banks. Therefore, the management of the risk related to that credit affects the profitability of the bank (Li and Zou, 2014).

Credit risk is one of significant risks of banks by the nature of their activities. Through effective management of credit risk exposure banks not only support the viability and profitability of their own business but also contribute to systemic stability and to an efficient allocation of capital in the economy (Psillaki, Tsolas and Margaritis, 2010 P.873).

Thus, management of credit risk is very important and central to the health of a bank and indeed the entire financial system. So that banks or financial institutions shall assess the investments and loans that the company is committing to it. Based on this the credit manager must think long-term and look critically at the soundness of each investment and loan as the company's financial health depends on safe, profitable investments. Moreover, these credit managers not only look at the business's loans, they must also review and determine the soundness of the credit the company is extending to customers. (Upadhaya, 2009)

Therefore, appropriate credit management practices help the banks to ensure selection of right type of loan or proposals and right type of borrower. For selecting the borrower security should not be the only thing to be relied upon. So, responsibilities of the bankers to investigate the client from different point of view. For instance, the strength and weakness of the clients that the client will be able to repay the bank loan as repayment schedule, loan approval, monitoring, and recovery of non-performing loans. To prevent future financial crises, it is absolutely necessary to manage credit so as improve the borrowers' financial literacy, the lenders'

The effective credit management practices give banks choice the right kind of loan proposal /project /venture /business and the right kind of borrower. Ensuring adequate protection is one of the most important aspects of the credit approval process. However, protection is not the only consideration. Banking Professional Responsibilities analyze remains one of the main themes. Lending Principle Similar to Borrower Principle liquidity and integrity allow lenders to assess whether customers can repay favorable bank loans as per negotiated terms and repayments time schedule. In order to improve the financial literacy of borrowers, it is important to control credit lender transaction process to prevent potential financial crisis. (Mekonnen, S.2018)

Effective management of credit risk is inextricable linked to the development of banking technology, which will enable to increase the speed of decision making and simultaneously reduce the cost of controlling credit risk. This requires a complete base of partners and contractors (Lapteva, 2009).

Loans are the most important product that banks sell to their customers and are their credit accounts majority of the bank's annual turnover. It's also true that bank loans are just as profitable as they are profitable risky For example, bank loans are volatile and subject to economic policy and economic changes general economy. It is therefore important for banks to

formulate their lending policies in this way associated risks are mitigated; additionally, banks benefit greatly from sound. Comprehensive credit process and credit policy. This allows authorities to handle credit issues ensure consistency, prevent misunderstandings, and facilitate the credit process. Sound politics leads to lending transparency (Jimenez, Ongena, Peydró, & Saurina, 2012)

The main use of Credit risk management is a structured approach to managing uncertainties through risk assessment, developing strategies to manage it, and mitigation of risk using managerial resources. The strategies include transferring to another party, avoiding the risk, reducing the negative effects of the risk, and accepting some or all of the consequences of a particular risk (Greuning and Iqbal, 2007).

The essential objective of credit management can be pronounced as protected guarding of the client's risk and advancement of operational money flow. Nevertheless, effectiveness in performing each step of the credit process using different parameters has a significant effect on the performance of its management. The study assesses the credit risk management practice in Abay Bank S.C.

## 1.2. Statement of the Problem

Studies indicate that a Bank's continuing profitability and its financial stability majorly depends on sound credit management whereas deteriorating credit quality is the most frequent cause of poor financial performance (Das & Das, 2007; Kessey, 2015; Lalon, 2015). Exposure to credit risk continues to be the leading source of problems in banks world-wide. As a result, Banks need to have useful evidence-based information from prior experience and empirical studies. They should have a deep awareness of the need to identify, measure, monitor and control credit risk as well as to determine that they hold adequate capital against these risks and that they are adequately compensated for risks incurred (Kessey, 2015)

The banking business is more sensitive due to more of their income (revenue) will be generated from credit (loan) given to their customers (Colquitt. 2007). This credit business operation exposes the banks to high credit risk which leads to loss. Hence, without effective credit risk management good bank performance or profit will be unthinkable.

Accordingly, the development and establishment of a system for credit risk management is extremely important from the viewpoint of ensuring the soundness and appropriateness of a financial institutions business. Based on this, the institutions management is charged with and responsible for taking the initiative in developing and establishing such a system (Solomon, 2013).

Banks are generally thought to have credit, markets, liquidity, operations and compliance (legal) regulatory and reputation risks known to be adversely affected by credit risk profitability and growth. The success of most commercial banks therefore rests on their track record in credit management to justify risk to an acceptable level (Hagos, 2010). Remember that the importance of credit management cannot be overstated and maintaining a good credit history management requires talented people and a solid credit rating Policies and Procedures. If the credit is properly managed it increases bank profitability and future sustainability. But if this doesn't happen, this poses the biggest threat to banks survival (Koch&MacDonald, 2003 and Singh, 2013).

Credit risk management practices is an issue of concern in financial institutions today and there is need to develop improved processes and systems to deliver better visibility into future performance. According to Fikadu Zerga (2016), indicated that it is important for profitability of the bank. Bank's credit risk policy and strategy are not renewed on time, there's no procedure in place to detect criminally motivated borrowers, the bank's internal risk rating system isn't applied to the entire portfolio, and the existence of collateral is not checked on a regular basis. The bank should regularly review its credit risk management strategy and policy, implement procedures to identify borrowers linked to crime, and change its Management Information System to provide enough data for decision makers.

The negative impact of credit risk to business profitability may be evident that the more commercial banks expose themselves to credit risk, the more accumulation of Non-Performed Loans (NPL), implying that these loan losses have produced lower returns to the bank. The accumulation of NPL caused by lack of proper credit risk management practices would have substantial adverse impact on the performance of the banks in particular and the overall economy in general (Sallemicahel, 2009).

Regarding to Abay Bank, Non-performed Loan (NPL) position of the bank was 3.77% in the year 2021/22 (Annual Report of Abay Bank 2021/22) and even if that is not exceeding the

standard limit of National Bank of Ethiopia (which is 5%), it is higher than Non-performed Loan (NPL) position of other competitive private banks of Ethiopia such as Awash Bank and Zemen Bank which is less than 2% (Annual report of Awash and Zemen Bank, 2021/22).

Accordingly, due to the NPL of the bank and lack of studies conducted mainly to identify the problems related to credit risk management practice of Abay Bank, the researcher felt it appropriately to take up the present research entitled “Assessment of credit risk management practice at Abay Bank” to examine the credit management problems and thereby to recommend the necessary course of action to improve the credit risk management practice of the bank. Therefore, the main concern of this study is to learn to what extent Abay Bank can manage its credit risks, and to what extent its existing performance is supported by proper credit risk management techniques

### **1.3. Research Questions**

This study was intend to answer the following questions

1. How the bank identifies credit risks?
2. What kind of process is applied by the bank to grant the loan?
3. What kind of practices is used by the bank for credit risk evaluation and monitoring?
4. Has the bank ensured adequate control over credit risk?

### **1.4. Object of the study**

The general objective of this study was to assess the practice of credit risk management practice at Abay Bank Share Company.

#### **1.4.1. Specific objective**

The specific objectives of the study are the following:-

1. To assess credit risk identification practice of the bank.
2. To assess loan granting process of the bank.
3. To assess the credit risk evaluation and monitoring process of the bank.

4. To assess the credit risk controlling practice of the bank.

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

This research would be significant to diagnose the existing credit risk management practice of the bank. Thus, the bank might reconsider and improve the existing credit risk management practice based on the recommendations given to the problems. It could also have practical relevance to the Ethiopian banks by providing data to a policy environment for the credit risk management operation of banks in the economy. Thus, it would also be a valuable lesson for the banking sector of Ethiopia.

Finally, the study could also contribute to the existing body of knowledge regarding the credit risk management and can serve as an insight or input for further research on the area.

### **1.6. Scope of the Study**

It is known that Abay bank is distributed throughout the country but it is very difficult to cover all branches in Ethiopia due to various reasons such as financial and time constraint. But there is no difference in credit risk management practice between branches and head office. The scope of the research covers on the credit risk management practice of Abay Bank at head office level. This is because, most of the bank's loan processing and lending function is done at head office level centrally and what happens at the head office is a good measure of what happens at the bank wide level. The focus of the research is assessment of credit risk management practice of Abay Bank and the researcher mainly focuses on credit analysis & appraisal department, credit follow up & management department, credit risk management department and related area at head office in order to gather relevant information about the area of study. Based on this, it has dealt only with the credit risk identification, measurement, loan granting process, credit risk evaluation, monitoring practice that are being employed by the bank to manage such risk. Methodologically the study is delimited to the questionnaire and interview thinking that the information obtained through the employment of those tools will enable to safely generalize the conclusions.

## **1.7. Organization of the Study**

The study organized into five chapters. The first chapter introduces the background of the study, statement of the problem, the research questions and objectives, scope of the study, limitation of the study, significance of the study, and organization of the study. The second chapter presents theoretical and empirical review of the related literatures. The third chapter deals with methodology of the study. The fourth chapter is concerned with data analysis and interpretation. The last chapter presents the conclusion and recommendations illustrate from findings of the data.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2. INTRODUCTION**

The purpose of this chapter is to provide & discuss the framework of both theoretical and empirical issues that can be integrated to the process of credit risk management practices in financial institution. The major activities of the banking industry are to mobilize deposit and channel them to the economy in the form of loans. The loan is the core activity and also the primary source of income to commercial banks.

#### **2.1. Theoretical Literature**

##### **2.1.1. Definitions of Credit Management**

Credit is derived from a Latin word “credere” meaning trust. When a seller transfers his wealth to a buyer who has agreed to pay later, there is a clear implication of trust that payment will be made at agreed date. Major causes of serious banking problems are directly related to lax credit

standards for borrowers. Poor portfolio assessment or lacks of attention to changes in economic circumstances are common in emerging economies Hirtel and Lopez, (1999).

Credit management is a dynamic field where a certain standard of long-range planning is needed to distribute the fund in various field and to minimize the risk and maximizing the return on the invested fund. (Rana Al Mashruf, 2013). It is also the means to make certain that customers will pay for the products delivered or the services rendered. According to Myers and Brealey (2003) it is made up of techniques and strategies used by an enterprise to ensure that an optimal level of credit and its effective management are kept.

Credit management is the strategies one uses to collect and control credit payments from clients. Myers and Berkley (2013), describe credit management as methods and strategies adopted by a firm to ensure that they maintain an optimal level of credit and its effective management. Nelson (2012) defines credit management as the practices used by an organization to manage the sales they make on credit. It is an essential practice for all the organizations that have credit transactions since some have managed their credit activities so well that they have zero credit risk.

Beasens and Gestel (2009) defines credit risk as the risk that a borrower fails to pay and does not act according to their obligation to service debt. They state that the causes for the failure to pay could be incapability of the other party to pay or failure to pay on the due date. Besides they mentioned that by its character credit risk is the most apparent risk of a bank. In addition to this the writers characterized credit risk by ways of three aspect the first one is default risk is the possibility that payment is not issued at least within three month this delay will happen due to Counterparts with a weak financial situation, high debt burden, low and unstable income have a higher default probability, sector information and management quality. The second aspect is loss risk or loss given default (LGD) which is a fraction of exposure in the case of failure to pay and exposure risk is ambiguity on the accurate amount at risk at the very instant of a future default.

Asiedu-Mante (2011) explained credit management involves establishing formal legitimate procedures and policies that will ensure that the proper authorities grant credit, the credit goes to right people; the credit is given for the productive activities or for businesses which are economically and technically viable. The proper amount of credit is given, the credit is

recoverable and there is adequate flow of management information within the organization to monitor the credit activity.

### **2.1.2. Credit Management Process**

The credit process relies on each bank's systems and controls to allow management and credit officers to evaluate risk and return exchange. Credit management process of a bank is very essential in order to capture the framework of the bad loans management. Weak credit risk management systems also can be sources of problem loans (Nishimura and al, 2001). The process of credit management begins with assessing the accurately credit-value of the customer base and their business viability.

As part of the evaluation process, credit management also calls for determining the total credit line that will be extended to a given customer. Several factors are used as part of the credit management process to evaluate and qualify a customer for the receipt of some form of commercial credit. This includes gathering data on the potential customer's current financial condition, including the current credit track record that discloses the character of a customer in meeting obligations as well as collateral value. As a result the writer discusses the different procedures that can be employed in each of these areas with the sole aim of examining the present loan management procedure of financial institution mainly bank. A weak credit risk management system is the reason for many non-performing loans (Nishimura and al, 2001).

