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**ADDIS ABABA UNIVERSITY COLLEGE OF BUSINESS AND
ECONOMICS**

**ASSESSMENT OF CREDIT MANAGEMENT PRACTICE AT
UNITED BANK S.C**

**BY
HABLE ASRAT
ID No.GSE/1547/08**

**Under Guidance of
Sewale Abate (P.H.D)**

June, 2018

ADDIS ABABA, ETHIOPIA

**ASSESSMENT OF CREDIT MANAGEMENT PRACTICE AT
UNITED BANK S.C**

**A THESIS SUBMITTED TO MBA COORDINATION OFFICE,
COLLEGE OF BUSINESS AND ECONOMICS, ADDIS ABABA
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**IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE
DEGREE OF MASTER OF BUSINESS ADMINISTRATION IN
FINANCE**

**BY
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DECLARATION

I, the undersigned, declare that the thesis entitled “**ASSESSMENT OF CREDIT MANAGEMENT PRACTICE AT UNITED BANK S.CO.**” is my original work, prepared under the guidance of Dr. Sewale Abate. All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

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APPROVAL

This is to certify that this Thesis has been submitted in fulfillment of the requirements for the award of the degree of Masters of Business Administration with my approval as a university advisor.

Advisor's Name: Sewale Abate (PhD)

Signature _____

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ENDORSEMENT

This thesis has been submitted to Addis Ababa University Faculty of Business and Economics for examination with my approval as a University advisor.

Advisor's Name: Sewale Abate (PhD)

Signature: _____

Addis Ababa University

June, 2018

**Addis Ababa
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ABSTRACT

Sound credit management is a prerequisite for a financial institutions stability and continuing profitability, while deteriorating credit quality is the most frequent cause of poor financial performance and condition. These research asses the practice and effectiveness of credit management in united bank s.co. Therefore the purpose of undertaking this study is to explore the credit management practice in united bank s.co and to see the possible factor that influence the credit management activity of the bank and to suggest possible solution for those factor affecting the bank credit management process negatively. For the purpose of the study both primary and secondary data is used. Primary data is collected using semi structured questionnaire and interview. The secondary data is collected from the bank's audited annual reports(2013-2017), directives, credit policy and procedure of the bank and bulletins of the bank. Based on the nature of the study the research design is descriptive with a qualitative research method. Descriptive statistical tools are used to analyze the data collected. Hence, the nature of the Study is descriptive. The research found that lack of credit follow up by branches, lack of information system to support the credit risk grading system of the bank, branches negligence to the credit policy and procedure of the bank when exercising their discretionary lending limit, will full default by borrower, borrower lack of knowledge on loan usage, fund diversion for unintended purpose, and centralized decision making by the bank influence the attainment of successful credit management at united bank s.co. Also on a positive note the banks credit policy and procedure is in line with NBE's rules and regulation. Also for the year under consideration the bank NPL to Term loan ratio is under 5% which is set by the NBE. Finally based on this findings recommendations are given. These includes keeping up with the current portfolio quality, to strictly adhere & implement the banks credit policy and procedure, to take up pre-audit a part of the credit analysis process, managing the length of hour it take to process one loan request.

Key word: credit management and credit portfolio, NPL

CHAPTER ONE

INTRODUCTION

1.1. Back Ground of the study

The Ethiopian government promulgated the Monetary and banking proclamation No.83/1994 and supervision of banking business No. 84/1994 to liberalize the financial sector through reforms by bestowed banking laws that encourage the entry of private banks into the financial system in order to stimulate competition with the public banks which significantly promoted the development of the banking sector tremendously. Accordingly, many private banks have already been established and their number is increasing from year to year. Currently there are a total of 19 banks in Ethiopia. Due to this fact a fierce competition among banks has come to exist. In order to stay strong in this competitive banking environment banks act as an intermediary to mobilize the excess fund of surplus sectors to provide necessary finance, to those sectors, which are needed to promote for the sound development of the economy.

Banks play an important function in the economy of many countries. They are the main intermediaries between those with excess money (depositors) and those individuals and businesses with viable projects but requiring money for their investment (creditors). Banks have at least the following functions: lending money, safeguarding individuals deposit, transferring money locally or globally and working as paying agent. In their operation banks face various risks the types and degree of risks to which banks are exposed depends upon a number of factors such as its size, complexity of the business activities, volume etc. credit, market, liquidity, operational, compliance/legal/ regulatory and reputation risks. Out of all risks credit risk is believed to have adverse impact on profitability and growth. Credit management also called credit control is a dynamic field where a certain standard of long-range planning is needed to allocate the fund in diverse field and to minimize the risk and maximizing the return on the invested fund by increasing collection, reducing credit cost, extending more credit to credit worthy customers, and developing competitive credit terms.

This indicates that credit provision should be accompanied by appropriate and attractive credit policies and procedures that enhance performance of credit management and protects the banking industry from failure.

According to Greuning (2003) more than 80% of all bank balance sheets relate to credit. The goal of the credit management is to maximize the performing asset and the minimization of the nonperforming asset as well as ensuring the optimal point of loan and advance and their efficient

management. The overall success in credit management depends on the banks credit policy, portfolio of credit, monitoring, supervision and follows up of the loan and advance. According to Basel Committee on Banking Supervision (1999) credit can be defined as a transaction between two parties which one (the creditor or lender) supplies money or monetary equivalent goods services, etc.

In return for a promise of future payment by the other (the debtor or borrower) before allowing credit facility a banker should be satisfied that the applicant qualifies the following five essentials which may be termed as 5 Cs Strischek, (2000) namely- Character: borrower's integrity, honesty and intention to repay the loan money, Capacity: borrower's business ability, particularly profit making report, Capital: financial strength to cover a business risk, Conditions: it is general business condition, Collateral: borrower's ability to produce additional securities Golin, J.(2005).

Lang and Jagtiani (2010) state that loan administration is a process which is designed to avoid damages to an organization as a result of events unanticipated even though possible. According to Asiedu-Mante (2011) loans management includes instituting proper rightful policies and measures that will make sure that proper authorities give out loans, the loans get to the right customers, and the loan is given for productive reasons which are economically viable and appropriate.

Effective Credit management practices help the banks to ensure selection of right type of loan proposals/projects/ventures/enterprise 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 view point i.e. the strength and weakness of the client so that the client will be able to repay the bank loan as repayment schedule with profit. To prevent future financial crises, it is absolutely necessary to manage credit so as improve the borrowers' financial literacy, the lenders' process of transparency and to better assess loan product affordability and suitability. Thus, the axle of this study is to make an in depth assessment on the relationship between the theories, concepts and models of credit management and what goes on practically in one of the reputed private banks in Ethiopia- United Bank S.C.

United Bank was incorporated as a share company on 10 September 1998 in accordance with a commercial code of Ethiopia of 1960 and supervision of banking proclamation No.1994.the bank obtained a banking service license from the national bank of Ethiopia and is registered with trade industry and tourism bureau of the Addis Ababa city administration. At the end of June 2017 united bank reported a net profit 381 million with earning per share of 27.17%.currently united bank is a full service bank that offers its customers a wide range of services with a network of 97 branches, 17 sub-branches, 89 out laying branches and 9 out laying sub-branches (UB Annual Report, 2017).

1.2. Statement of the problem

Bank credit can be defined as money provided by the banks for eligible customers to support execution of legally formed profitable business or investment activities that have economic importance, with an agreement to pay back the principal with interest within the period specified in the loan contract.

According to Shekhar, 1985, credit plays an important role in the lives of many people and in almost all industries that involve monetary investment in some form. Hence, the issue of credit management has a profound implication both at the micro and macro level. The very nature of the banking business is so sensitive because more than 85% of their liability is deposits from depositors (Saunders, Cornett, 2005). Banks use these deposits to generate credit for their borrowers, which in fact is a major revenue generating activity for most banks. Not being able to manage financial risk especially credit risk would lead to financial anguish including economic failure.

Credit management can be seen as an essential part of lending and as such in its absence, good loans can turn bad. Thus it is expedient to note that the importance of credit management cannot be over-emphasized and good credit management requires qualified personnel and the establishment of adherence to sound credit policies, procedures. If the loan is well managed; it will increase the bank's profitability and sustainability in the future. However, if failed to do so, it will be the major threat to their survival (Koch&MacDonald, 2003).

United Bank is one of private banks in Ethiopia playing an important role in country's economy and social life. Among the various services provided by the bank, lending has been the primary activity for over a decade. It advances a large sum of its income to borrowers. It is equally true that bank loans, as they are profitable, equally risky. Bank loans fluctuate and influenced by the changes in the economic policy and the economy in general. It is very important for the bank to formulate and update their loan policies in order to minimize risk associated with them.

A loan default that results from poor credit management reduces banks lending capacity. It also denies new applicant's access to credit as the bank's cash flow management problem augment in direct proportion to the increasing default problem. In other words, it may disturb the normal inflow

and out flow of fund a bank has to keep staying in sustainable credit market. It also increase the bank's legal cost if the loan pass the workout stage and the case goes to court

In light of this the practice of credit management in United Bank s.co is being studied in this research.

1.3. Research questions

This study was intended to answer the following questions

- Does the bank implement its credit policy and procedure properly?
- What cause the bank's borrower to default?
- What are the major factor influencing the credit management of United Bank s.co?
- What efforts are expected of branch's before and after loan disbursement to avoid bad debts?
- How is the bank' credit granting process of United Bank s.co. Supporting the credit management process.
- What credit collection strategies are adopted in the management of credit in UB?

1.4. Objective of the study

In view of the stated problems the general and specific objectives of the study are stated as follow.

1.4.1. General Objective

General objective of the study is to assess the practice of credit management at united bank S.C.

1.4.2. Specific objectives

- To assess the enactment of the credit management process by observing how it is conducted, monitored and updated in United Bank s.co.
- To assess bank specific factors that influence credit management practice of United Bank s.co .
- To analyze the credit portfolio diversification and credit collection strategies.
- To examine if there is a gap in the current process regarding the range of tools and methods employed in credit management.

1.5. Significance of the Study

Loans and advances are known to be the main stay of all commercial banks. They occupy an important part in gross earnings and net profit of the banks. The share advances in the total asset of the banks forms a lion share almost more than 80 percent and as such it is the back bone of banking

sector. Bank lending is very crucial for it makes possible the financing of agricultural, industrial, construction, and commercial activities of a country. The strength and soundness of the banking system primarily depends upon health of the advances. Therefore the ability of banks to formulate and adhere to policies and procedures that promote credit quality and curtail nonperforming loans is the means to survive in the stiff competition. In ability to create and build up quality loans and credit worthy customers leads to default risk and bankruptcy as well as hampers economic growth of a country. Hence even though this study is only limited to one commercial bank in Ethiopian because of the below mentioned limitations it assumed to be significant in indicating best practice and concepts for prudent lending to enhance the performance of credit management to all managers and policy makers of the bank as well as to all financial institutions and banks. Moreover, it may help as a benchmark for researchers who are interested in the area to extend it further.

1.6. Limitation of the study

In conducting this research the researcher was also involved in another professional work which makes time be a great constrain. Also for the Same reason the researcher is limited with the scope of the study as Well because of data availability the researcher limited the study to only one private bank in Ethiopia namely United Bank S. Co

1.7. Scope of the Study

Geographical Scope

The study covered united bank S.Co as a sample among other private banks due to the concern on the availability of data, time and budget.

Subject Scope

The study focuses on the assessment of credit management practice at united bank S.C.

Data scope

Primary data include structured questionnaires and interview where as secondary data's are review of working policy and procedure, reports for the financial years (June 30, 2013- June 30, 2017), NBE directives and other related publications.

1.8. Organization of the study

The Study is organized into five chapters. The first chapter introduces the background of the study, statement of the problem, the research objectives and questions, significance of the study, scope 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 drawn from findings of the data

CHAPTER TWO

LITERATURE REVIEW

2.1. Introduction

This chapter gives the framework of the present literature on the procedures and processes that can be included in the operations credit management in financial institution.

2.2. 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). Banks as financial institutions extend credit to their customers in form of loans, overdrafts and off balance sheet activities (i.e. letter of credit (LC) and guarantees). Banks grant credit to enhance their revenues streams, maintain a competitive edge, to act as its bargaining power in the industry, as the industry practice as well as to enhance the relationship with their customers.

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 implementing and maintaining a set of policies and procedures to minimize the amount of capital tied up in debtors and to minimize the exposure of the business to bad debts. (<http://www.smallbusiness.wa.gov.au/assets/Small-Business-Briefs/small-business-brief-credit-management.pdf>). 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. (<http://www.selfgrowth.com/articles/Tabije3.html>)

When it functions efficiently credit management serves as an excellent instrument for the business to remain financially stable.

2.3. Process of Credit Management

More than 80% of financial institution's balance sheet is related to credit. For this reason banks should take a careful care when dealing with credit. The process of credit management begins with accurately assessing the credit-worthiness of the customer base and his/her business viability. This is done by looking in to loan applications carefully which is part of the loan process. This is particularly important if the company chooses to extend some type of credit line or revolving credit to certain customers. Hence, proper credit management is setting specific criteria that a customer must meet before receiving the proposed credit arrangement. Basu and Rolfes (1995) indicate that the success of a financial institution is built on a proper and quality credit management process. 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 of institution mainly bank. A weak credit risk management system is the reason for many none performing loans (Nishiru 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 frame ork of the above category includes the following:-

- ✚ Credit application
- ✚ Credit assessment
- ✚ Credit disbursement
- ✚ Credit monitoring

Credit recovery

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 dependants, educational background, hometown, the type of business, business location ,number of years in business, reasons for the loan, amount required, the repayment period, security pledge if any and guarantors. 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. A loan defaulter can escape legal punishment if the content of the loan application form is not properly structured. Hence the need to evaluate the existing loan application forms to ensure that they are properly structured to protect the credit unions.

Credit Assessment

This is the procedure for gathering the necessary information on a potential borrower and projects in order to conduct risk assessment exercise to determine the associated risk. This is carefully done by the financial institutions before providing any loans. This is also done to check the viability of the proposed project to undertaken. This as well helps to examine the technical viability, the economic viability and the financial viability of the project to be undertaken. The risk associated with the loan can be reduced by doing the above. Credit risk simply means the risk of default as a result of a borrowers' failure to repay the loan taken from a financial institution.

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 will be relied on when the repayment of the loan becomes difficult. This is a fundamental point in the credit procedure. It is said to be the heart beat of a healthy credit portfolio. This involves collecting, analyzing and processing information as provided by the applicant on the credit application form. This helps to assess the applicants' credit

worthiness and helps to reduce the difficulties between borrowers as an agents and the financial institution as the principal. The lending institution's loans management processes procedures and directives controls the loan evaluation processes. The question that must be answered before anything else is whether or not the borrowers have the financial capacity to repay the loan, that is, repay the credit when 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). In another context, Rouse (1989) referred to mnemonics used as common checklist to review loan application as: CCCPPARTS (Character, Capital, Capability, Purpose, Person, Amount, Repayment, Terms and Security); PARSER (Person, Amount, Repayment, Security, Expediency, Remuneration); CAMPARI (Character, Ability, Margin, Purpose, Amount, Repayment, Insurance/Security).

The disparity in the mnemonics relates to the fundamental principle of evaluating the potential of having credit repaid. Credit Appraisal thus ascertains the risks associated with lending functions in financial institutions. This is an indication that if the credit assessment is not properly done by the credit union, the risk associated with the credit will not be identified. It is generally carried out by the trained staff of the credit department of the institutions which are engaged in providing credit to their customers. In the present case, process used in credit risk assessment and appraisal has been studied to identify the various parameters and stages in credit assessment; appraisal and disbursement processes exist in the financial institution. It is intended to make sure actions which lenders take which facilitate repayment or reduce repayment likely problems. This information about the riskiness of the borrower makes the financial institution to take remedial actions like asking for collateral, shorter duration of repayment, high interest rates and other forms of payment (Stiglitz and Karla, 1990). When a financial institution does not do it well, its performance is highly affected. Edminster (1980) stressed the importance of credit analysis when he observed that its abandonment often resulted into several banks using credit card to process. The variables we have, according to Hunte (1996) added the period taken to process loan applications, credit experience, part of collateral security to the loan approved. It was established that long waited period of time reflected a shortage of credible credit information required to make informed credit decisions and availability of funds for onward lending. This in turn leads to a bigger risk, more extreme credit rationing and low repayment

rates. 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.

A less borrower who is not experienced has less ability to handle a business loan and therefore is not credit worthy (Devaney, 1984; Robinson, 1962; Hunte, 1996). This shows that there are big risks linked with first time borrowers since the loan officer has scanty information on their credit records and little knowledge on their ability to repay the loan when due. Therefore financial institution should attach all the seriousness to the credit assessment process in order to reduce the credit risk associated with credit since loans are the largest assets of financial institution like banks. Financial institution like bank have hirercially arrangement in order to approve loan and based on their greads branches would have a discretionary lending limit. Discretionary lending limit is the limit is the limit set to each branches based on their grade allowing them to disburse loan in different sector (credit policy and procedure of united bank s.co.)

Credit Disbursement

After an applicant has been carefully assessed and has been proven that the applicant meet the credit requirement of the credit union. The credit officer together with the credit committee gives their approval by appending their signature on the loan application form. This gives bank the right to disburse the funds to the applicant.

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 money is made available to the customer after all assessment has been done and approval has been given. The assessment process also ensures that the authenticity of the security and other required documentations are received certified before funds are given out to the qualified customer. If the loan pay-out control is not strong, the reliability of the loan management process will greatly be affected and can be undermined and misused by the unscrupulous staff of the organization. Thus, documentations and pay-out of the loans are vital in the management of loans because they ensure that the lending institution has the right documentation, collateral and guarantees of the loan agreement. Insurance, signing loan contract, registration of the property/collateral the bank being primary owner. This are 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 guarantee the retrieval of the loan. This would eventually reduce the provision for bad debts that financial institutions have which will improve their

financial position. Once the credit application satisfies all the bank's credit conditions, a comprehensive analysis is done to determine if the application complies with the institution's conditions then approval is given for disbursement to the applicant. Financial institutions have quite different ways of disbursing loans to its members which is different from how other financial institutions do. The credit disbursement can be crediting the loan amount to the customer's account all at once or it is done phase by phase for project type loans

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. The general business policy and advice the client as to how to put things in order. A financial institution can modify its own lending policies as well as loan monitoring procedures. Furthermore, keeping track of deposits trend and deposits balances gives a clue to the present state of affairs of the customer. Monitoring of loan facilities given to customers 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 diversions) 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 defaults for repayment of interest and principal installments.

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 NPL or 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.

2.4. CREDIT RISK MANAGEMENT

OCC (2011) identifies fundamental credit risk management principles as sound underwriting, comprehensive financial analysis, adequate appraisal techniques and loan documentation practices, and sound internal controls. Rose and Kolari (1995) see credit risk as the likelihood that borrowers will not be able to repay their loans within the period agreed upon. Kay (2002) sees Credit risk as distribution of financial losses due to unexpected changes in the credit quality of counterparty in a financial agreement.

Kay (2002) also sees it as the possibility of loan default or any type of inability to honor a financial agreement when due. Kay stated that the likelihood of default is estimated by specifying a model of investor uncertainty; a model of the available information and its evolution over time and a model definition of the default event.

Smook (1997) defines risk assessment as the general procedure of risk identification, quantification, evaluation, acceptance, aversion and management. He explains that risk management involves risk evaluation and risk control. In the piece he states that Risk assessment is a complex procedure of developing tolerable levels of risk to individuals, groups, or the society in general. It includes the associated procedures of risk acceptance and risk aversion. Fatemi and Fooladi (2006) characterize credit risk as risk that occurs from the ambiguity in a borrowers' capacity to meet his/her debt. At a

different slant, King (2008) defines credit management as the “policies and practices businesses employ in recovering payments from their defaulting customers”.

With respect to the levels of priority in financial institutions, it is expected that their main focus is to make known that this type of risk management is efficient beyond all others Fatemi and Fooladi, (2006). Risk acceptance means that the risk taker is ready to admit some risks to make a gain or benefit from it. This is when the risk is not avoidable or cannot be controlled. The acceptance level is a reference level against which a risk is identified and then compared. If the risk determined is less than the level that it can be accepted, the risk is then said to be within the acceptable range. On the other hand, if it is higher than the accepted level it is seen as unacceptable and avoidable, steps may be taken to control the risk or the project in question should be stopped.

Credit risk means the possibility of loan loss as a result of a borrower’s inability to make payments as per the loan agreement. Credit risk management, meanwhile, is the practicing of measures that reduces the impact of those losses by appreciating the competence of both a bank’s capital and loan loss reserves at any given period time, a process that has long been a challenge for financial institutions to fully implement. The worldwide financial predicament and the credit crunch that followed makes credit risk management very relevant. Accordingly, regulators began to call for more transparency. They wanted to know that a bank has thorough knowledge of customers and their related credit risk. And new Basel III regulations have created an even greater regulatory trouble for banks. To abide by the more rigorous regulatory requirements and contain the higher capital costs for credit risk, many financial institutions are changing their approaches to credit risk. The institutions who see this as sternly being a compliance exercise are being short-sighted. Better credit risk management also creates a chance to greatly progress overall performance and secure a competitive advantage over the competitors. The perception and the reception of risks differ based on the nature of the risks and depend on many fundamental factors.