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

#### **2.1.2.1. Credit Application**

The credit application is the primary step in the credit management process. Regardless of the size and purpose of the loan a loan application is required. Though it may appear as simple questions to the applicants they should understand the importance of the document. The application documents contain detail information about the applicant. The information among other things include: name of the applicant, address, residential address, age, telephone number, marital status, number of dependents, educational background, hometown, the type of business,

business location ,number of years in business, reasons for the loan, amount required, the repayment period, security pledge if any and guarantors. It is the content of this document which financial institutions can take any legal action against a borrower who defaults. Since this is the initial stage of the credit management process any error committed at this stage goes a long way to negatively affect the whole process. (Abdou, H.A., & Pointon, J., 2011)

#### 2.1.2.2. Credit Assessment

Credit assessment is carefully done by the financial institutions before providing any loans to make sure the capability of the proposed project to undertaken. This also helps to look at the technical viability, the economic viability and therefore the financial viability of the project to be undertaken. The risk associated with the loan can be reduced by doing the above Appropriate assessment of a customer determines the financial situation and also helps to measure capability of the customer to repay the loan when due. This involves the authentication of primary and collateral security provided by the customer which can be relied on when the repayment of the loan becomes difficult. This is a sign that if the credit assessment isn't properly done by the depository financial institution, the danger related to the credit won't be identified. Hunte (1996) also realized that customers with loan experience showed the capability to manage the loans better hence good quality borrowers for the financial institution.

This is the system for collecting the important records on a capability borrower and initiatives in deferent to behavior risk evaluation workout to decide the related risk. This is cautiously carried out through the monetary establishments earlier than supply any loans. This is likewise executed to check the viability of the proposed task to be undertaken. This as properly allows to have looked at the technical viability, the monetary viability and the monetary viability of the undertaking to be undertaken. The risk related to the mortgage may be decreased through doing the above. Credit risk simply means the risk of default as a result of a borrowers' failure to repay the loan taken from a financial institution. Appropriate evaluation of a client determines the monetary state of affairs and additionally enables to degree functionality of the client to pay off the mortgage while due. This includes the authentication of number one and collateral protection supplied via way of means of the patron for you to be trusted whilst the compensation of the mortgage turn in to difficult. This is an essential factor in the credit score procedure. It is stated to be the pulse of a wholesome credit portfolio. This includes collecting, analyzing and

processing data as furnished with the aid using the applicant on the credit software form. This enables to examine the applicants' credit worthiness and enables to lessen the problem among debtors as a retailers and the monetary organization because the principal. The lending organization loans control techniques procedures and directives control the mortgage assessment procedures. The query that need to be spoke back earlier than whatever else is whether or now no longer the debtors have the economic ability to pay off the mortgage, that is, pay off the credit while due with the appropriate interest rate. The factors underlying the evaluation of a borrower should be based on the credit assessment principles of the financial institution which is the basic principles of lending which is also used by the financial institution , it is also known as the 5 C's which is Character, Capacity, Capital, Collateral and Conditions (Matovu and Okumu,1996).

#### 2.1.2.3. Credit disbursement

Credit disbursement is the act of giving or paying out money to customers who have been accessed and approved to be given credit. Disbursement ensures that cash is formed available to the customer in any case assessment has been done and approval has been given. If the loan pay-out control isn't strong, the reliability of the loan management process will greatly be affected and may be undermined and misused by the unscrupulous staff of the organization. Thus, documentations and pay-out of the loans are vital within the management of loans because they make sure that the financial institution has the proper documentation, collateral and guarantees of the loan agreement. That is Insurance, signing loan contract, registration of the property/collateral the bank being primary owner. This is the pre -disbursement requirement by bank. These are significant in the case of the customers fail to pay because the financial institution would be suitably secured and have legal backing to ensure the retrieval of the loan (Hassan, K., 2002).

#### 2.1.3. Credit Monitoring

Credit Monitoring is an integral part of lending activity. Financial institutions have a great responsibility to maintain the quality of the assets and to recover the interest and principal due in time. Though adequate precautions are taken during assessment and approval of a loan, a financial institution has to be more vigilant. Unless early warning signals are captured, a financial institution may not be able to take proper remedial measures to arrest and reduce bad debt in the institution. A financial institution needs to put in place a very sound and effective

credit monitoring system for watching the borrower's account from various angles for prompt action. In line with Robinson (1962) and Anjichi (1994), many of the agonies, frustrations and distress financial institutions can be reduced by good credit monitoring and follow up process. A good supervision helps maintain a good loan. It may be by visiting the borrowers' places of business to examine the general state of affairs. Insufficient maintenance is often an early sign of financial distress. Monitoring of loan facilities given to clients is an important task in ensuring that the project from which repayment will be made is successful. Huppi and Feder (1990) revealed that efficient monitoring leads to high retrieval of loans by revealing likely dangers (like loan diversion) and reminding defaulters of their responsibilities towards the lending institution ,thus calling for redoubling of efforts in the direction of loan repayments. Monitoring of credit facilities has been directed characteristically on ensuring repayment when there are signs of default for repayment of interest and principal installments.

#### 2.1.3.1. Credit Recovery /work out process/

It is undeniable fact that any institution in the business of lending is likely to meet customers who will default in payment or will fail to pay at all. This is why the institutions create provision for bad and doubtful debt in their books to take care of these eventualities. When despite every attempt by the lender to reach amicable arrangement for repayment and no agreement has been possible it will be necessary to treat the loan as a recovery matter. This is especially prominent in the financial institutions especially where the institutions provide services which are continuous but not one time. Loan recovery is the collection of a loan amount from a customer in default. In simple terms, loan recovery refers to the pay back of the principal loan amount together with interest. Financial institutions need to be aware of loans that are at risk of not being paid back (also known as non-performing loan). Collections department of the bank will begin contacting the individual loan defaulter's. They must notify them of the amount owed and any interest accrued. The financial institutions may also contact any guarantor of the loan if it is a secured loan, the institution may go through the laid down legal process to take over the asset. (Odonkor, A.A, 2018)

#### **2.1.4. Credit Risk**

Credit risk is most simply defined as the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms. The goal of credit risk management is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Banks should also consider the relationships between credit risk and other risks. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization (Basel Committee documents, 2000).

Credit risks appear in banking institutions because of the uncertainties plaguing the financial system. The uncertainties remain a major challenge in the country. Still, the major approaches applied by the banks are the continuing efforts on research and close monitoring. Banks believe that the research and monitoring are the key sources of uncertainties like data generating institutions and the treasury (Uchendu, 2009). The market structure is important in banking for it influences the competitiveness of the banking system and companies' access to funding or credit investment. The economic growth affects the structure and development of the banking system. In addition, the vast knowledge in risk assessment and managerial approach is recognized as part of the development. Moreover, because the banks and the processes are highly regulated, it became very useful in assessing the effects or impact of the credit risk management in the banks and even in other financial sources (Gonzalez, 2009).

Credit risk is the risk of a loss resulting from the debtor's failure to meet its obligations to the Bank in full when due under the terms agreed (Raghavan, 2003).

Credit risk has the highest weight among risks taken by the Bank in the course of its banking activities. Credit risk management in the Bank is carried out using the following main procedures: these procedures are putting in place limits for operations to limit credit risk; putting in place indicative limits for credit risk concentration and the share of unsecured loan portfolio; creation of security for credit operations; setting value conditions for operations with respect to payment for risks taken; permanent monitoring of risks taken and preparation of management reporting for the credit committee, the bank's management and units concerned; evaluation of regulatory and economic capital necessary to cover the risks taken in respect of the Bank's

operations and ensuring its sufficiency; carrying out hedging operations; Permanent internal control over the Bank's units in respect of observing regulations on operations procedure and risk assessment and management by independent units.

The Bank's risk management envisages: Applying systematic approach to overall Bank's loan portfolio risk management and separate operations with certain borrowers/counterparties (group of related borrowers/counterparties); Applying unified methodology for identification and quantitative assessment of credit risk which is adequate to the nature and scale of the Bank's operations; and Balanced combination of centralized and decentralized decision-making in respect of operations related to taking credit risk.

“Loan is the thing that is lent, specially a sum of money, the action 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 a debt, an obligation to repay the borrowed money plus interest” (Thomson, s Dictionary of Banking)

Banks grant 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 so. This results in non-performing loans (NPL). Non-performing loans are those loans which are past their due dates. According (Williams, 1998) to they are classified into three categories as shown below:

- 1. Sub-Standard:-** Non-performing loans or advances past due 90 days or more but less than 180 days shall at minimum be classified sub-standard.
- 2. Doubtful: -** Non-performing loans or advances past due 180 days or more but less than 360 days will be referred as doubtful.
- 3. Loss: -** Non-performing loans or advances past due 360 days or more will be classified as loss.

#### 2.1.4.1. Sources of credit risk

The main sources of credit risk include, limited institutional capacity, inappropriate credit policies, volatile interest rates, poor management, inappropriate laws, low capital and liquidity levels, directed lending, massive licensing of banks, Poor loan underwriting, lack of credit assessment, poor lending practices, government intervention, and insufficient control by central

bank (Coyle, 2000). To minimize these risks, it is necessary for the financial system to have well-capitalized banks, service to a wide range of customers, sharing of information about borrowers, stabilization of interest rates, reduction in non-performing loans, increased bank deposits and increased credit extended to borrowers. Loan defaults and nonperforming loans need to be reduced (Laker, 2007).

Credit risk is mostly inherent in assets on the balance sheet, but it can also be found in a number of off-balance-sheet liabilities.

Poor project supervision, evaluation, and management, as well as late loan disbursement, diversion of money, and loan beneficiary dishonesty, are all reasons of loan default, according to Okorie (1998). Another cause of credit risk is a lack of competent supervision, which occurs when financial institutions' boards or management are unable to control multiple divisions to check that they are appropriately adhering with policy. In today's unpredictable economy, all banks face a wide range of risks that could affect their survival and profitability. To put it another way, banking is a risky business. As a result, effective risk management is vitally necessary. In the financial sector, risk management is more crucial than in other areas of the economy. The goal of a financial institution is to generate income and provide the maximum value to shareholders by providing a wide range of financial services, particularly risk management. The primary goal of a financial middleman is to generate commissions or interest (Carey, 2001).

### **2.1.5. Credit Risk Management**

The fundamental objective of the bank management is to maximize shareholders wealth. This goal is interpreted to mean maximizing the market value of the firm's ordinary shares. Wealth maximization in turn requires that managers evaluate the present value of cash flows under uncertainty with larger near-term cash flows proffered when evaluated on a risk adjusted basis. To obtain higher yields on returns, a bank must either take an increased risk or lower operating costs. Thus managers must evaluate and balance the tradeoffs between the opportunity for higher returns, the probability of not realizing those returns, and the possibility that the bank might fail (Koch & MacDonald, 2006).

There are many definitions given for credit management by different scholars. Among these some are here cited as follows:

Credit management is defined as the efficient control and co-ordination of loan able funds so as to keep credit and the investment in credit at optimal level (Hempel, 1994). Credit management is a term used to identify accounting functions usually conducted under the umbrella of Accounts Receivables (Wise-geek, 2012).

Credit Management, from a debtor's point of view, is managing finances especially debts so as not to have a tail of creditors lurking behind your back. Credit management is a responsibility that both the debtor and the creditor should seriously take (Hagos, 2010). When it functions efficiently, credit management serves as an excellent instrument for the business to remain financially stable (Tekeste, 2016).

The significance of credit management has been highlighted by Mensha (1999) as follows: "credit management process deserves special emphasis since appropriate credit management greatly influences the success or failure of financial institutions". Knowledge of a bank's credit risk management process offers a key indicator of the quality of a bank's loan portfolio.

The crucial elements of successful credit management therefore are well developed credit policies and procedures; strong portfolio management; effective credit controls and the most central of all a well-qualified staff capable of implementing the system (Endeshaw, 2018).

#### **2.1.6. Credit Risk management practice**

Banks have diverse credit risk management regulations, methodologies those are differ from one financial institution to the next, even if they are exposed to the same risk. The practices differ based on the principles and beliefs that have been established earlier. Some or all banks may choose to use hedging methods or insurance to impact their profits and/or reduce the costs of changes, but the way they do so will differ. Another gap can be found in the area of risk tolerance. Each bank has its own level of risk that it can then choose to accept or reject based on the terms of its risk management plan. Depending on the nature or complexities of their credit, banks may have different risk management practices. To summarize this, it is clear that the same industry, but the implementation in practice differs. Practices are not consistent with theory. In

most cases because of data limitation for most industries, it is difficult to describe which firm's manage more risk than others or whether firms engage in dynamic risk management strategies and more importantly it cannot be reliably tested whether a firm's risk management practices conform to existing theories (Tufano 2006).