The risk may include a "dread" hazard or a common hazard, be encountered occupationally or non-occupationally, have immediate or delayed effects and may affect average or especially sensitive people or systems. Risk aversion is the control action taken to keep away from risk. Risk management is concerned with the outcome of future events, whose exact result is not certain and the design of strategies to handle these uncertainties, over a variety of probable results. Generally, outcomes are categorized as favorable or unfavorable, and risk management is the art and science of planning, assessing, and handling future events to ensure favorable outcomes.

The large amount of debt that has been dispersed in the financial institutions over the years has undoubtedly resulted in bad debts and loan arrears across most of the financial institutions. This survey will concentrate on the management of credit and its impacts on the existence and profitability of the credit unions.

2.5. Credit Policies and Procedures

A Credit Policy is not something that is only operated by the Credit and risk Department. All employees involved with customers, in any way, need to be aware of the credit policy and ensure that it is operated consistently. In order to be effective, credit policies must be communicated throughout the organization, implemented through appropriate procedures, monitored and periodically revised to take into account changing internal and external circumstances. They should be applied appropriately, on a consolidated bank basis and at the level of individual affiliates. In addition, the policies should address equally the important functions of reviewing.

Economic conditions and the firm's credit policies are the chief influences on the level of a firm's account receivable. Economic conditions, of course, are largely beyond the control of the financial manager. As with other current assets, however, the manager can vary the level of receivables in keeping with the tradeoff between profitability and risk. Lowering quality standards may stimulate demand, which, in turn, should lead to higher profitable receivables, as well as a greater risk of bad debt. The credit and collection policy of one firm are not independent of those of other firms. If product and capital markets are reasonably competitive, the credit and collection practices of one company will be influenced by what other companies are doing. Such practice related to the pricing "The examination of certain policy variables implies that the competitive process is accounted for in the specification of the demand function as well as in the opportunity cost associated with taking on additional receivables. The policy variables include the quality of the trade accounts accepted; the length of the credit period, the cash discount, any special terms such as seasonal dating and the collection program of the firm. Together, these elements largely determine the average collection period and the proportion of bad debt losses". (Horne, 1995: 361)

2.6 Credit Analysis

Credit analysis is the primary method in reducing the credit risk on a loan request. Credit analysis is also the primary step in the credit management process. This includes, accepting application determining the financial strength of the borrowers, estimating the probability of default and

reducing the risk of non repayment to an acceptable level. In general, credit evaluations are based on the loan officer's subjective assessment or judgmental assessment technique. Once a customer requests a loan, bank officers analyze all available information to determine whether the loan meets the bank's risk-return objectives. Credit analysis is essentially default risk analysis, in which a loan officer attempts to evaluate a borrower's ability and willingness to repay.

Similarly Compton (1985) identified three distinct areas of commercial risk analysis related to the following questions: 1) what risks are inherent in the operations of the business?

2) What have managers done or failed to do in mitigating those risks?

3) How can a lender structure and control its own risks in supplying funds?

The first question forces the credit analyst to generate a list of factors that indicate what could harm a borrower's ability to repay. The second recognizes that repayment is largely a function of decisions made by a borrower. Is management aware of the important risks, and has it responded? As (Timothy 1995) quoted, the last question forces the analyst to specify how risks can be controlled so the bank can structure to an acceptable loan agreement.

A bank's credit analysts often use the five C's of credit to focus their analysis on the key dimensions of an applicant's credit worthiness Lawrence (1997:776-777), identified five C's of credit. They are "character, capacity, capital, collateral and condition".

Character: The applicant's record of meeting past obligations, financial, contractual, and moral. Past payment history as well as any pending or resolved legal judgments against the applicant would be used to evaluate its character.

Capacity: The applicant's ability to repay the requested credit. Financial statement analysis, with particular emphasis on liquidity and debt ratios, is typically used to assess the applicant's capacity.

Capital: The financial strength of the applicant as reflected by its ownership position. Analysis of the applicant's debt relative to equity and its profitability ratios are frequently used to assess its capital.

Collateral: The amount of assets the applicant has available for use in securing the credit. When the amount of available assets larger the greater the chance that a firm will recover its funds if the applicant defaults. A review of the applicant's balance sheet, asset value appraisals, and any legal claims filed against the applicant's assets can be used to evaluate its collateral.

Conditions: The current economic and business climate as well as any unique circumstances affecting either party to the credit transaction. For example, if the firm has excess inventory of the

items the applicant wishes to purchase on credit, the firm may be willing to sell on more favorable terms or to less creditworthy applicants.

Analysis of the general economic and business conditions, as well as special circumstances that may affect the applicant or firm is performed to assess conditions.

The credit analyst typically gives primary attention to the first two C's-character and Capacity because they represent the most basic requirements for extending credit to an applicant. Consideration of the last three C's-Capital, Collateral, and Conditions- is important in structuring the credit management and making the final credit decision, which is affected by the credit analyst's experience and judgment.

According to Golden and Walker (1993), there are five C's of bad debt; which represent things to guard against in order to help prevent problems. They include: **Complacency, Carelessness, Communication breakdown, Contingency, and Competition.**

Complacency refers to the tendency to assume that because things were good in the past they will be good in the future. Common examples are an over reliance on guarantors, reported net worth, or past loan repayment success because it's always worked out in the past.

Carelessness involves poor underwriting, typically evidenced by inadequate loan documentation, a lack of current financial information or other pertinent information in the credit files, and a lack of protective covenants in the loan agreement. Each of these makes it difficult to monitor a borrower's progress and identify problems before they are unmanageable.

Loan problems often arise when a banks credit objectives and policies are not clearly communicated. This is **communication breakdown**. Management should articulate and enforce loan policies, and soon as they appear.

Contingency refers to lenders' tendency to play down or ignore circumstances in which a loan might in default.

Competition involves following competitors' behavior rather than maintaining the bank's own credit standards.

During credit analysis bank use various lending tool and techniques

- **Credit/Concentration/ limit:** - Credit limit is one of the tools financial institutions use to control their loan portfolio. Setting credit limit is one of the main ways financial institution use to control its' credit process to reduce risks associated with lending. Bessis (2002) shows the significance of employing the credit limit process so as to avoid any credit risk which

could imperil the financial position of the institution. In Ethiopia private bank work according to the concentration limit set by national bank of Ethiopia.

- **Affordability:**-Increased regulatory focus and rising interest rates mean lenders need to revisit their measures of affordability ahead of changes. Precisely evaluating customers' affordability and suitability are indispensable requirements for all lending institutions who wish to widen credit responsibly as well as reducing exposure to risk. As lending institutions trying to balance growth with risk, some customers are faced with insufficient disposable incomes, the current economic situation has made it necessary for lending institutions to employ a better credit processes. Failure to implement a proper credit management process could put pressure on customers and lenders at a time when the economic climate not improving. 'Affordability is the assessment of a customer's financial capabilities to fund new and outstanding loan now and in the future. Thomas (2009) indicates that when assessing the affordability of a borrower it is their lack of cash flow and not assets that causes loan default in institutions.
- **Risk assessment model:** - Risk Assessment Model is internal rating software intended to aid a bank or financial institution in evaluating a borrower for credit. This is in line with the requirement under the internal ratings-based processes of the Basel II Accord.
- **Credit scoring/credit risk grading:** - This is a statistical system used to foretell the possibility that a loan will be in arrears, become delinquent or a borrower will default in repayment (Loretta 1997). Credit. This method is largely accepted as the primary system of examining the creditworthiness of customers.
- **Arrears intervention:** - Arrears is a legal term used by lending institutions to describe the part of a loan that is unpaid, overdue or repayments is missed as per the agreed loan terms. Finlay (2008) indicates that pressure should be put on loan defaulters at the early stages of the default, this action remind the defaulters about their obligations towards the institution. In line with Finlay's assertion, Hinder (2004) urges financial institutions to integrate adequate communication process when retrieving debt in arrears from customers.

2.7 Credit Information

Credit information is another tool that is used by bank in credit analysis. Adequate and timely information that enables a satisfactory assessment of the creditworthiness of borrowers applying for a bank loan is crucial for making prudent lending decisions. Prudent lending decisions made on the

basis of adequate information on the creditworthiness of borrowers are one of the principal factors in ensuring the financial soundness of banks. But, there has been serious difficulty in Ethiopia of getting accurate and timely information on prospective borrowers that facilitates the making of such prudent lending decisions. One of the means for alleviating this difficulty of getting accurate and timely information on prospective borrowers is the establishment of a Credit Information Center (CIC) where relevant information on borrowers is assumed to be pooled and made available to lending banks.

Binging this to our country context according to article 36 of the Licensing and Supervision of Banking Business Proclamation No. 84/1994, the National Bank Ethiopia (NBE) has issued these directives to establish such a Credit Information Center (CIC). Though there is still serious limitations in the accuracy of the credit information extracted the summary of the directive is as follows:

- Banks shall provide, alter and update credit information on each and every one of their borrowers using online system.
- Upon written request by banks, the Supervision Department of the NBE shall provide to the requesting bank, in writing, all credit information available in the Central Database on a prospective borrower within three working days from the date of receipt of the request;
- Access to the Central Database shall be restricted to the user group;
- The role of the NBE shall be restricted to administering the Credit Information Sharing system, providing in writing credit information on borrowers available at Credit Information Center to banks, ensuring that access to online system to update or alter credit information is given only to authorized persons and ensuring that the system is operating smoothly and reliably;
- The NBE shall not be responsible for any damages, claims or liabilities that may arise as a result of inaccurate, misleading or incomplete credit information on borrowers supplied to the Credit Information Center by individual banks and shared, through the NBE, with other banks.
- Each bank shall provide, electronically, the initial credit and other related information to the Credit Information Center on each and every one of its borrower;

- Each bank shall be fully responsible for providing accurate, complete and timely credit information to the Credit Information Center. In cases where errors have been made, such errors shall be corrected promptly by the concerned bank;
- Each bank shall be fully responsible for any damages, claims or liabilities that may arise as a result of providing inaccurate, misleading or incomplete credit information to the Credit Information Center or failure to provide, inadvertently or otherwise, information to the Center that should have been provided in line with these directives;
- Each bank shall use the credit information on borrowers obtained from the Central Database of the Credit Information Center only and only for making a lending decision. Such information shall be treated with utmost confidentiality and shall not be disclosed to any third party or used for any other purpose;
- Each bank shall be fully responsible for any damages, claims or liabilities that may arise as a result of disclosure of credit information on borrowers obtained from the Credit Information Center to third parties or use of that information for purposes other than for making a lending decision.