### **2.1.7. Credit risk management strategies**

A strategy means a way to go about an activity. Thus, banks have their own strategies to attain their desired goals in the same or different way. The idea to go about a particular activity can exist to the knowledge of the bankers but the strategy of how to implement so that desired goals can be attained and/ or to make difference will be different for each bank or company. Given the competitive environment in which banks operate, it is always good to have strategy position of how to manage its credit risk that will make or show its difference from its competitors. A strategy positioning means performing different activities from rivals or performing similar activities in different ways –a company can outperform its rivals only if it can establish a difference that it can preserve choosing to perform activates differently than rivals do. When a bank carries out its operational activities which are same activities carried out by other banks, they should try to a make difference from their rivals by not only trying to be more efficient but by trying to make difference in effective way. this can be done by performing different activities from the rivals or performing the same activities in a different way for example: although specific risk management practices may differ among banks depending on the nature or complexities of their credit risk activities, a bank which will want to show a difference will use a comprehensive credit risk management strategy like the others by addressing and keeping a proper credit risk environment, operating under a good credit giving process, and keeping a proper credit risk environment in connection with improved techniques in asset quality assessment, allocation and reserving adequacy, and credit risk disclosure (Porter 2016).

The strategies used by financial institutions to avoid or decrease the unpleasant result of credit risk. A well-planned credit risk management structure is vital for institutions to enhance profitability, guarantee & survival. The strategies for credit risk include but not limited to the following:

**Credit Derivative:** This provides banks with an approach which does not require them to adjust their loan portfolio. The commonest sort of credit derivative is credit default swap whereby a seller agrees to shift the credit risk of a loan to the protection buyer. Recent inventions in credit derivative markets have improved lenders' abilities to transfer credit risk to other institutions while maintaining relationship with borrowers (Marsh, 2008).

**Credit Securitization:** it's the transfer of credit risk to insurance company and this relieves the bank from monitoring the borrower and fear of the hazardous effect of classified assets. This approach insures the lending activity of banks. Those banks typically use the instrument of securitization to diversify concentrated credit risk exposures and to explore an alternate source of funding by realizing regulatory arbitrage and liquidity improvements when selling securitization transactions (Michalak and Uhde, 2009).

**Compliance to Basel Accord:** The Basel Accord is international principles and regulations guiding the operations of banks to make sure soundness and stability. Compliance with the Accord means having the ability to spot, generate, track and report on risk-related data in an integrated manner with full audit ability and transparency and creates the opportunity to enhance the danger management processes of banks. The New Basel Capital Accord places explicitly the duty on banks to adopt sound internal credit risk management practices to assess their capital adequacy requirements (Chen and Pan, 2012).

**Adoption of a Sound Internal Lending Policy:** The lending policy is responsible in guiding banks in disbursing loans to customers. Strict adherence to the lending policy is far and away the most cost effective and simplest way of credit risk management. The lending policy should be in line with the general bank strategy and therefore the factors considered in designing a lending policy should include; the prevailing credit policy, industry norms, general economic conditions of the country and therefore the existing economic atmosphere (Kithinji,2010).

**Credit Bureau:** this is often an establishment which compiles information and sells this information to banks as regards the lending profile of a borrower. The bureau awards credit score called statistical odd to the borrower which makes it easy for banks to form instantaneous lending decision.

### **2.1.8. Process of credit risk management**

Risk management contains; identification, measurement, aggregation, planning & controlling and monitoring of the risk arising in a banks overall business. Risk management is thus a continuous process to increase transparency and to manage risks. Each bank has to establish a long-term vision and strategy in respect of integrated risk management based on its scale, focus, positioning, and resources targeted with senior management's full commitment. Risk management is a complicated process that necessitates specialized knowledge and abilities (Saheb & Krishan, 2018).

#### **2.1.8.1. Identification of credit risk**

Identification of credit risk is the first step in the function of credit risk management. It can be divided in to three categories default, exposure and recovery risk. Default risk is the probability of an event of default, which is driven by the potential failure of a borrower to make promised payments. The second one is exposure risks arise out of uncertainty attached to future amounts at risk. Exposure risk does not exist with all lines of credit. It may be considered negligible for all lines of credit for which there is a repayment schedule. Project financing implies uncertainty in the scheduling of outflows and repayments. All off-balance sheet items can generate future exposures. The third one is recovery risk arise the event of default not being predictable. The last one takes the form of collateral risk, third party guarantee risk and legal risk. Collateral risk: refers to an uncertainty with respect to the ability to access the collateral, to dispose it off and to the costs required to sell it. The use of collateral to control credit risk transforms the credit risk into recovery risk plus an asset value risk. Third party guarantee risk: arises when a third party fails to commit to pay on behalf of the borrower. Also, there arises a joint default risk when the guarantees as well as the borrower default at the same time. Legal risk: arises when the legal procedure takes over in case of default. The chosen method of identifying credit risk may depend on culture, industry practice and compliance. The credit risk of a bank portfolios a rise from internal as well as external factors. The internal factors have been identified as deficiencies in loan policies or administration, lack of prudential credit concentration limits, inadequate setting of lending limits, deficiencies in appraisal of borrowers' financial position, inadequate risk pricing, lack of loan review mechanism etc. the external factors include state of economy, fluctuations in interest and foreign exchange rates, economic sanctions, government policies, and trade restrictions (Ketan, 2009).

According to Gardner, Mills and Cooperman (2005), the bank's overall lending policy follows and implements loan request procedures. The protocols ensure that loan presentations are consistent and that loan committee members may easily access them. The procedures include determining the source of the business, the primary contacts for the loan, the participation structure (if other banks are involved in the loan), the amount and rationale for the loan request, and financial statement analysis, including historical and ratios focusing on the company's ability to repay its debt, brief history and operations of the firm, optional industry analysis if needed, profile of managers and their experience and expertise, financial statement analysis, including historical and ratios focusing on the company's ability to repay its debt, collateral/risk analysis, which summarizes the available collateral as well as the loan's dangers such as entry obstacles into a particular industry, loan review and rating suggestion by the loan officer, including how the loan would be categorized as A, B, or C from excellent to average or below ratings, depending on the bank's classification of loan ratings, and finally conclusion as well as thoughts on the loan's beneficial and unfavorable aspects. Essentially, loan procedures focus on the risks inherent in the loan applicant's business, how those risks have been managed, the loan's usage and amount, the borrower's ability to repay the loan in terms of profits, and other sources of repayment and collateral which is held as a guarantee for the loan.

#### 2.1.8.2. Measurement of credit risk

It is necessary to measure the credit risk. The purpose of the credit risk measurement is the quantification of potential losses from credit operation. The amount of losses is never known with certainty therefore it is necessary to estimate it.

According to "Measuring Credit Risk," credit risk measurement entails calculating Expected Loss (EL) and Unexpected Loss (UL). For the measurement of credit risk, quantification of the following components is necessary probability of default, expected exposure at default, loss given default, maturity or tenor of the exposure and degree of diversification in a bank credit portfolio.

The basic goal of credit rating a loan account is to determine if the account will remain a performing asset and will not default after a certain length of time has passed. The NBE study also provided banks with the essential standards for applying credit ratings to their borrower accounts and categorizing them according to their rating category. It has also advised banks to

develop and maintain necessary data on borrowers' loan defaults based on their credit rating category, as this will aid in the effective management of credit portfolios, as well as having a prior estimate of expected defaults, expected contribution, and capital requirements to keep the portfolio (Padmalatha & Justin 2010).

#### 2.1.8.3. Credit Granting

Assessment of the overall risk Credit Risk Analysis (CRA) is the study from the perspective of a supplier of credit of a present/prospective claim on other economic agents in the form of debt. Credit risk analysis is important to borrower as well. It enables them to understand what the usual considerations of banks and financial institutions are while extending credit facilities. This not only facilitates proper presentation of facts but also enables the borrower to decide about the most feasible sort of financing (Assafa, 2009).

According to Padmalatha and Justin (2010), character, capacity, capital, condition, and collateral are all represented by the 5Cs model. These are used to assess a loan applicant's credit risk; as a result, the loan officer must have a thorough understanding of the customer's character, capability, collateral, terms, and capital. Character is the borrower's willingness and determination to meet the obligations of the loan. Interviews and background checks, both personal (based on references provided by the borrower) and business, must be undertaken as part of the review. Capacity refers to the borrower's ability to create cash from its entire operations or from a single project (standalone credit), as well as the borrower's capacity to manage cash in past projects. The borrower's equity position is defined as capital, and the borrowers must contribute equity to the project for which the loan is required. By contributing an acceptable quantity of equity capital, the borrower must be willing and able to share project risk with the lending bank. The borrower must demonstrate his or her willingness to repay the loan.

The current state and prognosis of the local, regional, and national economies, as well as the borrower's industry, are referred to as condition. Various economic conditions and expectations for various businesses typically necessitate different loan requirements at different points in the business cycle. Collateral, which can take the form of actual collateral or a guarantee, can help to compensate for weaknesses in one or more of the areas mentioned above.

### **2.1.9. Monitoring & Controlling of Credit Risk**

Monitoring of the credit risk ongoing active monitoring and management of credit risk positions is an integral part of credit risk management activities. Monitoring tasks are primarily performed by the divisional credit risk units in close cooperation with the business which acts as first line of defense, dedicated rating analysis teams and portfolio management function. Credit risk monitoring can be divided into two level, (i) monitoring of credit risk at the level of the client and (ii) monitoring of credit risk at the level of the credit and bank portfolio.

**Monitoring of credit risk at the level of the client:** - at the level of individual trade operations, there is a regular monitoring, when the bank monitors the fulfillment of the contract conditions, financial situation of the client, and also the macroeconomic conditions. To identify changes in the ability to repay the loans, the bank may set many identifiers, such as turnover, repayment discipline, profitability, liquidity. Regular monitoring and identification of the changes in the ability to pay is an important tool for risk management. In the moment of the deterioration of debtor, the bank may initiate steps to maximize the return of their claim, or to minimize the losses, for example the negotiation of the additional conditions, the use of hedging instrument, the restructuring of the debt, and others. The frequency of credit risk monitoring depends on the creditworthiness of the client. Clients with good rating has been monitoring one a year, clients with a worse rating has been monitoring quarterly or monthly. In this regular monitoring, there is all the information about the client again evaluated, for example his financial situation and also the ability to meet his commitments. The output of the regular annual renewal is either the confirmation or modification of the rating and the revision of rating is updated by new calculation of limits. The information system monitors the exceeded the gross credit exposures compared to the currently valid limits. Bank follows up the changes of the client and if fund some of the following facts, the extraordinary monitoring is used. The impetus for extraordinary monitoring is exceeding of the credit exposure with comparison to applicable limits, new records in the bank or non-bank registers, changes in financial indicators outside the limits of tolerance, information about the execution or insolvency, changes in the number of turnovers on account, payment after the due date. The progress and content of the extraordinary monitoring is almost the same as the proper monitoring, but is caused by external factors, and given the nature of these factors can be expected deterioration in the situation of the client.

**Monitoring of credit risk at the level of the credit and bank portfolio:** - the credit portfolio is divided into four main segments: non-financial corporations, mortgages, consumer credits and the other credits. Structure of the credit portfolio is dependent on the type of the bank, i.e. whether the bank is universal or specialized. One of the basic rules of the credit risk management is the principle of diversification. The degree of diversification of the credit portfolio significantly related to the clients to who the bank is concentrated. If the bank provides a large amount of the credits to retail clients, mainly to households, the degree of diversification is higher than at the bank that provides credits to the large corporations. The quality of the credit portfolio of the bank depends on the economic position of individual credit borrowers. Status and basic trends of credit portfolio are expressed in terms of return of the credits, the cause of the subprime loans involve not only the ability but also the willingness of the borrower to repay the loan including interest. One of the methods of credit risk measurement is based on this principle, i.e. the willingness and ability to repay the credit and also on the behavior of individual components of the credit portfolio and uses the expected default rates. The expected default rates tell us what percentage of the credit will not be repaid whether due to inability or unwillingness of the client. At the level of the portfolio, the bank assesses the degree of diversification, the pumping limits and accumulation of debtor in the individual rating levels. Next, the bank assesses the developments in individual sectors and adjusts the funding levels for subjects of particular sectors of economy. The aims of the entire portfolio monitoring are to ensure, that the cumulative amount of credit does not exceed the established credit limits, to monitor the trends in individual credit portfolios managed by bank, and to ensure, that the limits set by the bank will minimize the risk and maximize the returns. Monitoring and evaluation of the credit portfolio as a whole often lead to identify trends that are not evident in individual credit monitoring. The most important trends of development that should be monitored are the share of abandoned assets in comparison with the total volume of assets, the classification of the risk, according to the number of clients in each class and according to the value of the credits in each class (weighted average risk rating), the trend to the concentration by the sector and geographical distribution, credit ratio, credits which were re-negotiated the conditions, to the total volume of loans, the technical exceptions, the profitability, and the marketing information such as number of credits, number of clients. The trends and limits are assessing at the level of credit portfolio. All the exceeded limits and warning trends must to by subject to analysis and if it is necessary

take steps to remedy, such as block the credit limits, the rejection of applications for prolongation credits, considering of credit limit revision, reconsider the cost of credit. Credit risk management at the level of bank credit portfolio is based on the fact that the risk is present on the active side of the bank and it is included in the following items: receivables from clients and purchased credit securities (Erica, Kataria & Peter 2015).