2.8. Non-Performing Loan

Loans and advances constitute the primary source of income by banks. As any business establishment a bank also seeks to maximize its profit. Since loans and advances are more profitable than any other assets, a bank is willing to lend as much of its funds as possible. But banks have to be careful about the safety of such advances (Radha .M, et al, 1980). Bankers naturally try to balance the issue of maximizing profit by lending and at the same time manage risk of loan default as it would impair profit and thereby the very capital .Thus a bank needs to be cautious in advancing loans as there is a greater risk which follows it in a situation where the loan is defaulted.

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.

2.9. Credit Collection Techniques

Effective credit collection techniques are one of the necessities for financial institutions in any economic climate. Knowing how to encourage customers to pay their outstanding debts to financial institutions like banks on time can increase the cash flow of banks. Therefore a number of collection techniques are employed. Under normal circumstances loan clients are expected to pay in cash or deposit or keep their installment repayment as per the agreement made. As the loan account becomes past due or overdue the collection effort becomes more personal and strict. The basic techniques are:

- **Telephone Calls:** If the loan client passes the due date, a telephone call may be made to the customer to request immediate repayment and up to date his or her account.
- **Personal visits:** - If the telephone call made is not resulted positive response vesting his business and discussing the issue with the customer can be a very effective collection procedure.
- **Reminder Letters:** - If the efforts made so far is unsuccessful and not resulted positive response a polite letter is to be served reminding the customer of its obligation followed by warning letters for the action to be taken in future and its consequence.

- **Using Collection Agencies:** Firms can turn uncollectible accounts over to a collection agency or an attorney for collection. The fees for this service are typically quite high; the firm may receive less than fifty percent on accounts collected in this way.
- **Legal Action:** legal action is the most stringent step in the collection process. It is an alternative to the use of a collection agency not only is direct legal action expensive, but is may force the debtor in to bankruptcy, thereby reducing the possibility of future business without guarantying the ultimate receipt of overdue amount.

2.10. Credit Risk Grading System in Credit Operations

This is another tool that is used during credit analysis Risk grading is a key measurement of a bank's asset quality and it is a robust process. Therefore borrower's risk grade should be clearly stated on the credit application form for using credit decision making process. Although the major objective of credit rating is to determine the ability and willingness of a borrower to pay at the agreed terms, the rating does a bit more than just classifying the borrowers into „pass and fail categories. Treacy and Carey (2000) suggested that in designing a credit rating system, a bank In CRG Manual, five risk components viz. financial risk, industry/business risk, management risk, security risk and relationship risk have been identified which are responsible of failing to meet the obligations by the borrowers. (credit risk grading manual of united bank s.co). These risk components are rated based on the some basic parameters. Note that there are twenty parameters under the five risk components to reflect the risk exposure. Financial risk comes from the financial distress of the counterparty.

It includes identification of extent of leverage through debt-equity ratio, liquidity of the borrower through current ratio, profitability performance through operating profit margin and coverage through debt-service coverage ratio. Business/Industry risk arises due to adverse change in business or industry situation. In order to assess the borrower's business/industry risk the size of borrower's business in terms of annual sales volume, age of business, industry growth, market competition and entry & exit barriers are to be assessed. Management risk is conducted in assessing the competence and risk taking propensity of the management. It covers the parameters like experience, second line/succession plan and team work of the management. Security risk is assessed by analyzing the primary security, collateral security and support. Relationship risk is considered under CRG by assessing the account conduct, utilization of limit, compliance of covenants and balance of personal deposits.

2.11. Loan follow up

Lending decision is made on sound credit risk analysis /appraisal and assessment of creditworthiness of borrowers. But past records of satisfactory performance and integrity are no guarantee future, though they serve as useful guide to project trend in performance. Loan granted on the basis of sound analysis might go bad because of the borrower may not meet obligations per the terms and conditions of the loan contract.

It is for this reason that proper follow up and monitoring is essential. Monitoring or follow-up deals with the following vital aspects:

- Ensuring compliance with terms and conditions
- Monitoring end use of approved funds
- Monitoring performance to check continued viability of operations
- Detecting deviations from terms of decision
- Making periodic assessment of the health of the loans and advances by noting some of the key indicators of performance that might include: profitability, activity level and management of the unit and ensure that the assets created are effectively utilized for productive purposes and are well maintained.
- Ensuring recovery of the installments of the principal and interest in case of term loan as per the scheduled repayment program

- Identify early warning signals, if any, and initiate remedial measures thereby averting from possible default. Basically there are three types of loan follow up systems. These are: Physical follow up, financial follow up and legal follow up. Each is discussed in section that follows.

a) Physical Follow -up

Physical follow-up helps to ensure existence and operation of the business, status of collateral properties, correctness of declared financial data, quality of goods, conformity of financial data with other records (such as taxes ,register books), availability of raw materials, labor situation, marketing difficulties observed ,undue turnover of key operating personnel, change in management set up among others.

b) Financial follow up

Financial follow up is required to verify whether the assumptions on which lending decisions was taken continues to hold good both in regard to borrowers' operation and environment , and whether the end use is according to the purpose for which the loan was given.

c) Legal Follow-up

The purpose of legal follow up is to ensure that the legal recourse available to the Bank is kept alive at all times. It consists of obtaining proper documentation and keeping them alive, registration, proper follow up of insurances. Specific issues pertaining to legal follow up include: ascertaining whether contracts are properly executed by appropriate persons and documents are complete in all aspects, obtaining revival letters in time (revival letters refer to renewal letter for registration of security contracts that have passed the statutory period as laid down by the law), ensuring loan/mortgage contracts are updated timely and examining the regulatory directives, laws, third party claims among others.

2.12. Provisions

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

Business Directives SBB/43/2008 in determining the extent of provisions for impairment losses. The Directive classifies loans and advances into the following.

a) Pass Loans

Loans and advances in this category are fully protected by the current financial and paying capacity of the borrower and are not subject to criticism. It is fully secured, both as to principal or interest payments, by cash or cash substitutes are classified under this category regardless of past due or other adverse credit factors.

b) Special Mention

Any loan or advance past due 30 days or more, but less than 90 days.

c) Substandard

Non-performing loans or advances past due 90 days or more but less than 180 days.

d) Doubtful

Non-performing loans past due 180 days or more but less than 360 days.

e) Loss

Non-performing loans or advances past due 360 days is classified as loss.

Extent of Provision Required

As per the directive of the national Bank of Ethiopia the extent of provision required for impairment of losses is determined as follows.

- I. Pass loans 1 percent of outstanding loan balances
- II. Special mention loans 3 percent of outstanding balance
- III. Substandard loans 20 percent of the net loan balance
- IV. Doubtful loans 50 percent of the net loan balance
- V. Loss 100 percent of the net loan balance

2.13. Review of Empirical Studies

Credit management is a serious threat to banks; therefore various researchers have examined the impact of credit management on banks in varying dimensions.

Ahmad and Ariff (2007) examined the key determinants of credit risk of commercial banks on emerging economy banking systems compared with the developed economies. The study found that regulation is important for banking systems that offer multi-products and services; management quality is critical in the cases of loan-dominant banks in emerging economies. An increase in loan loss provision is also considered to be a significant determinant of potential credit risk. The study

further highlighted that credit risk in emerging economy banks is higher than that in developed economies.

Ahmed, Takeda and Shawn (1998), in their study found that loan loss provision has a significant positive influence on non-performing loans. Therefore, an increase in loan loss provision indicates an increase in credit risk and deterioration in the quality of loans consequently affecting bank performance adversely. Ben-Naceur and Omran (2008) in attempt to examine the influence of bank regulations, concentration, financial and institutional development on commercial banks' margin and profitability in Middle East and North Africa (MENA) countries from 1989-2005 found that bank capitalization and credit risk have positive and significant impact on bank's net interest margin, cost efficiency and profitability.

Berger and De Young (1997), poor management in the banking institutions results in bad quality loans, and therefore, escalates the level of non-performing loans. They argue that bad management of the banking firms will result in banks inefficiency and affects the process of granting loans. The banks' management might not thoroughly evaluate their customers' credit application due to their poor evaluation skills. Therefore, banks' inefficiencies might lead to higher non-performing loans.

Kargi (2011) evaluated the impact of credit risk on the profitability of Nigerian banks. Financial ratios as measures of bank performance and credit risk were collected from the annual reports and accounts of sampled banks from 2004-2008 and analyzed using descriptive, correlation and regression techniques. The findings revealed that credit risk management has a significant impact on the profitability of Nigerian banks. It concluded that banks' profitability is inversely influenced by the levels of loans and advances, non-performing loans and deposits thereby exposing them to great risk of illiquidity and distress.

Pyle (1997), in his study on bank risk management held that banks and similar financial institutions need to meet forthcoming regulatory requirements for risk measurement and capital. However, it is a serious error to think that meeting regulatory requirements is the sole or even the most important reason for establishing a sound, scientific risk management system. It was held, managers need reliable risk measures to direct capital to activities with the best risk/reward ratios. They need estimate of the size of potential losses to stay within limits imposed by readily available liquidity, by creditors, customers and regulators. They need mechanisms to monitor positions and create incentives for prudent risk taking by divisions and individuals.

Girma (2011) investigated the relationship between bank performance and credit risk management. It could be inferred from their findings that return on equity (ROE) and return on assets (ROA) both

measuring profitability were inversely related to the ratio of non-performing loan to total loan of financial institutions thereby leading to a decline in profitability.

Tekele (2011) studied the reasons behind the problem of loan recovery and determinants of loan default and summarized some of the causes for loan defaults as improper selection of an entrepreneur, poor analysis of project viability, inadequacy of collateral.

He further discussed that factors affecting loan recovery can be categorized as pre-establishment problem, implementation, and operational problem.

Wondimagegnehu (2012) on “The determinants of Nonperforming loan on commercial banks of Ethiopia” also found as poor credit assessment, failed loan monitoring, underdeveloped credit culture, lenient credit terms and conditions, aggressive lending, compromised integrity, weak institutional capacity, unfair competition among banks, willful defaults by borrower and their knowledge limitation, fund diversion for un expected purposes and overdue financing has significant effect on NPLs. The above empirical review of literature emphasizes that all the studies so far conducted are mainly discussing the loan recovery problems, determinant factors for default of borrowers, the effect of Credit risk on bank performance and profitability in financial institutions in general at Macro-level and micro level.