Failure to monitor credit risk is the cause of many credit losses. Monitoring is typically conducted by gathering some information from the consumer and processing it through some minimal ratio analysis. Credit risk monitoring is defined as the proactive control of credit risk before major problems emerge. It necessitates a strong understanding of the operational and financial risks in order to detect bad changes in any of the underlying elements. The credit risk monitoring hypothesis should be that deterioration in economic and other business situations is unavoidably reflected in obligors' performance. The frontline credit risk management officer should be on the lookout for negative developments, such as early warning indications (Joseph, 2005). Because lending is a bank's primary and most important operation, the risk connected with it accounts for a significant portion of the bank's total risk exposure. As a result, lending activity must be backed up by a robust management and monitoring system. . At the branch level (transaction level), the bank engages in loan activity, which is pooled at the bank level to build a portfolio. A clear, well-documented, and well-communicated credit policy at the transaction level has become vital for controlling and monitoring credit risk. At this point, it's important to remember that a well-designed credit information system is the foundation of the industry (Sahlemicahel, 2009).

#### **2.1.10. Mitigation of Credit Risk**

Parties to a loan can arrange for mitigates such as collateral, guarantees, letters of credit, credit derivatives, and insurance during and after the loan is underwritten. Credit derivatives are also been used to efficiently transfer risk while preserving customer relationships. Although these mitigate have similar effect, there are important distinctions, including the amount of loss protection that must be considered when assigning risk ratings. For example, a letter of credit may affect a loans risk rating differently than a credit derivative. Credit mitigates primarily affect

loss when a loan default and, except for certain guarantees, generally do not lessen the risk of default. Therefore, their impact on a rating should be negligible until the loan is classified.

Examiners should be alert for ratings that that overstate how much of a loans credit risk is mitigated. Account officers at time assign less severe ratings based on the existence of collateral or other mitigates rather than undertaking a realistic assessment of the value the bank can recover. (Padmalatha & Justin, 2010).

### **2.1.11. Non-Performing Loan**

Non-performing loans in the main refer to loans which for a relatively long period do not generate income; that is the principal, and/or interest on these loans has been left unpaid for at least 90 days (NBE, 2008). Besides, the stability of banking is a pre-requisite for economic development and flexibility against financial crisis. Success of banking is assessed supported profit and quality of asset it possesses. Even though banks serve social objective through their priority sector lending, mass branch networks and employment generation, maintaining asset quality and profitability is critical for his or her survival and growth. A major threat to the banking sector is frequency of Non-Performing Loans (NPLs). Non-performing Loans represent bad loans, the borrowers of the Assessment of Credit Management Performance in Emerging Private Commercial Banks in Ethiopia which failed to satisfy their repayment obligations.

Non- performing Loans calculates the portion of gross loans which are doubtful in banks’ portfolio. The principal source of income for banks is loans and advances. A bank, like any other business, wants to maximize its profits. A bank is likely to offer as much of its capital as possible since loans and advances are more rewarding than any other asset. However, banks must exercise caution when it comes to the security of such advances (Radha .M, et al, 1980). Bankers naturally aim to strike a balance between maximizing profit through lending while also managing the risk of loan default, which would decrease earnings and thus equity. As a result, a bank must exercise extreme caution when making loans because there is a significant risk of default.

Under the Ethiopian banking business directive, non-performing loans are defined as “loans or advances whose credit quality has deteriorated such that full collection of principal and/or

interest in accordance with the contractual repayment terms of the loan or advances in question (NBE, 2008).” It further provides that:

..., loans or advances with pre-established repayment programs are nonperforming when principal and/ or interest is due and uncollected for 90 (ninety) consecutive days or more beyond the scheduled payment date or maturity (NBE, 2008). In addition to the above mentioned category of non- performing loans, overdrafts and loans or advances that do not have pre-established repayment program shall be non-performing when:

- The debt remains outstanding for 90 (ninety) consecutive days or more beyond the scheduled payment date or maturity;
- The debt exceeds the borrower’s approved limit for 90 (ninety) consecutive days or more;
- Interest is due and uncollected for 90 (ninety) consecutive days and more; or for the overdrafts,
  - (i) the account has been inactive for 90 (ninety) consecutive days or
  - (ii) deposits are insufficient to cover the interest capitalized during 90 (ninety) consecutive days or
  - (iii) The account fails to show the 20% of approved limit or less debit balance at least once over 360 days preceding the date of loan review.

## **2.2. Review of Empirical Evidence**

Al-Tamimi& Al-Mazrooei, (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 and analysis, risk monitoring, and credit risk analysis (independent variables). The regression results 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 and risk management, risk assessment and analysis and Monitoring and controlling aspects while did not with practice of risk identification, risk management practice and credit risk analysis. Generally reported as foreign bank were more effective in risk management practice then nationally incorporated bank due to quality of staffs and regulatory requirement.

There are, a number of studies have been made on different aspects/issues of credit risk. Afande (2014), for instance, investigated the practice of credit risk management in commercial Banks of Kenya. The study disclosed that together with other strategies, commercial banks in Kenya make use of different credit risk management practices such as a thorough loan appraisal, asking for collateral and checking the credit history of the borrowers, credit rationing, loan securitization, and loan syndication.

A study by Kessey (2015) examined credit risk management practices in the Banking industry of Ghana: processes and challenges and obtained the following findings. Some of the key findings from the study revealed that the bank has documented policy guidelines on credit risk management with a senior manager having oversight responsibility for implementation. However, the study showed that there were some implementation challenges of the credit risk policies which have resulted to low quality of loan portfolio of the bank. It is also recommended that Bank's risk policies should be reviewed frequently.

Benjamin (2015) conducted study on "An examination of agricultural development bank Ltd's credit risk management practice" and concluded that ADP's management needs adopt a credit risk management policy. It is focused toward awarding current loans while dramatically reducing the approval of loans that have the potential to become suspect or lose money in the long term, and the necessity to appropriately equip credit experts in order to minimize the risk of loan defaults.

Another study by Chen and Shuping (2012) on credit management of Commercial Banks of Lianyungang City for the small scale and medium enterprises (SMEs) also came up with its own finding... Investigators have found out that the risk management plan and operation method that

really suit for credit demand for the SMEs is still not mature and it caused that the bad debts and dead loan were overstocked in Lianyungang commercial bank, thus it seriously impact on the capital operation of commercial banks, and then it has caused some adverse impact to the development of local economy. Therefore, it is necessary for commercial banks in Lianyungang city to supervise and manage the whole process of credit of the small and medium-sized enterprises.

Abdus (2004) has examined empirically the performance of Bahrain's commercial banks with respect to credit (loan), liquidity and profitability during the period 1994-2001. Nine financial ratios (return on asset, return on equity, cost to revenue, net loans to total asset, net loans to deposit, liquid asset to deposit, equity to asset, equity to loan and non-performing loans to gross loan) were selected for measuring credit, liquidity and profitability performances. By applying these financial measures, the study found out that commercial bank's liquidity performance was not as per with the Bahrain Banking industry. Commercial Banks are relatively less profitable and less liquid and, are exposed to risk as compared to banking industry. With regard to asset quality or credit performance, this paper found no conclusive result.

Hagos (2010) investigated Credit Management on Wegagen Banks. The main objective of the study was to evaluate the performance of credit management of Wegagen Bank in Tigray Region as compared to National Bank's requirements in comparison with its credit policy and procedures. The following findings were the result of the investigation: the issues impeding loan growth and rising loan clients complaint on the bank regarding the valuing of properties offered for collateral, lengthy of loan processing, amount of loan processed and approved, loan period, and discretionary limits affecting the performance of credit management.

Solomon (2013) concluded in his study "credit risk management methodologies and practice of NIB International Bank" that commercial banks' credit risk management systems are ineffective. Separation of credit risk management from credit sanction, credit processing/approval from credit administration, and lastly the formation of an independent credit audit and risk assessment function should be included as a check and balance for credit extension.

Onyango (2010), conducted a research on "Assessment of the credit risk management practice of commercial banks in Kenya" he said, adding that banks should be aware of the need to identify,

measure, monitor, and control credit risk, as well as ensure that they have sufficient capital to cover these risks and that they are properly compensated for risks incurred. Defining the risk, determining the risk, classifying it, evaluating it, and then monitoring the effectiveness of the loan and managing it effectively and successfully are all part of the credit risk management process. These procedures have proven to be effective in addressing a variety of risk areas.

The study of NBE (2009) identified and ranked three important types of risks in which Credit risk was ranked firstly and then followed by operational and liquidity risk.

The literatures indicate that several studies were carried out about credit risk management on commercial banks abroad and in Ethiopia. However, due to diversified and intensified investments in the country during last 13 and or above years there is an increase of loan demands among investors from commercial banks in the country. In addition to this, high demands for loan commercial banks are highly busy in launching branches throughout the country. These situations have created an environment in which commercial banks to encounter risks in credit management. Loans are becoming large and at the same time, bad loans have increased substantially during the past few years, Sahlemichael (2009) investigated the newly emerging challenges in credit risk management process that commercial banks encounter in Ethiopia.

### **2.3. Literature Gap**

The literature has tried basically to review the concepts of risk, risk management, credit risks and the activities undertaken by commercial banks to handle these risks. It also included a discussion of the theories that guided the research, as well as the meaning and significance of credit risk management to any commercial banks. Credit risk management is the process of controlling the impact of credit risk-related events on the financial institution and involves the identification, understanding, and quantification of the degree of potential loss and the consequential implementation of appropriate measures to minimize the risk of loss to the financial institutions (Saheb & Krishna, 2018). This is therefore, it is one the most important tasks for the financial liquidity and stability of banking sector in connection with increased sensitivity of banks to the credit risks and changes in the development of prices of financial instruments (Kisef'áková and Kisef'ák, 2013).

In general on credit risk management has decisive role in overall performance of the bank activity. The study conducted in Ethiopia had showed that the strong credit risk management has positive impact overall performance of the business. Similarly effective credit risk management practice profitability of the business. On the other hand according to the literature's credit risk management and credit risk exposure of the banks has inverse relation towards profitability of the business (bank managements, risk managements of the bank). However, most of literature's under review were focused to part of credit management aspect such as performance, profitability, credit exposures instead of assessing the credit risk management of the bank thus, researcher tries to fill the gap and contribute to the literature by giving addressing problems of credit risk management of Abay bank. Moreover, previous researches did not consider Abay Bank, which is the private bank and which has one of credit provision among the private banks operating in the country. Consequently, this research tried to fill the knowledge gap by focusing on assessing the credit risk management practices of the bank.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1. Research Design**

As Saunders and Philip (2012), research design is a general plan of how you would go about answering your research questions. It would contain clear objectives derived from your research questions, specify the sources from which you intend to collect data, and how you propose to collect and analyze them. It is composed of a series of prior decisions that, taken together, provide a master plan for executing a research project. The descriptive research design was used to assess the current state of credit risk management practices at the bank. Furthermore, the study used a descriptive research approach, which is applicable because an applied descriptive design

focuses on real-world questions. It also answers practical questions by providing a relatively immediate solution related to credit risk management, and findings generally lead to management's action rather than additional research.

### **3.2 Research approach**

A quantitative study approach was applied to assess credit risk management practice of Abay Bank. In order to fulfill the objectives of the study of the research utilize both qualitative and quantitative data. By doing this, the study aimed to describe, and interpret the current credit risk management practice of the bank. The techniques was used to collect data by distributing a questionnaire to respondents those work on credit business department especially directors, managers and senior officers and conducting an interview with division manager of the departments at head office level.

### **3.3 Data Source**

A questionnaire is defined as a document containing questions and other types of items designed to solicit information appropriate to analysis (Babbie, 1990). A questionnaire is equally used in survey research, experiments, and other modes of observation. A questionnaire should allow us to collect the most complete and accurate data in a logical flow.

Both qualitative and quantitative data was used in the study. Quantitative data are the items that are gathered through questionnaires, whereas qualitative data are those that are gathered through interviews. The study was employ primary sources as its data sources. Primary data was gathered by distributing questionnaires to bank employees who work in the credit business operation, such as directors, managers, and officers, and by conducting an interview with the division manager of the credit management department. This is to compile a wide range of baseline credit risk management data. The use of questionnaires to gather data is justified since it is an easy and affordable tool, particularly when large populations need to provide huge amounts of data.

### **3.4. Population, Sample size and Sampling Techniques**

#### **3.4.1. Target Population**

The population was defined as the total number of individuals that evaluated credit risk management practice in Abay Bank S.C. The population of this study was limited to employees of Abay Bank at head office in the credit department who work directly with credit risk management in the organization. It includes all staff and management personnel who used credit risk management in head office. The researcher carefully picked workers from the credit department based on their position. The department has a total of 52 employees working in credit management department, which makes up the population. The Population Distribution was calculated using the number of employees in the bank credit risk department.

#### **3.4.2. Sample size and Sampling Techniques**

A sample here refers to the operation of the universe which reasonably reflects the opinions, attitudes, or behaviors of the entire group. Sampling, also known as sample size, was the process of selecting a proportion of the population that was thought to be adequate to represent all of the existing characteristics within the target population for the purpose of generating the finding from the sample itself. The sample was obtained using the all-population. Therefore, the sample size of the population was 52 and the researcher was issued the same number of questionnaires to the staff of all employees in Abay Bank. The Census sampling techniques allow for generalization to take place.

### **3.5 Method of Data Collection**

This study was used primary data. The study was collect the primary data through a self-administered questionnaire and an interview with the head of credit and risk management department. The questionnaire use in the study has two parts. The first part was designed to collect the demographic information from each respondent. The second part contains information to assess variables and is prepared on five point Likert scale ranged from "1=Strongly Disagree" "2= Disagree" "3=neutral" "4=agree" and "5=Strongly Agree". In addition to this, the study interviewed the department head at the head office to obtain responses on open ended questions prepared. The interview questions were prepared to obtain additional information about the practice of credit risk management at the bank. The head of credit portfolio and management

department is chosen for an interview since it is directly involved with credit management. This research conducted an Interview as it affords a follow up questions to respondents for clarity.

### 3.6 Method of Data Analysis

Based on the research questions of the study, a questionnaire and document analysis were employed to collect data. After the data was collect from the sample using the specified instrument, analysis was made to answer the research questions. Data analysis was done with SPSS version 25.0 software. Accordingly the primary data gathered through questionnaires was analyzed using descriptive statistics and tables which are expressed in the form of frequency distribution, percentage distribution and mean was used for the data analysis when the Mean score < 3.39 was considered as “low”, the mean score from 3.40 - 3.79 was considered as “moderate” and mean score > 3.8 was considers as “high” as illustrated by comparison bases of mean of score of five point Likert scale instrument( Zaidaton & Bagheri, 2009).

### 3.7 Reliability

<i>No</i>	<i>Scale</i>	<i>Cronbach's Alpha</i>	<i>No. of items</i>
1	<i>Identification practice of credit risk</i>	.937	5
2	<i>Credit Granting Process</i>	.968	13
3	<i>Credit risk evaluation and monitoring process</i>	.955	8
4	<i>Credit risk controlling practice</i>	.947	8
<i>Total</i>		.989	34

Saunders et al. (2003) defined reliability in this way, “reliability refers to the extent to which the data collection techniques or analysis procedures was yield consistent findings”.

Cronbach’s alpha is a measure of reliability. Reliability refers to the consistency or dependability of a measuring instrument. It is defined as the proportion of the variability in the responses to the survey which is the result of differences in the respondents. That is, answers to a reliable

survey was not differ because respondents have different opinions, but because the survey is confusing nor has multiple interpretations.

The Cronbach's alpha for the total scale and the sub scales are above 90% which means that the scales that was be used in this study are considered reliable.

### 3.8 Validity

According to Marczyk (2005), the concept of validity refers to, what the test or measurement strategy measures and how well it does so. Conceptually, validity seeks to answer the following question: "Does the instrument or measurement approach measure what it is supposed to measure?"

The following steps were taken to ensure the validity of the study. Questionnaires were prepared from the literature review as a reference to validate the result. Pilot test was conducted on the month of January 2024 with a sample of the participants at Abay Bay bank in credit department to enhance the questionnaire's validity in terms of the respondents understanding and comprehension. Comments from professionals and respondents were solicited to ensure validity. The comments of the advisor were at last incorporated to enhance the validity of the measures.

### 3.9 Ethical Considerations

The researcher assured that the research is independent and impartial. The respondents were given a privilege of not writing their name and other identities. This was done mainly to hide participants form possible unwanted approach that might come from groups or individuals with interest. Further to this the participants was assured on the confidentiality of their responses. No respondent was forced to fill the questionnaire unwillingly and before the actual purpose of the research was made clear to him/her.

## CHAPTER FOUR

### DATA ANALYSIS AND INTERPRETATION

The general goal of this study was to assess the credit risk management practice at Abay Bank. To reap the objective of the study, data from primary source was collected through questionnaires distributed to employees working in the credit and risk management department at the head office of Abay Bank. In this chapter data presentation, interpretation and discussion are presented. The data of the respondents is analyzed by using descriptive statistical tools. The first part of this chapter discusses about the response rate and demographic characteristics of respondents, while the second part deals with the analysis and interpretation of findings of the study.

#### 4.1. Response rate and demographic characteristics of the respondents

##### 4.1.1 Response rate

As stated in the previous chapter the study took a sample size of 52 employees who work in credit and risk management department of the bank. Thus, fifty two questionnaires were given to the relevant employees of the organization. Of which 50 questionnaires were correctly filled in and returned which makes a response rate. The response rate is above 96% which is relatively high and the participants have good level of commitment and by the factor of sample size, response rate and data collection methods was evaluated. This response rate was good enough to make conclusions for the study.

##### 4.1.2 Demographic Characteristics of Respondents

The demographic aspect of the respondent has a significant contribution in the credit risk management systems of the bank to understand and implement the credit procedure, policy, manuals and improve when it is necessary. As a result, demographic features of respondents such as educational level, field of specialization and credit related experience are taken into account and assessed in this process.

*Table 4.1: Educational Level of Respondents*

Educational level	Frequency	Percent (%)
First degree	38	76
Masters (second Degree)	12	24

Total	50	100
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Source: study finding (2024)

Source: Results of a survey conducted by a researcher using primary data sources Educational background of employee is a significant element to be considered with regard to making credit business decision. As it is indicated on the above table (table 4.1), 38(76%) of the respondents have a bachelor degree and the remaining 12(24%) of respondents have master degree. This implies that the majority of the respondents working in credit area are bachelor and master degree holder and this enables them to perform the credit management operation systematically and scientifically in terms of the best interest of the bank. It also helps the researcher to obtain better quality of data regarding to credit management practice of the bank.

Furthermore, the assumption that the subjects educational qualification helps them to conduct credit management operations systemic and scientifically with expertise is a point which in one way or the other supports the reliability of this research because the respondents are assumed to do their work appropriately since they are assumed to have the qualification required in the bank.

*Table 4.2: Field of specialization of Respondents*

Field of study	Frequency	Percent (%)
Accounting	30	60
Economics	8	16
Business administration	4	8
Management	8	16
Total	50	100

Source: study finding (2024)

Source: Results of a survey conducted by a researcher using primary data sources Field of specialization of the employee is an important factor to be considered with regard to conduct the credit business operation at professional way. As it is indicated on the above table (table 4.2), 30(60%) of the respondents are accounting graduates, 8(16%) the respondents are economics graduates, 4(8%) the respondents are business administration graduates, and the remaining 8(16%) of respondents are management graduates. This means that the majority of the respondents working in credit management department are graduates of business and business-

related fields and they have appropriate profession for the area and this enables them to undertake the credit management operation professionally because credit management is one element of business administration.

*Table 4.3: Credit Related Experience of Respondents*

Years of experience in credit	Frequency	Percent (%)
<1 year	2	4
1-5 years	9	18
6-10 years	28	56
More than 10 years	11	22
Total	50	100

Source: study finding (2024)

Source: Results of a survey conducted by a researcher using primary data sources Field of specialization of the employee is an important factor to be considered with regard to conduct the credit business operation at professional way. As it is indicated on the above table (table 4.3), about 28(56%) of the participants have 6-10 years of experience on credit management, and 11(22%) of the respondents have more than 10 years“ experience. This would help the researcher to gather better quality of data on credit granting, monitoring and controlling process of the bank. Additionally, their experience enables them to perform the credit management operation of the bank accurately and with better quality.

## **4.2 Research related questionnaires**

The subject of research related question is the central issue or topic that the question seeks to investigate or explore the assessment of credit risk management practices related question. It provides a focus for research and helps to guide the direction of the study. Research question generally represent the main concept that the researcher is involved in exploring.

The theme of question in assessment credit risk management practices is to emphasize the importance of classifying and knowing potential credit risk inherent in lending activity, to assess the creditworthiness of the debtors before extending credit and evaluating the financial strength and repayment capacity, the ongoing assessment and monitoring of credit exposure ensure the risk are managed and evaluate the borrowers financial performance continuously, and also to set

appropriate credit limits collateral requirements risk pricing and to establish risk mitigation techniques. To ensure sound of credit risk management within financial institution. This holistic approach aims to minimize potential losses arising from credit defaults and maintain the overall health and stability of the institutions loan portfolio.

### Identification practice of credit risk

credit risk identification practice by data collection to gather relevant data and information about the clients financial statement economic indicators economic trends and using credit scoring models to assign a quantitative score to the debtors based on credit history. Framework for credit appetite by defining the institutions risk appetite and tolerance level for credit risk. Identification of credit risk management is financial sectors which enhance their ability to identify and assess credit risk effectively and maintain a healthy credit portfolio.

Table 4.4: Identification practice of credit risk

	SA		A		N		D		SD		TOTAL
	F	%	F	%	F	%	F	%	F	%	F (%)
The bank identifies all of the risks inherent with the credit products and activities.	10	20	33	66	4	8	3	6	0	0	50(100) Mean=4.00 S.D=0.73
The bank measures the maturity of all exposure risks associated with the credit business	25	50	12	24	7	14	6	12	0	0	50(100) Mean=4.12 S.D=1.06
The bank use credit scoring to assess the creditworthiness of the borrowers	0	0	12	24	5	10	22	44	11	22	50(100) Mean=2.36 S.D=1.08
The bank use evaluation of collateral	33	66	13	26	4	8	0	0	0	0	50(100) Mean=4.58 S.D=0.64
The bank use risk mitigation strategies	27	54	13	26	10	20	0	0	0	0	50(100) Mean=4.34 S.D=0.80
The aggregates mean											3.88

Source: study finding (2024)

As it can be seen from table 4.4, the bank identifies all of the risks inherent with the credit products and activities respondents were asked whether the bank identifies all of the risks

inherent with the credit products and activities. Based on this, 10(20%) of the respondents strongly agreed, 33(66%) agreed, 4(8%) are neutral and 3(6%) disagreed. As it is indicated that most of the respondents replied as the bank identifies all of the risks inherent with the credit products and activities. The majority of the respondents agreed with the mean value of 4.00. Due to this the bank enables to know the nature and types of credit related risks to manage properly and clearly understanding of credit related risk and to enable effective risk management.

The bank measures the maturity of all exposure risks associated with the credit business, 25(50%) of the participants strongly agreed, in addition to this 12(24%) of the respondents agreed, 7(14%) of the participants are neutral whereas 6(12%) of them disagree and none of them strongly disagree. As it is indicated that most of the respondents replied as the bank measures the maturity of all exposure of credit risks. Based on this, the moderate result and 4.12 mean value indicates that the bank knows when exposure of credit risk is ended and this enables the bank to develop adjusted repayment collection schedule.

The bank use credit scoring to assess the creditworthiness of the borrowers, respondents were asked whether the bank use credit scoring model. 11(22%) of the participants strongly disagreed, in addition to this 22(44%) of the respondents dis-agreed while 5(10%) of the respondents are neutral and 12(24%) are agreed. As it is revealed that most of the respondents replied as the bank does not scoring the creditworthiness of the borrowers. The moderate result and the mean value of 2.36 indicates that the bank does not know the debtors credit history and the income level.

The bank use evaluation/assessed of collateral, respondents were asked whether the bank use collateral evaluation Based on this 33(66%) of the respondents“ strongly agreed and 13(26%) of the respondents“ also agreed and 4(8%) are neutral. It implied that almost all respondents witnessed that the bank is evaluate the collateral of the debtors. The sum result and the mean value is 4.58 which indicates that the bank enables to secure the loan to determine its adequacy in covering potential losses.

The bank use the strategies for mitigation of risk 27(54%) of respondents strongly agreed that the bank use the strategies for mitigation of risk whereas 13(26%) agreed and the remaining 10(20%) were neutral. As it is revealed that most of the respondents replied as the bank use the

strategies for mitigation of risk and this would help the bank to develop and maintain data regarding risk mitigation strategies the moderate mean value is 4.34. As it is indicated that most of the respondents replied as the bank's background are appropriate credit limits and to recognized reserves for potential credit losses effectively.