Nagarajan (2001) in his study of risk management for financial institutions in Mozambique found that risk management is a dynamic process that could ideally be developed during normal times and tested at the wake of risk. It requires careful planning and commitment on part of all stakeholders. It is encouraging to note that it is possible to minimize risks related losses through diligent management of portfolio and cash-flow, by building robust institutional infrastructure with skilled human resources and inculcating client discipline, through effective coordination of stakeholders.

As to the knowledge of the researcher there are no studies conducted mainly to identify the problems related to lack of effective credit management with reference to united Bank Share Company. Thus, the researcher felt it appropriate to take up the present study entitled “ASSESSMENT OF CREDIT MANAGEMENT PRACTICE AT UNITED BANK SHARE COMPANY ” to examine the credit management problems and thereby to recommend courses of action that are assumed to promote quality loan growth and curtail non-performing loans.

2.14. Conceptual Framework

Wikipedia defines conceptual frame work as an analytical tool with several variations and contexts. It is used to make conceptual distinctions and organize ideas. it is particularly important in organizing

devices in empirical research. According to Miles and Huberman (1994), “a conceptual framework explains, either graphically or in narrative form (both much preferred), the main thing to be studied, the factors, constructs or variables, and the presumed relationships among them” (P. 18). The whole purpose of developing conceptual framework is to make research findings meaningful. From the previous empirical works the dependent and independent variables and their effect on one another is put as follows. The center of the study is credit management



As it can be seen from the above conceptual framework the variables involved are interdependent on one another and also affect the credit management practice of a bank directly or indirectly. And some factors like economic condition of a country affect

CHAPTER THREE

Research design and Methodology

3.1. Introduction

The methods used in assembling data and information for this research is shown and justified in this chapter. This stage is about how research was executed and how respondents were approached, as well as how the research was completed. Therefore in this section the research identifies the procedures and techniques that were used in the collection, processing and analysis of data. Specifically the following subsections are included; research design, data collection instruments, data collection procedures and finally data analysis.

3.2. The Research Design

Data could be collected and analyzed on the basis of research design because it provides the structure for such an assessment, Bryman and Bell (2013). This research is a descriptive research; the research uses questionnaire and interview as data collection tool. This was exactly used to collect useful information for assessment of credit management process at united bank s.co.

In this work, the respondents' opinions and experiences gathered from the questionnaire and interviews provided the needed input to the data. These data are gathered from both primary and secondary sources. The data are evaluated and added to the findings of the research. The survey is a quantitative one as a result of that the research questions are intended to suit the quantitative analysis. Due to that, a lot of the questions are close ended questions; however few of the questions are open ended questions while the interviews are all open ended questions

3.3. Population

The population of this study are the employees who are directly involved in credit processing and administering. This means Department heads, division heads, Branch managers, Assistant branch managers, Loan section heads, Loan officers, Loan supervisor, and Loan Committee members of all branches are included in the target group.

3.4. Data Collection Procedures

For the purpose of this study, both primary and secondary data are used. Interviews and questionnaires are used to collect primary data. The interviews are conducted with the management of the credit portfolio and management as the topic of the research relates directly to them and the

questionnaire are distributed to branches to loan offices and branch assistant or managers, and to members of credit management & analysis department.

3.4.1. Primary Data

This source provides data which is original and might have not been used before. The questionnaire and interviews are used as the principal source of data gathering.

3.4.1.1. Questionnaire

Questionnaire constitutes a very important instrument of data collection. The difficulty with it is when respondent are scattered around a very large area and when a large number of the sample size is illiterate. With this study, the questionnaire contained close ended questions as well as questions which open ended in nature. The questions that are close ended offer the respondents the opportunity to choose from answers provided whereas the open ended questions allow the respondents to give their answers. This technique helps to maintain the focus of the work on its primary objectives. The questionnaires for the purpose of this study the questionnaires are distributed right inside the case study both at branch and head office level. This allows the recovery possibility to be very high.

3.4.1.2. Interview

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

3.4.2. Secondary data

Secondary data were collected from annual report of the bank from 2013 to 2017, working policy and procedure of the bank , 2015, related journal, NBE directives, management directives of the bank issued at various times like Mgt. Directive No.002/10 on loan work out procedure of the bank, Mgt. Directive No.005/12 credit information user guide line and other relevant data's to aid the researcher.

3.5. Sampling techniques

The sampling technique used for the purpose of this study is stratified random sampling the technique of stratification is often employed in the preparation of sample designs because it generally provides increased accuracy in sample estimates without leading to substantial increases in costs. Though in order to select relevant respondents stratified random sampling is employed thus the

population is divided in to sub groups or strata based on branches and head office and samples were selected from each stratum.

3.6. Sampling size

Considering the objectives of the study, Proportionate Stratified Sampling (PSS) approach is followed to select the number of respondents from each stratum by which the researcher considered 50 branches (53%) as samples drawn from the entire population out of the entire 94 branches as of June 30, 2017 which are found in Addis Ababa city. The branches are chosen as a sample because one of the most important and primary activities in the credit management process i.e. Credit analysis takes place at branch level. To this end the minimum numbers of staffs directly involved at a branch level are two thus 100 employees were selected from branch level as a sample. Moreover due to the fact that the number of officers found at head office level at credit analysis and appraisal department, follow up department and risk department are 30 all are considered as a sample which brings the total sample size 130.

3.7. Data analysis

Most of the data were more of qualitative in nature thus; they are summarized and presented using descriptive statistical tools like percentages, frequency counts and ratios. Furthermore tables and figures are used to facilitate the analysis and to make it presentable for the readers. After the respondents answers are analyzed on the respective table explanation regarding the practice of credit management at united bank s.co is given based on the respondents answer.

CHAPTER FOUR

ANALYSIS, RESULTS, AND DISCUSSIONS

This chapter is concerned with the presentation, analysis, and interpretation of the data gathered via primary sources both questionnaires and interviews and secondary sources collected from the bank's annual reports, manuals and data bases.

4. Questionnaires Distributed and Collected

Table 4.1.: Performance of Questionnaires Administered

Questionnaires	Freq.	%
Distributed	130	100
Collected	105	81

Source: Researcher's Survey Result from Primary Data Sources

As it can be seen from Table 4.1, 130 questionnaires were distributed to employees of the bank who are working and experienced in credit area. In this cases 105 (81%) percent of the distributed questionnaires were collected. As the distribution and collection of questionnaires is managed by self and assistant of others whom the researcher believed to have experience in the area together with high cooperation rendered from the employee the achievement was to the required level and this has enabled to extract sufficient and relevant information to the objective of the research.

4.1. Demographic Characteristics of Respondents

The demographic nature of the employee has a great contribution in the credit management of loans and advance in understanding the credit policies and procedures as well as exercising and improving it when demanded. Thus, in this research process the demographic characteristics of respondents like gender, age, marital status educational level, work position and credit related experience are assessed.

Table 4.2.: Gender

Issue Gender	Frequency	%
Male	80	76
Female	25	24
Total	105	100

Source: Researcher's Survey Result from Primary Data Sources

The mix of gender of the employee in the loan area is, 76 percent dominated by the male parts and 24 percent is female as it is shown in table 4.2.

Table 4.3.: Age

Age	Freq.	%
20-30	60	57
31-40	35	33
41-50	10	10
Above 50	0	0
Total	105	100

Source: Researcher's Survey Result from Primary Data Source

Most of the age of the respondents young and adolescent as shown in table 4.3., 57 percent are in the range of age between 20 to 30, and 33 percent are also between the ranges 31 up to 40. This implies the bank has the human resource that can work energetically and competitively understanding the mission and goals of the bank in this area.

Table 4.4.: Marital status

Marital status	Fre	%
Single	50	48
Married	55	52
Total	105	100

Source: Researcher's Survey Result from Primary Data Sources

By its nature the financial industry is very sensitive and risk exposed requiring human resources who are responsible, trust full, and accountable for the prudent management of the finance. Hence if the employee working in such risk exposed area is tied up with such social responsibilities it adds value. In the table 4.4 52 percent of the respondents are married while 48 percent are yet single.

Table 4.5.: Educational Qualifications of Respondents

Qualification	Fre	%
Diploma	0	0
First degree	80	76
Masters	25	24

PHD	0	0
Total	105	100

Source: Researcher's Survey Result from Primary Data Sources

Educational background of employee is an important factor to be considered with regard to making loan related decisions. As it can be reviewed from table 4.5, 76 percent of the respondents are degree holders whereas 24 percent of respondents are Masters Holders. This denotes that the majority of the respondents working in credit area are well experienced and trained and still updating themselves. This enables the Bank to perform most and become competitive.

Table 4.6.: Work Position of Respondents

Position	Fre	%
Managerial	30	29
Loan work out process	25	24
Clerical	50	47
Total	105	100

Source: Researcher's Survey Result from Primary Data Sources

Table 4.6 shows 29 percent of the respondents are at managerial position which includes branch managers and assistant branch managers where as 24% are professionals at officer level and 47 percent are clerics mainly loan officers and analyst.

Table 4.7.: Credit Related Experience of Respondents

Duration	Fre	%
1-5 year	44	42
6-10 year	46	44
Above 10 year	15	14
Total	105	100

Source: Researcher's Survey Result from Primary Data Sources

As it can be seen on table 4.7., More than 40 percent of the respondents have credit experience of 6- 10 years and 14 percent have above 10 years experience which helped the researcher to capture good quality of data Credit processing and appraisal is done by the bank prior before providing any loans and advances which starts since a prospective borrower walks in to the branch.

4.2 Research related questionnaires

Table 4.8.: Credit Processing/Appraisal

No		Strongly agree		Agree		Uncertain		Disagree		Strongly disagree		Total	
		Fre	%	Fre	%	Fre	%	Fre	%	Fre	%	Fre	%
A.	The bank demands a business plan from all clients to identify risk exposure	18	17	50	48	10	10	25	24	2	2	105	100
B.	The bank look at relevant experience of the loan applicant	95	90	10	10	0		0		0		105	100
C.	The bank carries out credit processing activities independent of the appraisal	11	10	52	50	15	14	25	24	2	2	105	100
D.	The banks credit granting and approval process establish accountability to decision makers	51	49	50	48	4	4	0	0	0	0	105	100
E.	There are times the credit granting and monitoring of applicant's can be influences by directors, senior managers or influential staff of the bank	6	6	40	38	25	24	20	19	14	13	105	100
F.	The bank look at collateral whenever granting any loan	105	100	0	0	0	0	0	0	0	0	105	100
G.	The bank consider the past repayment track record of	5	5	100	95	0	0	0	0	0	0	105	100

applicants													
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Though; Solid loan appraisal process is considered as the foremost means to control loan quality. Following this the researcher raised some questions. As indicated in table 4.8 item (A) Respondents were asked whether the bank analyze borrowers risk exposure by inquiring business plan 17% of the respondents strongly agreed with the issue while 48% agreed in the mean time 24% of them disagree, 2% of them strongly disagree and 10% of the respondents are uncertain.