All respondents were responding for the questions regarding credit risk identification practice of the bank. The aggregate mean value for the identification credit risk of the bank is 3.88. This shows the majority of the respondents were high with the availability and relevance of credit risk identification practice.

Based on the evident that the bank has been effective in identifying and managing credit risk associated with its credit product and activities. The result suggest that the bank has a strong foundation in credit risk identification but must focused on enhancing credit scoring practices to further capabilities of credit assessment. This establishes that the bank has a comprehensive understanding of the nature and the types of credit risk to enable and manage them successfully.

**Credit granting process**

Credit process mainly involves potential customer and the debtor's recruitment is one of the most important tasks of the bank which requires evaluating the credit-worthiness of the debtors and the conditions under which will be offered. In this case a borrower will usually start with a loan application that should be bank submitted. And which is credit issuance procedure includes gathering necessary data concerning the debtor's financial portfolio, credit score by utilize different tools and multiple techniques and the bank utilize the exacting analysis and risk rating techniques to spot the level of risk involved in lending to an applicant.

*Table 4.5: Credit Granting Process*

	SA		A		N		D		SD		TOTAL
	F	%	F	%	F	%	F	%	F	%	F (%)
Bank's credit professionals always conduct a face to face meeting to discuss the customer's history and future plans.	6	12	7	14	7	14	20	40	10	20	50(100) Mean=2.58 S.D=1.31

Your bank always provides expertise advise in the event of loan work out situation with a customer	27	54	18	36	3	6	2	4	0	0	50(100) Mean=4.40 S.D=0.78	
The bank perfectly analyzes the reputation of the customer before granting the loan.	15	30	23	46	11	22	1	2	0	0	50(100) Mean=4.04 S.D=0.78	
The bank conducts comprehensive financial analysis of the customers before granting the loan.	18	36	29	58	3	6	0	0	0	0	50(100) Mean=4.30 S.D=0.58	
Adequacy of collateral requirement is properly evaluated and measured.	4	8	25	50	1	2	7	14	13	26	50(100) Mean=3.00 S.D=1.02	
Marketability of collateral requirement is properly evaluated and measured.	23	46	14	28	8	16	5	10	0	0	50(100) Mean=4.10 S.D=0.92	
Enforceability of collateral requirement is properly evaluated and measured.	17	34	28	56	0	0	4	8	1	2	50(100) Mean=4.12 S.D=0.24	
The bank has established credit limit for all types of credit services.	47	94	3	6	0	0	0	0	0	0	50(100) Mean=4.94 S.D=0.98	

The entire economic factors will be analyzed before the loan is granted.	30	60	14	28	0	0	6	12	0	0	50(100) Mean=4.36 S.D=0.82
Nature of the business is properly analyzed before the loan is granted.	25	50	20	40	2	4	3	6	0	0	50(100) Mean=4.34 S.D=0.82
Nature of the industry is properly analyzed before the loan is granted.	25	50	20	40	2	4	3	6	0	0	50(100) Mean =4.34 S.D=0.81
The bank diversifies its credit exposure to different industry sectors.	28	56	16	32	4	8	2	4	0	0	50(100) Mean=4.40 S.D=1.39
The bank diversifies its credit exposure to different geographical area.	7	14	8	16	3	6	20	40	12	24	50(100) Mean=2.56 S.D=0.85
The aggregates mean											3.949

Source: study finding (2024)

As indicated on table 4.5 respondents were asked whether the Bank’s credit professionals always conduct a face to face meeting to discuss the customer’s history and future plans; 10(20%) of the participants strongly disagreed with the questions presented to them while 20(40%) of the respondents disagreed, while 7(14%) of them agreed 7(14%) of the respondents are neutral and the remaining 6(12%) are strongly agreed. The sum result and 2.58 mean value which suggests a tendency towards disagreement with the practice. The interpretation also suggests that not conducting face to face meeting may lead to the bank miss out on relevant information about the debtor’s future plans and history. And also the interpretation is correct it raises concern about the potential impact on the bank credit risk controlling practice as a face to face meeting can provide valuable insight in to debtor’s creditworthiness and potential risks associated with extending credit. The bank may need to consider revised risk controlling practice to ensure that adequate measures are in place to gather essential information about the debtor’s future plans and history

even face to face are not possible, to involve other assessment methods like document reviewing of phone meeting to mitigate the risk of missing important information.

On Your bank always provides expertise advise in the event of loan work out situation with a customer the respondents were asked whether the bank always provides expertise advice in the event of loan work out situation with a customer. Based on this 27(54%) of the participants strongly agreed and 18(36%) of the respondents also agreed, while 3(6%) of the respondent are neutral and the remaining 2(4%) of them are disagree. The moderate mean value is 4.40. As it is indicated that most of the respondents replied as the bank provides expertise advice in the event of loan work out situation with a customer. This enables the bank to work closely with its customers.

The bank perfectly analyzes the reputation of the customer before granting the loan., 15(30%) of the participants strongly agreed that the bank perfectly analyzes the reputation of the customer before granting the loan and 23(46%) of them also agree, 11(22%) of the respondents are neutral and the remaining 1(2%) of them are disagree and the moderate result and 4.04 mean value. As it is indicated that most of the respondents replied as the bank analyzes the reputation of the customer before granting the loan. This enables the bank to know or understand the background of its customer.

The respondents were asked whether the bank conducts comprehensive financial analysis of the customers before granting the loan. 18(36%) of the participants strongly agreed, in addition to this 29(58%) of the respondents agreed while 3(6%) of them were neutral. The moderate mean value is 4.30 which indicated that almost all of the respondents replied as the bank conducts comprehensive financial analysis of the customers before granting the loan. This enables the bank to understand the financial capacity of its customer and the ability to repay the loans. Such as turnover, repayment discipline, profitability, liquidity of the clients.

The respondents were asked whether adequacy of collateral requirement is properly evaluated and measured. 4(8%) of the participants strongly agreed with the question presented to them where as 25(50%) agreed and 1(2%) of the respondents are neutral while 7(14%) of the respondents disagreed and the remaining 13(26%) of the respondents are strongly disagree. The item sum result mean value is 3.00. As it is revealed that most of the respondents replied as the

bank evaluate and measure the adequacy of collateral requirement before granting the loan. This enables the bank to hold adequate collateral for the compensation for uncollectable account.

For the question issued for the respondents whether marketability of collateral requirement is properly evaluated and measured; on Marketability of collateral requirement is properly evaluated and measured. 23(46%) of the participants strongly agreed, 14(28%) of the respondents agreed and 8(16%) of them were neutral and 5(10%) were disagreed. The moderate mean sum value is 4.10. As it is showed that most of the respondents replied as the bank evaluate and measure the marketability of collateral requirement before granting the loan. This enables the bank easily to convert non-financial asset (collateral) to cash.

Whether enforceability of collateral requirement is properly evaluated and measured; 17(34%) of the participants strongly agreed while 28(56%) of the respondents agreed while 4(8%) of the respondents disagree and the remaining 1(2%) of them are strongly disagree. The moderate mean value is 4.12. As it is indicated that majority of the respondents replied as the bank evaluate and measure the enforceability of collateral requirement before granting the loan. This enables the bank easily to take over the collateral.

The bank has established credit limit for all types of credit services; presented that 47(94%) of the participants strongly agreed and the remaining 3(6%) of them agreed that the bank has established credit limit for all types of credit services. The moderate mean value is 4.94. As it is indicated that all of the respondents replied as the bank establish credit limit for all types of credit services. This enables the bank to control the credit level based on its risk level.

The entire economic factors will be analyzed before the loan is granted; being 30(60%) of them strongly agreed while 14(28%) agreed and the remaining 6(12%) of disagreed on the question presented as the bank analysis the entire economic factors before the loan is granted and the value of mean is 4.36. As it is indicated that most of the respondents replied as the bank conducts economic factor analysis before granting the loan. Due to this the bank knows or understand economic condition of the environment to reduce the risk level which associated with the economy.

The respondents were asked whether nature of the business is properly analyzed before the loan is granted. Based on this 25(50%) of the respondents strongly agreed and 20(40%) of the

respondents also agreed while 2(4%) of the respondents are neutral and the remaining 3(6%) of them are disagree. The moderate mean value is 4.34. As it is indicated that majority of the respondents replied as the bank conducts business analysis before granting the loan. This enables the bank to reduce credit risk that associated with the nature of the business.

On the Nature of the industry is properly analyzed before the loan is granted; 25(50%) of respondents strongly agreed on the question presented as the bank properly analyze nature of the industry before the loan is granted and 20(40%) of them also agree and 2(4%) of the respondents neutral and the remaining 3(6%) of them are disagree. The moderate mean value is 4.34. As it is revealed that most of the respondents responded as the bank conducts industry analysis before granting the loan. It implied that the bank can reduce the risk level that associated with the nature of the industry.

As it is indicated on the participants were asked whether the bank diversifies its credit exposure to different industry sectors; 28(56%) of the participants strongly agreed in addition to this 16(32%) of the respondents agreed, 4(8%) of them are neutral and the remaining 2(4%) of the respondents were disagree. The aggregate mean value is 4.40. As it is indicated that majority of the respondents replied as the bank diversifies its credit exposure to different industry sectors. This enables the bank to minimize the risk level that related with the specific type of industry.

The respondents were asked whether the bank diversifies its credit exposure to different geographical area; 7(14%) of the participants strongly agreed with the question presented to them additionally 8(16%) of the respondents agreed while 20(40%) of them disagree, 12(24%) of the respondents are strongly disagree and the remaining 3(6%) of the respondents are neutral. A moderate mean value is 2.56. As it is indicated that most of the respondents replied as the bank does not diversifies its credit exposure to different geographical area. This enables the bank is not minimize the risk level that associated with the specific geographical area.

As indicated in table 4.5 an aggregate mean value of employees' perception on credit granting process is 3.949 which is high. From this we can conclude that the aggregate mean value of credit granting process is indicated that the respondents were agreed with the credit granting process methods of the bank. Failure on the Bank's credit professionals always conduct a face to face meeting to discuss the customer's history and future plans.

Based on the evaluation of the credit granting process is evident that the bank has been successful in certain areas but need improvement. The bank has shown strengthen in providing expertise advice to analyzing debtors reputation, conducting comprehensive financial analysis, evaluating collateral marketability and there is clear need for improvement in conducting face to face meeting and evaluating collateral adequacy.

### Credit risk evaluation and monitoring process

The Credit risk evaluation and monitoring process can be involve by several components like credit risk monitoring the debtors financial healthiness and creditworthiness in the assessment of financial statement ,credit report, credit risk review is periodically review the Credit risk evaluation and monitoring process are necessary to ensure that it remains effective and up to dated credit policies procedure, risk model based on market condition changes, regularly report the credit risk performance and exposure.

Table 4.6: Credit risk evaluation and monitoring process

	SA		A		N		D		SD		TOTAL
	F	%	F	%	F	%	F	%	F	%	F %
The bank strictly monitors loan terms and conditions that have been stipulated at the time of loan approval.	26	52	20	40	0	0	4	8	0	0	50(100) Mean=4.36 S.D=0.85
The bank uses a loan covenant checklist that routinely tracks its customer's adherence to covenants.	9	18	31	62	3	6	7	14	0	0	50(100) Mean=3.84 S.D=0.89
The bank regularly reviews and monitors the performance of Credit quality at individual level	25	50	21	42	4	8	0	0	0	0	50(100) Mean=4.42 S.D=0.64
The bank regularly reviews and monitors the performance of credit quality at portfolio level	24	48	22	44	2	4	2	4	0	0	50(100) Mean=4.36 S.D=0.75

Credit file is regularly updated in our bank	20	40	24	48	6	12	0	0	0	0	50(100) Mean=4.28 S.D=0.67
The bank has properly applied its own internal risk rating system.	31	62	17	34	2	4	0	0	0	0	50(100) Mean=4.58 S.D=0.57
Credit monitoring procedure is regularly reviewed in our bank.	0	0	3	6	14	28	15	30	18	36	50(100) Mean=2.04 S.D=0.95
Credit monitoring procedure is regularly updated in our bank.	0	0	11	22	9	18	17	34	13	26	50(100) Mean=2.70 S.D=1.10
The aggregates mean											3.82

Source: study finding (2024)

As indicated on table 4.6 the respondents were requested about the bank strictly monitors loan terms and conditions that have been stipulated at the time of loan approval; 26(52%) of the respondents strongly agreed with this point, 20(40%) agreed and the remaining 4(8%) of the respondents are disagreed. The moderate mean value is 4.36. As it is showed that most of the respondents replied/responded as the bank strictly monitors loan terms and conditions that have been stipulated at the time of loan approval. This implied that the bank ensures the fulfilment of the contract terms and conditions of the client to identify and take corrective action if there are any changes in the ability to repay the loan.