In the same table item (B) respondents were asked whether the bank look at the relevant experience of loan applicants with this regard 90% of the respondents strongly agreed and 10% of them also agree. As it can be seen on item (c) of table 4.8, 10% of respondents strongly agreed the bank carried out credit processing activities independent of the appraisal where as 50% agreed.

On table 4.8 item (d) respondents were asked whether the credit granting process establishes accountability to decision makers; 49% of the respondents strongly agree at the same time 48% of them agreed while 4% of the respondents were uncertain and none of them disagree.

Regarding the question presented whether credit granting and monitoring of applicants influenced by senior bank management members and directors on table 4.8 item (e) 6% of the respondents strongly agree while 38% of them agree and 24% of the respondents were uncertain where as 19% of respondents disagree and 13% of them strongly disagree. Item (f) of table 4.8 describes that 100% of the respondents strongly agree that the bank look at collateral when ever granting a loan.

It is clearly seen that 100% of the respondents witnessed that the bank look at the past repayment track record of applicants on table 4.8 item (g) being 95% of them strongly agreed and 5% of agreed. While the above table 4.8 is summarized; one can see that the credit processing and appraisal of the bank is in a good condition except matters that the credit granting and monitoring is influenced by Influential persons of the bank and the case that the bank sometimes requests business plan from prospective borrowers which might deteriorate the bank asset quality. Requesting business plan tells the customer has a clear direction as to how to operate his/her business. It is also noticed that even though the bank has it as a policy to request for a business plan most interested applicants are not able to provide because they do not have the culture of preparing one. On some occasions it was also noticed that the banks influential bodies involve in the decision making of some loan related decisions to certain customer when it is believed that the customer has a potential and the customer's relation with the bank is found to be beneficiary. The

bank estimates the securities offered by its own engineers and takes the value it believes that property deserves (Property estimation guideline of the bank, 2013).

Table 4.9.: Monitoring and Control Of Credits

No		Strongly agree		Agree		Uncertain		Disagree		Strongly disagree		Total	
		Fre	%	Fre	%	Fre	%	Fre	%	Fre	%	Fre	%
A.	Does collateral estimation regularly assessed & related to applicants financial health	20	18	65	62	10	10	10	10	0	0	105	100
B.	Does the bank do pre audit before fund has been released to the applicant					5	5	100	95			105	100
C.	The bank periodically prepare credit quality reports for signaling loan loss in any portfolio	16	15	89	90	0	0	0	0	0	0	105	100
D.	Customers are given sufficient advice on the usage of loans.	0	0	0	0	3	3	26	25	76	72	105	100

Source: Researcher's Survey Result from Primary Data Source

Also the Structured Questioners prepared were focusing on the monitoring and control of credits among this in the aforementioned table 4.9 item (a) respondents were asked whether the bank do collateral estimation regularly related to the borrowers financial health with this regard 62% of the respondents agree and 18% of them strongly agree where as 10% of them disagree and 10% of the respondents were uncertain.

Item (b) of table 4.9 assessed whether the bank do pre-audit before disbursement has been made to the borrower 95% of the respondents strongly disagree with the statement where as 5% of them are uncertain. As it is shown on the above mentioned table 4.9 Item (d) on table 4.9 shows 15 and 90 percent of the respondents strongly agree and agreed respectively regarding, the periodical preparation of quality credit report signaling loan loss of any portfolio the bank. As it is depicted on item (e) of table 4.9 respondents were asked whether sufficient customer training on the usage of loan 25 and 72 percent of them disagree and strongly disagree respectively while 3 percent showed that they are uncertain. Every three years

securities offered for loans are re-estimated as long as the loan is active (Property estimation guideline of the bank, 2013).

Hence, proper monitoring of credit has assumed greater significance in the effective management of leading yet most of the respondents have witnessed that the bank does not provide any advice on the usage of loan and no pre audit is made prior to disbursements which are critical factors. the bank advice branch manages to undertakes pre and post disbursement visits usually the pre disbursement visit is undertaken but the post disbursement is not taken seriously by branches or the bank as whole and beside this monitoring mechanism it would be advisable for the bank to provide advice to the customers on how to use the credit. Pre audit can be costly especially time wise but it can be used as one important control mechanism in credit analysis and appraisal process but it can be seen that the bank does not take in to consideration. The credit portfolio management department collects data's related to loan on a monthly and quarterly basis compile that data and report to National Bank of Ethiopia, the bank's president office and board of directors.

Table 4.10: Credit Risk Management

No		Strongly agree		Agree		Uncertain		Disagree		Strongly disagree		Total	
		Fre	%	Fre	%	Fre	%	Fre	%	Fre	%	Fre	%
A.	The loan portfolio is invested in different sectors of the economy	15	14	70	67	15	14	5	5			105	100
B.	Does the bank loan portfolio concentrate in particular sectors of the economy			60	57			20	19	25	24	105	100
C.	The bank quickly responds to market changes			75	71	10	10	15	14	5	5	105	100

Source: Researcher's Survey Result from Primary Data Sources

The importance of prudently managing sectoral concentration risk in banks' credit portfolio is generally well recognized On the above mentioned table 4.10 item (a) 14 and 67 percent of the respondents strongly agree and agree respectively that loan portfolios of the bank are invested in different sectors of the economy while 5% of the respondents replied their disagreements and 14 percent are uncertain about the sectoral distribution.

On the same table item (b) 57 percent of the respondents strongly agree the bank loan portfolios concentrates on particular sectors while 19 and 24 percents of the respondents describe their level of disagreements and strong disagreement on the statement. Most of the bank's loans are concentrated on certain risks most of the time mainly domestic trade, transport loan and export. This arises from the demand but also exposes the bank to concentration risk.

Table 4.10 item (d) raises question about whether the bank quickly respond to market change with this regard 71 percent of the respondents agree 10 are uncertain while 14 and 5 showed the ir disagreement and strong disagreement which is relatively good from the researcher point of view. This shows that the bank tries to stay competitive still protecting the market value of the bank and the share holder's interest. Any change in the market a good example can be the 2017 devaluation which led the bank to increase the interest rate by 2% on every loan and advance.

Table 4.11: Credit risk grading/rating

No		Strongly agree		Agree		Uncertain		Disagree		Strongly disagree		Total	
		Fre	%	Fre	%	Fre	%	Fre	%	Fre	%	Fre	%
A.	The bank has an internal credit rating system.	105	100	0	0	0	0	0	0	0	0	105	100
B.	Does the bank do credit rating on all projects approved at branch level			95	90				10	10		105	100
C.	The bank quantifies risk through credit rating			75	71	30	29					105	100
D.	The bank rate the management capacity of loan applicants	105	100									105	100
E.	Does the bank rating system predicts debt repaying capacity of loan applicants	25	24	80	76							105	100
F	The rating system is supported by information systems			45	43	35	33	25	24			105	100

Source: Researcher's Survey Result from Primary Data Sources

The credit risk grading is the process of assessing the risk that the bank has engaged in every borrower of the bank. It's among many essential instruments for sound credit management. United bank co have it on

credit risk grading/rating system developed by its IT team. The system tries to rank the loan applicants of the bank a risky/bankable/ and not risky/not bankable/. The system uses five parameter in order to do that namely track record/past loan repayment and account operation history/, management experience, relationship of the customer with the bank, realizable and coverage of the security offered, and financial performance of the applicant's business In relation to credit rating/grading/ 100% of the respondents strongly agree that the bank has internal rating system.

In table 4.11 item (a) but regarding the question with respect to the bank do rating on all the projects approved at branch level 90 and 10 percent of them agree and disagreed respectively on the same table item (b) this implies branches when they approve a loan using their discretionary lending limits does credit risk grading as long as it is not for staff loan. Table 4.11 item (c) describes whether the bank quantifies its risk through credit rating with regard to this 71% of them agree and 29% of them are uncertain. . There are 1 to 5 ranks in the credit risk grading system 1 being a good grade and showing that the customer is bankable while 5 is to a customer that can't be financed most of the time this process is only done because it is mandatory and is rarely used for decision making. Item (d) of table 4.11 depicts whether the bank rates the management capacity of respondents in line to this 100% of the respondents strongly agree. Respondent's reaction with regard to whether the bank predicts debt servicing capacity of loan applicants is reflected on item (e) of table 4.11 so 76% of them agree whereas 24% of them shows their strong agreement. On Table 4.11 item (f) questions raised whether the bank rating system is supported by information systems with regard 43 of the respondents agreed, 33 are uncertain and 24 percent disagreed with the statement this implies there is a critical need to support the grading process through information system to avoid subjectivity. Even though there is an information system supported credit risk grading system currently it can easily be manipulated.

Table 4.12: prevailing factors affecting timely decision

No		Strongly agree		Agree		Uncertain		Disagree		Strongly disagree		Total	
		Fre	%	Fre	%	Fre	%	Fre	%	Fre	%	Fre	%
A.	Delay in obtaining credit information			15	14	20	19	70	67			105	100
B.	Lack of adequate man power			5	5			30	28	70	67	105	100
C.	Centralized decision making process	50	48	55	52							105	100
D.	Submission of incomplete data by prospective borrower			78	74			27	26			105	100

Source: Researcher's Survey Result from Primary Data Sources

One of the major ways customers decide to use a bank is the possibility of getting a loan and the time it takes to be done with the process. Therefore even though timely and accurate credit decisions are critical to banks there are factors which hinders them to do so therefore the researcher aspired to question which are the most prevailing factors affecting timely decision among this table 4.12 item (a) describes how much is the impact of delay in obtaining credit information 14 and 70 percent of them show their agreements and disagreements respectively where as 19% of them says they are uncertain about the statement. Credit information is a mechanism of having a customer's credit relation with any of the banks it is done by using a system that is developed by national bank of Ethiopia and is updated every month end. It is actually one of the requirement of the national bank of Ethiopia not to process a loan without enquiring credit information.

Item (b) questions if there is lack adequate man power 5% of the respondents agreed while 28 and 67 percent of them disagree and strongly disagree respectively. This is noticed mainly in new branches where there are not a lot of loan activities.

Item (c) of table 4.12 questions whether centralized decision affects timely decision with this regard 48 and 52 percent of them strongly agree and agree with the statement. Loans at united bank s.co are approved at different level based on their discretion by three committee BCC (branch credit committee), CMC (credit management committee), ECC (executive credit committee) the later two are at head office level so the delay mainly happen when loans are approved at head office level.

Item (d) shows that 74% of respondents agree that Submission of incomplete data by prospective borrower is most prevailing factor in timely credit decision where as 24 percent of them disagree. Even though loan are not granted to customer ho submit incomplete document the problem is after informing the loan applicant's of the required document it take the loan applicant to provide the bank with all the document needed to process the loan on time. Customer's document presentation is mainly affected by what they were told at the beginning when they initiated the loan process if they are not given full information then they will be greatly dissatisfied with the service they get and mainly the will lose time and other times it is lack of proper documentation by the customer causing this problem.

Table 4.13: Credit policy, processing, and collection procedures

No	Credit policy, processing and collection	Yes		No		Total	
		Fre	%	Fre	%	Fre	%
A.	The bank has credit policy or manual	105	100			105	100
B.	The bank has updated credit policy	100	90	5	5	105	100
C.	The bank's credit policy in compliance to NBE rules and regulations.	105	100			105	100
D.	The bank's loan service are as per client's preference	68	65	37	35	105	100
E.	Collection technique used by the bank are effective	73	70	32	30	105	100

Source: Researcher's Survey Result from Primary Data Sources

In the table 4.13, 100 percent of the bank employee replied positively for having credit policy and procedure manuals. It is one of the tool and technique used in credit management process. Hence it is crucial to have credit policy document to protect the bank against over exposure, mal-administration of credit, managing of non-performing loans, and arrive at a trade-off between returns and risks. 90 percent of respondents recognized it is updated. The bank updated the main credit policy and procedure manual through time by issuing various procedures about a specific amendment. The revision the banks credit policy and procedure is based on change in the, bank specific factors.

Moreover, 100 percent of the employees have agreed on the compliance of the credit policy and credit procedures to the regulation and directions of the National bank of Ethiopia (NBE), which is the regulatory body of the nation. In the table 4.13, 65 percent of the employees believed that the

prevailing loan service is to the client preference of the prevailing growth of loans while as well as 35 percent of them have recognized the deviation of the loan service provided with the preference and expectation of the potential loan clients. Still the bank tries to recognize potential loan areas and sectors and is trying to reach all societies need by introducing new loan products. Finally on item E of Table 4.13. 70 percent of the respondents agreed that the collection techniques are effective while 30 percent voted against it.

Table 4.14 Time interval for processing a single loan and make decision

No	Time interval in loan process	Fre	%
A.	Less than 15 Days	10	10
B.	15 Days To 30 Days	20	19
C.	Above 30 Days	75	71
	Total	105	100

Source: Researcher's Survey Result from Primary Data Source

Many factors contribute to the time it takes to complete one loan process like the time it takes to collect the needed documents, analysis both at the branch and the approving organ also depends on where the loan is being approved branch, liquidity status of the bank. Loan processing is one of the measurements of credit management in banks. Hence, the processing procedure, transparency, and length of time are some of the factors determining the convenience of lending facilities which contributes to loan growth and lasting client - bank relationship. Bearing this in mind the researcher raised question about the time interval for processing single loan and to pass decision 10% of the respondents says it takes less two weeks where as 19% of the respondents replied it takes between two weeks to a month while 71% of the respondents replied more than a month

Table 4.15: Credit Creation by the bank

Credit creation	Fer	%
By staffs approaching promoted clients	25	24
By new clients approaching with new	80	75

request		
Total	105	100

Source: Researcher's Survey Result from Primary Data Sources

As it is shown in the table 4.15, 75 percent of the loan is created by new applicants approaching the Bank with credit request while 24 percent is created by the employees approaching potential loan clients. These shows the Bank employees especially branch managers should further exert efforts to approach potential loan clients as it is the best way of creating quality loans as well as to win the prevailing so stiff competition.

Table 4.16: Collection techniques of the bank

	Fre	%
Debiting customers account as per an undertaking letter	56	53
Cash/cheque payment	15	14
Transfer	29	28
All	5	5
Total	105	100

Source: Researcher's Survey Result from Primary Data Sources

The collection technique so far adopted by the Bank is cash/check payment, debiting own account per the given undertaking authorization, and transferring through the bank's branch excluding commission charge. As it is shown in table 4.16, 53 percent adopts debiting the clients account, 14 percent uses cash collection system, and 5 percent uses either cash or debiting account system of collection technique While 28 percent uses transferring when the clients are out of the branch. Hence, the most common collection techniques used by the bank is transfer and debiting Clients account.

Table 4.17: Credit policy and procedure of the Bank

Credit policy and procedure	Fre	%
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Rigid	35	33.3
Flexible	32	30.5
Average	38	36.2
Total	105	100

Source: Researcher's Survey Result from Primary Data Sources

How encouraging and flexible a bank's credit policy is another factor for customers to decide to be a customer of a bank or not in compliance to the policy of the regulating body, all banks formulate their own credit policies and procedures which assist to provide different type of credit within each credit policy to their loan customers. Therefore, knowing the outlook of loan clients for each bank is very important in reshaping its credit policy and procedures.

Hence, In order to know the nature of the Bank's credit policy, the researcher raised questions for the employees of the Bank. Consequently, as revealed in Table 4.17, 36.2 percent of the respondents said the credit policy and procedure of the bank is on average in its workability and 33.3 percent claimed as it is rigid. While, 30.5 percent of them said that the credit policy of the Bank is flexible. In the interview made most of the division and department managers have agreed on the importance, attractiveness and convenience of flexible credit policies and procedures as it assists for loan creation and growth. They also noted that the flexibility should come by keeping the protection and the best interest of the bank in mind.

Table 4.18: Rate of credit analysis and processing

Rate of analysis and process	Fre	%
Excellent	5	5
Very good	48	45
Good	42	40
Fair	10	10
Poor	0	0
Total	105	100

Source: Researcher's Survey Result from Primary Data Sources

In relation to credit analysis, as indicated in table 4.18, 45 percent of the bank employees have rated the credit analysis of the bank very good, 5 percent rated Excellent, 40 percent rated good while 10 percent rated fair. Hence, there is a gap needed to improve the quality of credit analysis and loan processing at both head office and branch level to the status of excellent level that enables to create quality loans managing non-performing loans.

Table 4.19: Methods used to improve repayment

Measure	Fre	%
Loan scheduling	10	10
Additional loan	5	5
Frequently insisting the client	90	85
Total	105	100

Source: Researcher's Survey Result from Primary Data Sources

Branches should start on the repayment probability of the loan since the beginning of the loan. They should consult with the customer on the frequency of the repayment based on the cash flow of the customer's business. As it is indicated in table, 4.19, 85 percent used to settle the non-performing loan through frequent follow up and insisting the loan client. Moreover, 10 percent of the bank employees have replied the bank reschedules loans when the cause of default occurs justifiable while 5% of them replied additional loan is made. From the interview with the staff of the portfolio and credit management they would go in to a great length before the loan could go in to the legal department and foreclosure could follow but the first and the most important step in done in the branch where the loan was granted.

Table 4.20: Effectiveness of forcing measures

Forcing measure effectiveness	Fre	%
Effective	75	71

Ineffective	30	29
Total	105	100

Source: Researcher's Survey Result from Primary Data Sources

With regard to the enforcing mechanisms, the researcher raised questions and assess their effectiveness as shown in table 4.21 above, 71 percent of the respondents confirm the effectiveness while 29 percent disclosed its ineffectiveness. The main reason for the ineffectiveness is that in most cases people do not want to buy others property which is held as collateral by banks.

Table 4.21 Non- performing Loans to Total Loan Ratio

Year	Disbursement	Collection	Outstanding loan	NPL	NPLTL IN %
2013	2.22	2.58	4.71	119.2	2.53
2014	2.08	3.30	5.06	87.9	1.73
2015	2.17	3.23	6.86	116.2	1.69
2016	3.17	5.24	8.5	143.1	1.68
2017	4.95	5.98	11.9	95.9	0.81
Total					

Source: NBE Annual report, Annual Progress Report of the Bank and own computation

The whole disbursement and outstanding loans figure is in billion while the collection and outstanding loan figure is in millions.

Non- performing Loans to Total Loan Ratio is one of the most important criteria to assess the quality of loans or asset of any commercial bank. NPTL measures the percentage of gross loans which are doubtful in banks' portfolio. The lower the ratio of Non-performing loans to total loan ratio, the better is the performance with this in mind when we look at the NPTL ratio of the bank taken five years from 2013-2017 its shows the bank has managed to keep the ratio below the threshold set by NBE which is 5%.

Table 4.22 Provision held for Non- performing Loans

Year	Actual amount held	Planned	Variation
2013	87.56	95.4	7.84
2014	77.81	99.75	21.94
2015	73.04	103.41	30.37
2016	83.87	91.53	7.66
2017	110.98	119.43	8.45

Source: Annual Progress Report of the Bank, Annual report of the bank and own computation

The whole figure is in millions in the above table. As can be seen from the above table the bank holds provision less than they anticipates also beside the year 2016 & 2017 the amount held showed a decreasing trend. As can be seen from the data presented on table 4.23 for the years where there is low NPL there is higher provision held for example year 2017. The explanation for this misunderstanding is the concept of NPL. Non-performing loans (NPL) is status given for loan and advances that stays outstanding for more than 90 Days. Not over due/impaired loans (provision held 1%), overdue but not impaired (provision held 3%), impaired loans (provision held 20%,50%,100%) for the last status the provision percentage depends on the number of days the loan stays outstanding/unpaid.

From the fiscal year ended 2013 going on to fiscal year 2014 the newly disbursed loan are very low showing only an increase of 0.3 billion so as can be seen from the table with reference to table 4.22 the provision held decreased following the decrease with NPL and Loan and Advances in the fiscal year ended 2014. Therefore in the two years the banks provision decreased 11.05%. from the fiscal year 2014 to 2015 the provision increased only by 2.01% mainly because there was only a 0.09 billion increase in a freshly disbursed loans in the fiscal year 2015

As I tried to mention above NPL only covers the impaired portion of the loans but it should be noted that the bank is required to hold provision for each outstanding loans under the different 5 stages by NBE.

From the fiscal year 2015 to 2016 the increase in the banks provision is not major only by 14.8%. in the two years under neither past due nor impaired loans increased by 1.6 million, past due but not impaired loans increased by only 238,718 which is small relative to other years under consideration. Impaired loans increased by 26.8 million again relatively it is small.