The participants were requested whether the bank uses a loan covenant checklist that routinely tracks its customer’s adherence to covenants; Based on this 9(18%) of the participants strongly agreed, 31(62%) of the respondents also agreed, 7(14%) of them are disagreed and the remaining 3(6%) of the respondents are neutral. The moderate mean value is 3.84. As it is indicated that most of the respondents replied as the bank uses a loan covenant checklist that routinely tracks its customer’s adherence to covenants. This implied that the bank ensures the fulfilment of customer’s obligation and this enables the bank to take the required corrective action before the loan is none performed.

The respondents are requested whether the bank regularly reviews and monitors the performance of credit quality at individual level; 25(50%) of the participants strongly agreed, in addition to this 21(42%) of the respondents agreed and the remaining 4(8%) of them are neutral and the item sum of mean is 4.42. Based on the respondents replied as the bank regularly reviews and

monitors the performance of credit quality at individual level. This enables that the bank to know the customer's status on the ability to meet their commitments at individual level.

The respondents are requested whether the bank regularly reviews and monitors the performance of credit quality at portfolio level; 24(48%) of the participants strongly agreed, additionally 22(44%) of the respondents agreed and the remaining 2(4%) of the respondents are dis agreed and the remaining 2(4%) are neutral. The moderate mean value is 4.36 and as a result the majority of respondents replied as the bank regularly reviews and monitors the performance of credit quality at portfolio level. This enables that the bank to know the client's status on the ability to meet their commitments at portfolio level.

The respondents were requested as credit file is regularly updated in the bank; 20(40%) of the participants strongly agreed with the questions presented for them additionally 24(48%) agreed and the remaining 6(12%) of the respondents are neutral. As it is indicated on the above figure, even if 6(12%) of the respondents standing as neutral. The moderate mean value is 4.28 and we can confidently Said that the bank updated the credit file. This enables that the bank to have current information on the overall loan status. Regarding the question presented whether the bank has properly applied its own internal risk rating system.

The bank has properly applied its own internal risk rating system; 31(62%) of the participants strongly agreed, additionally 17(34%) of the respondents agreed and the remaining 2(4%) of them were neutral. The item mean value is 4.58. As it is indicated here above most of the respondents replied as the bank properly applied its own internal risk rating system. This enables that the bank to acquire and maintain a relevant data and information regarding to loan defaults of clients based on their rating classification as it helps to handle credit portfolio management properly and to maintain a prior measure of expected defaults and amount of capital that needed to manage the portfolio.

About credit monitoring procedure is regularly reviewed in the bank; 18(36%) of the respondents strongly disagree, 15(30%) of them also disagreed, 14(28%) were neutral and the remaining 3(6%) of them agreed. The moderate mean value is 2.04 which indicate that most of the respondents replied as the bank does not regularly reviewed the monitoring procedure. Due

to this the bank cannot detect the problem that is associated with credit monitoring procedure to take an immediate course of action.

On Credit monitoring procedure is regularly updated in our bank; describes that 11(22%) of the respondents agree 9(18%) of them are neutral and 17(34%) of the respondents disagree the remaining 13(26%) of them are strongly disagreed that credit monitoring procedure is regularly updated in the bank. The moderate mean value is 2.70 which implied that most of the respondents replied as the bank does not regularly updated the monitoring procedure. This leads the bank to follow and implement outdated credit monitoring procedure.

As indicated in table 4.6 an aggregate mean value of employees’ response credit evaluation and monitoring processes is 3.82 From this we can conclude that even if the mean of credit evaluation and monitoring processes is high, we should not ignore the items of Credit monitoring procedure is regularly reviewed and updated in our bank. In those points the numbers of respondents who disagreed are significant in number. And this shows that there is a gap in the items of Credit monitoring procedure is regularly reviewed and updated in the bank.

Over all the results that the bank has healthy credit evaluation and monitoring processes with strong emphasis on ensuring compliance with loan terms, monitoring borrowers adherence the agreements, and regularly reviewing credit quality at both portfolio level and individual level, the effective application of internal risk rating system improves the bank’s ability to manage credit risk and maintain a proactive approach to credit portfolio management.

**Credit risk controlling practice**

Credit risk controlling practice is a several key steps which is some components are credit analysis to involve the assessing of borrowers creditworthiness by analyzing their financial statements, credit policy by establishing criteria and guidelines granting credit by setting the limits of exposure to individual debtors or industries by determining acceptable collateral and establish term and condition for landing, credit decision making by making decision on whether to approve or decline the credit application based on credit risk assessment.

*Table 4.7: Credit risk controlling practice*

	SA		A		N		D		SD		TOTAL
	F	%	F	%	F	%	F	%	F	%	F (%)

The bank constantly takes immediate corrective action for credit default sign.	29	58	19	38	1	2	1	2	0	0	50(100) Mean=4.52 S.D=0.65
Credit policy is regularly updated in our bank.	31	62	18	36	1	2	0	0	0	0	50(100) Mean=4.60 S.D=0.70
Policy measures have been taken regularly to solve loan recovery problem.	22	44	25	50	3	6	0	0	0	0	50(100) Mean=4.38 S.D=0.60
The bank maintains the actual risk profile at or under its risk tolerance	22	44	25	50	1	2	2	4	0	0	50(100) Mean=4.34 S.D=0.72
Credit policy is consistently applied in all credit activities of the bank.	13	26	27	54	3	6	5	10	2	4	50(100) Mean=3.88 S.D=1.04
The bank constantly monitors the financial condition of counterparties and action taken as required.	29	58	18	36	3	6	0	0	0	0	50(100) Mean=4.52 S.D=0.61
The bank actively responds to new information in all aspect of credit products and activities.	35	70	15	30	0	0	0	0	0	0	50(100) Mean=4.70 S.D=0.46
The bank gives adequate risk management training for concerned staffs.	0	0	6	12	4	8	2 1	42	1 9	3 8	50(100) Mean=1.94 S.D=0.78
The aggregates mean											4.11

Source: study finding (2024)

According to table 4.7 The bank constantly takes immediate corrective action for credit default sign; 29(58%) of the respondents strongly agreed there is a constant and immediate corrective action has been taken by the bank for credit default. 19(38%) of respondents agree with the above statement and 1(2%) of the respondents are neutral the remaining 1(2%) disagree with it. The moderate mean value is 4.52. Even if the remaining respondents being stand on neutral and disagree on the above statement, it is confident to say banks has constantly takes immediate corrective action for credit default sign that has been occurred in due course of time as required. This would help the bank to solve credit related problems on time.

According to Credit policy is regularly updated in our bank; 31(62%) of the respondents strongly agreed there is a regularly updated on Credit policy in the bank. 18(36%) of respondents agree with the above statement and the remaining 1(2%) are neutral and the item value of mean is 4.60. This implied that it would help the bank to work with latest credit policy and this also contribute a significant role to manage the credit business operation of the bank.

According to Policy measures have been taken regularly to solve loan recovery problem; 22(44%) of the respondents strongly agree there is a policy measures that have been taken regularly to solve loan recovery problem of the bank. 25(50%) of respondents agree with the above statement and the remaining 3(6%) of respondents are neutral on the above statement and the moderate mean value is 4.38 which indicates that the regular policy measures have been taken to solve loan recovery problem of the bank as required. This would help the bank to develop common awareness and consistency of credit activities among the employees of the department.

According to the bank maintains the actual risk profile at or under its risk tolerance; 22(44%) of the respondents strongly agree the bank has maintained the actual risk profile at or below its risk tolerance, 25(50%) of respondents agree with the above statement and 1(2%) of the respondents are neutral and the remaining of 2(4%) are disagree. None of the respondents being stand on strongly disagree on the above statement, and the moderate value of mean is 4.38. Therefore it is confidentially to say that the bank has keep its actual risk profile at or below its risk tolerance as required. This implied that the bank has performed in accordance with the standard which is established to tolerate the credit risk.

According to Credit policy is consistently applied in all credit activities of the bank; 13(26%) of the respondents strongly agree the credit policy is consistently applied in all credit activities of the bank. 27(54%) of respondents agree and 3(6%) of the respondents are neutral while 5(10%) of the respondents are disagree and the remaining 2(4%) strongly disagree with the above statement. The moderate mean value is 3.88. For that reason it is confidentially to say that the credit policy is consistently applied in all credit activities of the bank as required. It implied that the bank enables to assure the credit business operation of the bank is carried out in accordance with the standard of the bank.

According to The bank constantly monitors the financial condition of counterparties and action taken as required; 29(58%) of the respondents strongly agree the bank constantly monitors the financial condition of the counterparties and action was taken as required. 18(36%) of respondents agree and the remaining 3(6%) neutral with the above statement and the item mean value is 4.52. Therefore it is confident to say that the bank is constantly monitors the financial condition of counterparties and action taken as required and this enables would help the bank to understand the customer's and counterparties status on the ability to meet their commitments.

According to the bank actively responds to new information in all aspect of credit products and activities; 35(70%) of the respondents are strongly agree the bank actively responds to new information in all aspect of credit products and activities. 15(30%) of respondents agree with the above statement and also the moderate mean value is 4.70. Therefore it is confidentially to say that the bank actively responds to new information in all aspect of credit products and activities as required. This would help the management of the bank to make updated and latest decision on credit business operation.

According to the bank gives adequate risk management training for concerned staffs; 19(38%) of the respondents strongly disagree the bank is not giving adequate risk management training for concerned staffs as required. 21(42%) of respondents disagree and 8% of the participants are neutral and the remaining 6(12%) of the respondent are also agree with the above statement and also the item mean value is 1.94. As a result it is possibly to say that the bank is not constantly giving adequate risk management training for concerned staffs as required consequently it is possible to conclude that lack of adequate risk management training for concerned staffs negatively affects credit risk management practice of the bank. Hence the banks must give attention to arrange short term or/and long-term training to update the employees understanding about risk Management.

As indicated in table 4.7 an aggregate mean value of respondents' perception on credit controlling practices is 4.11. From this we can conclude that the mean value of effective credit controlling practices is high but we should not ignore the variables which were valued in adequate risk management training. And this shows that there is a gap in the adequate risk management training for concerned staffs in the bank.

All over the result can be concluded that the bank has effective credit controlling practices in the place and it is important for the bank to address any inconsistencies or differing opinions regarding the consistent application of credit policy in order to ensure uniformity in credit activities. The bank adheres to established standards to tolerate credit risk effectively, and the bank established consistent practice to solve loan recovery issues and promotes common awareness and consistency among employees. Generally the bank take an immediate corrective action for updating credit policy, implementing regular policy measures, maintaining risk profiles, applying credit policies regularly and monitoring counterparties financial conditions.

### **4.3 Interviews**

In order to get better understanding on the credit risk management practice of Abay Bank, I conducted the interview with division managers of credit management department. All of the interviewees have had more than ten years' experience on credit business operation in the bank. Accordingly, most of the responses obtained from the interview are presented and analyzed in the questionnaire analysis and it was used as a supportive response. Based on this, my interview guide line was; first I select the working unit (department) which has a direct relation to the topic of my study. Since my research is about credit risk management practice of the bank, credit management is an appropriate working department to conduct the interview. Next, I choose the manager of the division who has more than ten years' work experience in credit business operation. Regarding to this, my interview was conducted on the existing credit risk management practice of the bank. Therefore, the summary of the interview with the corresponding response is shown as follow: -

I- Summary of responses on the overall perception of credit risk management practice of the bank According to the interviewee's response regarding to their perception about credit management practice of the bank, all of the respondents supposed that the mechanism of identifying credit risk as inherent risk in the bank has a strong understanding of credit related risk and which allows effective risk controlling. The measure of exposure risk the interviewee's response that the bank was praised for its capability to measure the maturity of exposure risks related to the business, the bank has not used effective credit scoring in the assessing the creditworthiness of the borrowers which indicates a gap in the bank practice understanding of borrowers credit history and income level. The bank used an admire Collateral evaluation

assessing of debtors collateral quality and value, and also the bank strategies for risk mitigation is setting an appropriate credit limits and establish reserves for potential credit losses effectively.

II-Summary of responses regarding to the evaluation of granting of loan of the debtors (applicants) According to the interviewee's response to assessing the analysis of customer reputation the bank is a strong understanding the background of its customers is admirable. In the bank there is a lack of face to face communication/meeting which is missing of relevant information about customers' future plans and history of the clients. The bank which have an effective assessment of collateral marketability that allowing for easy convertible to cash if needed. The bank was appreciate for conducting comprehensive financial analysis of the borrowers before granting the loans, which means that the bank is effective assessment of financial capacity and ability to repay loans based on financial factors. This would help the bank to minimize the risk of uncollectable loan.

III-Summary of the responses towards the bank's major process of credit risk monitoring practice: - According to the interviewee's response, the bank's which is strictly monitoring loan terms and condition stipulated at the time of loan approval which means that the bank ensures the fulfillment of terms of contract and condition and to addressing any changes in the borrows ability to repay the loan. The bank to monitor customer's obligations and take corrective action before any loan performance issues arise. In the case of individual and portfolio credit quality monitoring the bank regularly review and monitor the performance of credit quality both individual and portfolio level. The bank stated a risk-rating and grades system, which includes subjective factors, such as management quality allows the bank to assign credit costs more precisely and the management information system of the bank helps them to track credit exposure. However, they stated as the bank does not update the credit monitoring procedure regularly. Therefore, in order to promote the lending function to the required level, the bank should produce and follow up to date credit monitoring procedure that is appropriate to the credit business operation.

IV- Summary of the response towards the control of credit risk According to the interviewee's response, the control of credit risk of the respondents stated that there is a lack of adequate risk management training for the concerned staffs. The bank stated that the bank's ability to take immediate corrective action for credit defaults is effectively solve credit related problems on the

time, and regarding to regularly updated the bank's credit policy which stated the bank use the latest credit policy developments and effectively manages its credit business operations. The respondents stated that the bank has successfully maintained its actual risk profile with in its risk tolerance. The respondents indicates that the bank effectively the financial condition of counterparties and takes necessary actions to assess the ability of borrowers and counterparties to meet their commitments. Based on this, the respondents also indicated as different risk controlling mechanisms has to be implemented to minimize or to reduce its credit risk exposure.

## **Chapter five**

### **CHAPTER FIVE SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION**

#### **Introduction**

In this chapter, major findings are going to be summarized and the subsequent conclusions are made. Based on the conclusion, recommendations are forwarded in relation to literatures reviewed to suggest the better credit risk and management practice for Abay bank.

#### **5.1 Summary of Key Findings**

Among the findings of the research that has been discussed on chapter four, the key findings are summarized as follow: - The bank identifies all risks inherent with the credit products and activities and measure expected loss of credit risks both at individual and portfolio level. This would help the bank to develop and maintain the required data regarding to the nature, types and amount of expected loss of credit risk to manage properly. The credit granting process of the bank is in a good condition that the bank analyzed the credit worthiness of the clients, the industry and economic condition thoroughly and properly before the loan is granted. The bank also monitors and evaluates the credit quality both before and after disbursement by making a regular review and monitor of the credit quality both at individual and portfolio level.

Unlike to the major findings stated here above, the bank's credit professionals do not conduct a face to face meeting to discuss the customer's history and future plans. Due to this the bank fails to know or understand the background of the customers. The bank does not adequately measure

unexpected loss of credit risk. Therefore, the bank does not know the amount of unexpected loss of credit risk which might be faced during its credit operation. As it is revealed on the finding of the study, the credit monitoring procedure of the bank is not regularly reviewed and updated. This leads the bank to follow and implement outdated credit monitoring procedure. Due to this, the bank fails to improve the credit business operation. In turn this would hinder the credit risk management practice of the bank.

## 5.2. Conclusion

The bank identifies all credit risk properly and measures the entire expected loss of credit risk both at individual and portfolio level. This enables that the bank to develop and maintain necessary data on the nature and type of credit risks and the amount of expected losses as it would help to manage credit risk in proper way and to have earlier estimation of expected loss of defaults, expected contribution and capital requirement to develop financial stability. However, there is lack of proper and adequate measurement of unexpected loss of credit risk. Due to this the bank unable to develop and maintain necessary data regarding to the amount of unexpected losses and this leads the bank to conduct wrong decision on loan management and it would be a cause for financial distress since it has not adequate information on the amount of unexpected losses.

Abay bank is currently working on wide-ranging credit granting process so that the bank conducts comprehensive analysis such as analysis on customer reputation, financial analysis, business analysis, industry analysis and economic analysis. This would help the bank to learn the financial capacity of the clients by analyzing the financial reports to understand profitability, cash flow, liquidity, and leverage of the company and to learn what the company does and how it operates. Then examine how it fits into its industry and how it is affected by economic conditions. All this information is relevant to know the clients status on the ability to meet their commitments. Adequacy, marketability and enforceability of collateral requirement is also properly evaluated and measured by the bank. This would help the bank to mitigate its risk on default loan. Therefore, collateral requirements is one of the credit risk management tool that refers to properly promised to the lender as compensation if the borrower defaults, it lesser the lender's losses in the case of a loan default and it may be seen as a strategic instrument to control

borrower incentives for repayment of the debt. In addition to this the bank diversifies its credit exposure to different industry sectors and geographical area. This enables the bank to minimize the risk level that related with the specific type of industry and geographical area. Apart from this the bank's credit professionals do not conduct a face to face meeting to discuss the customer's history and future plans. Due to this the bank might be loose some relevant information that raised on the meeting to know about the customers future plans and history.

Regarding to the credit monitoring and evaluation practice of the bank, the finding of the research revealed that loan terms and conditions has been strictly monitored, the bank uses a loan covenant checklist that routinely tracks its customers adherence to covenants and the bank regularly reviews and monitors the performance of credit quality both at individual and portfolio level. As far as the bank is working to assure the quality of credit business operation; the bank implemented its own internal risk rating or grading system to support the loan processes by classifying borrowers based on their risk level. However, proper reviewing and updating of credit monitoring procedure has greater significance in the proper management of credit business operation yet the data obtained from the respondents showed that the bank does not reviewed and updated the credit monitoring procedure regularly. This would expose the bank to follow and implement outdated credit monitoring procedure.

The bank is working by taking immediate corrective action for credit default sign, updating credit policy on regular basis, taking policy measures to solve loan recovery problem, keeping its actual risk profile and generally the overall credit controlling mechanisms of the bank is in good conditions. However, the bank is not giving adequate risk management training for concerned staffs as required and there is also lack of adequate number of staffs in credit management department. Consequently, it is possible to conclude that lack of risk management training and adequate number of staffs negatively affects credit risk management practice of the bank. Hence the bank has to arrange and deliver training programs that enables them to properly evaluate the creditworthiness of clients before loans are disbursed.

### 5.3 Recommendation

The following are some of the suggestion that I would like to recommend to Abay Bank management and concerned parties

- The bank's credit professionals are advisable to conduct a face to face (formal) meeting to discuss the customer's history and future plans before the loan is granting. This is very essential to know the background of the customer and it is also one of the best ways to get to know the customer's needs and establish the bank as a valued financial institution is through face-to-face meetings to discuss the customer's history and future plans.
- The bank review and update the credit monitoring procedure consistently. This is because regular reviewing and updating of credit monitoring procedure has assumed greater significance in the effective management of credit risk and this would help the bank to consider the new events on credit business operation by working with the latest credit monitoring procedure on regular basis.
- The bank quantify or measure the entire unexpected loss of credit risk by considering the causes like losses due to a sudden downturn in market conditions, falling interest rates, natural disasters resulting in major business failures. This is because the purpose of the credit risk measurement is the quantification of potential losses from credit operation. It would help the bank to obtain the required data regarding to the amount of unexpected loss and this would help the bank to manage the credit risk properly.
- The credit risk management team should always comprise adequate number of well trained, skilled, and knowledgeable staff to improve on accuracy, reliability, efficiency and effectiveness of required service to the customer lack of having trained and competent staff may lead the bank to poor service quality, misconduct, customer complaints and employee disputes and it can may result in adverse publicity. Hence the bank should give attention to hire new employees to adequately staffed the credit management department and arrange short term or and long-term training to update and enhance the employees understanding about credit risk management.

#### 5.4 Limitation of the Study

The research topic involves a sensitive issue, there will be limitation in getting information that is confidential to the bank. Additionally, time and budget will also be major constraints. So as to this, all the existing problems regarding credit risk management in banks cannot be covered. In addition to this, since the study is conducted in a single organization it will be hard to make

generalization. Because of time and budget limitations, the research will be limited to only cover the credit risk management practice of only one private bank namely Abay bank S.C.

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## Appendices

### Appendix 1

ADDIS ABABA UNIVERSITY

SCHOOL OF GRADUATE STUDIES

MASTERS OF SIENCE

A questionnaire to be filled by employees Dear Respondents, I am a postgraduate student of Addis Ababa University. I am currently undertaking a research thesis on assessment of credit risk management practices in Abay bank. Please recall that you are selected as a possible participant because you are an employee of Abay bank. Your participation in the study is completely voluntary. The research work is for academic purpose only. Any information obtained in connection with this study will remain strictly confidential. Your honest and true opinion will be valuable for this research. Thank you in advance for your participation.

Workneh Lashetew Mobile: +251-912367260

Email: [workeneh2008la@gmail.com](mailto:workeneh2008la@gmail.com)

Part 1: Demographic Information of the research Instruction: Please fill the answer by putting “√” mark.

1. Job Title: \_\_\_\_\_

2. Highest educational level obtained

Diploma

Master's Degree

Bachelor Degree

PhD

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

Accounting

Management

Economics

Business Administration

Others Please Specify \_\_\_\_\_

4. Years of work experience

< 1 Year

6-10 years

1-5 years

More than 10 years

Part Two: - Information on Credit Risk Management Practice of the Bank 1= strongly disagree, 2= disagree, 3=Neutral, 4=Agree, and 5 = strongly agree

**1. Identification practice of credit risk**

<b>Factors</b>	<b>5</b>	<b>4</b>	<b>3</b>	<b>2</b>	<b>1</b>
1. The bank identifies all of the risks inherent with the credit products and activities.					
2. The bank measures the maturity of all exposure risks associated with the credit business.					
3. The bank use credit scoring to assess the creditworthiness of the borrowers					
4. The bank use evaluation/assessed of collateral					
5. The bank use the strategies for mitigation of risk					

Please give any experience, comment or opinion about credit risk identification practices which is applicable at your Bank. -----

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2. Credit granting process

<b>Factors</b>	<b>5</b>	<b>4</b>	<b>3</b>	<b>2</b>	<b>1</b>
1. Bank's credit professionals always conduct a face to face meeting					

to discuss the customer's history and future plans.					
2. Your bank always provides expertise advise in the event of loan work out situation with a customer					
3. The bank perfectly analyzes the reputation of the customer before granting the loan.					
4. The bank conducts comprehensive financial analysis of the customers before granting the loan.					
5. Adequacy of collateral requirement is properly evaluated and measured.					
6. Marketability of collateral requirement is properly evaluated and measured.					
7. Enforceability of collateral requirement is properly evaluated and measured.					
8. The bank has established credit limit for all types of credit services.					
9. The entire economic factors will be analyzed before the loan is granted.					
10. Nature of the business is properly analyzed before the loan is granted.					
11. Nature of the industry is properly analyzed before the loan is granted.					
12. The bank diversifies its credit exposure to different industry sectors.					
13. The bank diversifies its credit exposure to different geographical area.					

Please give any experience, comment or opinion on credit granting process which is applicable at your Bank. -----  
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3. Credit risk monitoring process

<b>Factors</b>	<b>5</b>	<b>4</b>	<b>3</b>	<b>2</b>	<b>1</b>
1. The bank strictly monitors loan terms and conditions that have been stipulated at the time of loan approval.					
2. The bank uses a loan covenant checklist that routinely tracks its customer's adherence to covenants.					
3. The bank regularly reviews and monitors the performance of Credit quality at individual level					
4. The bank regularly reviews and monitors the performance of credit quality at portfolio level					
5. Credit file is regularly updated in our bank.					
6. The bank has properly applied its own internal risk rating system.					
7. Credit monitoring procedure is regularly reviewed in our bank.					
8. Credit monitoring procedure is regularly updated in our bank.					

Please give any experience, comment or opinion on credit risk monitoring process which is applicable at your Bank. -----  
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4. Credit risk controlling practice

<b>Factors</b>	<b>5</b>	<b>4</b>	<b>3</b>	<b>2</b>	<b>1</b>
1. The bank constantly takes immediate corrective action for credit default sign.					
2. Credit policy is regularly updated in our bank.					
3. Policy measures have been taken regularly to solve loan recovery problem.					
4. The bank maintains the actual risk profile at or under its risk tolerance.					
5. Credit policy is consistently applied in all credit activities of the bank.					
6. The bank constantly monitors the financial condition of					

counterparties and action taken as required.					
7. The bank actively responds to new information in all aspect of credit products and activities.					
8. The bank gives adequate risk management training for concerned staffs.					

Please give any experience, comment or opinion on credit risk controlling practice which is applicable at your Bank. -----  
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**Appendix 2**

Interview Questions

1. What are the mechanism of identify credit risk in Abay bank?
2. How to evaluate the guaranty of loan in Abay bank?
3. What are the major process of credit risk monitoring in the bank?
4. How to control the credit risk in Abay bank?

Thank you for your cooperation