From the fiscal year 2016 to 2017 NPL (impaired loan) decreased from 143 million to 95.9 million ie by 47 million. Here the bank held 20%, 50%, 100%, while the past due but not impaired loans increased by 94.9 million where the bank held 3% provision. The banks neither past nor impaired outstanding loan increased by 3.4 billion where the bank was required to held 1% provision that means over all it incurred a 32.32% increase in provision.

4.3. In depth interview

In order to get deep understanding about the credit management of United Bank s.co, in-depth interview was conducted with department managers and division heads. All of the interviewees have had over seven year's credit experience. Accordingly the interviewee's responses to the questions are depicted briefly as follows. However, most interview responses are presented and analyzed in the questionnaire analysis part as a supportive response. Before the response is presented in a summarized way an interview guide line is given as follow.

First before I choose my interviewees profiled their position function in relation to the topic of my research. Since they study is about credit management there is no better place than credit portfolio management department the bank to conduct the interview with since the staff in that department is solely engaged in the credit management process. The next step I took was setting a requirement and from all the staffs I choose the manager of the department who has a long year experience in credit management and loan work out. Since this is an additional way of collecting primary data I set my priority to asking about the actual credit management practice to be my priority and only limited my question to that.

The summary of the questions asked with the response is shown below:-

A. Generally Perception about Credit Management of the Bank by the interviewees

Most of the respondents have so many in common as to what they believed the credit management practice of the bank. Loan processing and lending function is the core product of all banks in general as it contributes the major shares of revenue to its profitability. In other words loans and advances are known to be the main stay of all banks. They occupy an important part in gross earnings and net profit of the banks. The share advances in the total asset of the banks forms a lion share (almost more than 60%) and as such it is known as the back bone of banking sector. The strength and soundness of the banking system primarily depends upon health of the advances. Therefore, in order to promote the lending function to the required level the Bank should produce and follow up to date, convenient credit policies, and procedures to attract potential loan clients so as to develop a long lasting two way borrower and bank relationships.

B. Interviewed responses summary for factors that affect credit management of Bank.

Respondents indicated that several factors affect credit management of the bank. The fundamental aim of managing credit is to perk up the quality of business decision making at all levels of the firm and thereby to maximize shareholder wealth. Thus Most of the respondents exposed the need of improvement prevailing procedures in accepting loan applicants by the bank, underestimation of properties offered for collateral, length of loan processing time, excessive reduction of loans requested and recommended by the branch and diversion of loan funds, over presenting of project costs by borrowers, poor projects feasibility studies from the customer sides, Bank's clients started new businesses in which they had no experience, un updated exchange of clients credit information are the major ones.

C. Summary of interviewed responses for how the bank asses credit worthiness of applicants

As per the interviewee's response once a customer requests a loan, bank officers analyze all available information to determine whether the loan meets the bank's risk-return objectives. Credit analysis is essentially default risk analysis, in which a loan officer attempts to evaluate a borrower's ability and willingness to repay. The Bank assesses the creditworthiness of a loan applicant mostly by gathering detail information Depending on the type of credit exposure and the nature of the credit relationship with the borrower, the factors to be considered and documented in credit approval include:

- Interview and site visit

Interview

- ✓ Purpose of the loan
- ✓ Type of business
- ✓ Financial need of the business
- ✓ Liability of the business if there is any
- ✓ Source of repayment
- ✓ Customer and market base
- ✓ Competency of the management
- ✓ Past performance of the business

Site visit

- ✓ This is important to get a broader of the applicant's business to make a physical examination and verification of items declared on financial statement.

- ✓ To see future conditions of the business.
 - Financial viability of the applicant's business and the applicant be classified as bankable
 - Knowing customer (character, capacity, capital, Collateral and condition)
 - Summary of borrower and affiliated credit relationship with UB and other banks. Are there any non-performing loans with other banks,
 - Fulfillment of documentation and compliance requirements such as renewed trade license, TIN, tax clearance, memorandum and article of association, financial statements, due diligence and etc ...
 - Financial ratio analysis
 - Credit information enquiry responses to check whether the applicant has any loan arrear with other banks
 - Collateral identification and valuation are the major ones.

D. Summary of interviewed responses towards the bank preference of collateral based lending.

As per the interview conducted the Bank prefers the business type and applicant creditworthiness as first way out and collateral is the second way out as basis for lending. In principle, loan can be provided both on clean base and on collateral base. However, the Bank prefers collateral based lending because of the following main reasons:

- The economic level of the country: the living standard of the society, poverty, etc;
- The culture of the society in lending is at its infant stage.
- The educational level of the society.
- Limited resources of the bank
- It is believed to be the safest way of lending in minimizing credit risk and others.

The other most important issue to be continually reviewed related to collaterals is period of limitation of loan and mortgage contracts and their registration.

E. Factors believed to cause occurrences of NPL by the interviewees

Respondents indicated that several factors contribute to loan default. As per the outcome of the interview the factors can be categorized as banks' internal situations and borrowers related. The factors are organized and presented under the respective subtitles.

Banks internal factors

These are factors relating to internal inefficiencies due to systems, governance, human resource issues and the related. Under theme this most of the interview participants raised the following issues:

- Bankers lack of integrity,
- relaxation in the follow up of loans,
- Credit analyst's capacity limitation,
- Banks aggressive lending to maximize profit,
- Not conducting Know your customers (KYC) principles properly before lending,
- Mistakes on estimation of collateral and evaluating the borrower's financial report
- Lack of credit information from other banks on a timely basis
- Lack of communication and consultation with the defaulter not after the loan is declared NPL but when the applicant first applies for loan.

Customer related factors

These are factors that emanate from borrowers and have strong bearing on occurrences of Loan default.

Under this ground the following were raised:

- Fund being directed to unintended purpose,
- Unstable economic and political condition
- Borrowers not making competitive analysis before engaging in a particular sector,
- Excess government intervention in the applicant business/sector
- Business management problems- most of family owned businesses don't have good management and they also suffer from succession,
- Poor record keeping by businesses,
- Intentional or willful default,

F. Summary of interviewed response of the bank credit recovery.

The credit recovery method, used by the bank is treated in the same fashion as of credit collection methods. The measures that are used include strict follow up and insisting the client, debt rescheduling, court proceeding, and foreclosure. In the bank, credit is transferred to the legal service when it fails to

regularize or settle the loans in default and when all efforts to amicably settle the loans fail and it is ascertained that legal action is to be the last alternative.

G. Summary of interviewed response about portfolio management of the bank.

As per the interviewees view, the loan portfolio is typically the largest asset and the predominant source of revenue for the Bank. As such, it is also one of the major sources of risk for the Bank's safety and soundness. Accordingly UB employs various risk assessment mechanisms such as customer grading, portfolio limit management, credit review and provisioning to effectively manage its credit risk exposure.

Chapter Five

Conclusion and Recommendation

5.1. Conclusion

In this chapter, conclusions of the research findings that has been discussed and analyzed in detail in the previous chapters is briefly presented. In addition, general conclusions that are highly related with the research objective of this paper are offered. Furthermore, possible recommendations based on the findings are made. Lastly, implication for further research is indicated.

As qualified, socially responsible and experienced manpower enhances competence majority of employees of the bank working in credit area are Degree holders still updating their educational status, married and highly experienced, this enables the bank to accelerate its service delivery and become competitive in the growing stiff competitive industry, to meet its vision of “Becoming the most preferred Bank in Ethiopia.” And “number one bank in Africa in 2030”.

The credit policy and procedures as well as other pertinent manuals and guidelines help to create common understanding and uniformity among all employees. The Bank is compliant to all directions of national bank of Ethiopia in all of its activities of credit management. Hence the way of categorizing and holding provisions for the non performing loans is as per the direction and requirement of the National bank of Ethiopia.

As far as the bank strives hard to assure the quality of its credit; the Bank implemented internal risk rating/grading/ procedure majority of respondents believed it is well implemented at branch level to support the loan processes and to classify customers on a risk level. The majority agreed that it is supported by information systems while the remaining are uncertain or disagreed.

Submission of incomplete documentation and centralized credit decision mainly affects accurate and timely decision which makes loan delivery time of the bank lengthy. The majority of the respondents agreed that one loan process takes more than 30 days to be finalized.

The collection techniques so far adopted by the bank is appropriate and effective that most common collection techniques used by the bank is transfer and debiting Clients account per pre undertaking.

Document study revealed that NPL position of the bank is below the thresh hold set by NBE which is 5% considering the period from 2013 to 2017.

Most of the time loans are created by new clients approaching the bank but respondents believed that the service is not that much to the clients' preference.

Most respondents revealed the credit analysis and appraisal of the bank is in a very good condition except matters that the credit granting and monitoring is influenced by influential persons of the bank which makes decision subjective. It was an understanding of most respondents that influential personnel's involve mainly when they found the client having a potential for the most part.

Hence, proper monitoring of credit has assumed greater significance in the effective management of leading yet most of the respondents have witnessed that the bank does not provide any advice on the usage of loan and no pre audit is made prior to disbursements which are critical factors. Most branches even though it is clearly stated on the credit policy of the bank do not also undertake post disbursement visit unless there is something wrong with the loan repayment.

From the analysis it is clearly shown that even though the bank portfolio is invested in different sectors of the economy and is as per the pre-set concentration limits in every sector which respondents witnessed. The bank is currently concentrating on specific sectors in the years under consideration.

In addition in depth interview found out that due to underdevelopment of credit orientation borrowers engaged in business that they had no depth knowledge, diverted loans and advances for unintended purpose, willful default, over presenting of project costs and poor projects feasibility studies are factors which leads to customers default.

As a point of future studies if a comparison among various commercial banks in this manner is undertaken to clearly see bank specific gaps in the credit management process of banks.

5.2. Recommendation

The following are some of the suggestion that I would like recommend to United Bank S.Co management and concerned parties

- The bank advisable give more emphasize on its implementation on credit policy and procedure, in order to have a better approach that will meet the objective of the bank.
- As it is disclosed in the analysis part of the study most of the bank employees have complaints on the credit policy and guidelines regarding loan discretion, length of loan processing time, repayment schedule, and excessive requirements for analysis. These are the major factors impeding client reputation and retarding to attract potential loan clients. Hence, the bank should made remarkable changes on its credit policy and procedure guidelines regarding the above aforesaid drawbacks in order to solve the current problems and achieve the client reputation.
- The bank advisable frequently follow-up by visiting borrowers business to create long- lasting relationship and assure future payment.
- In today's competitive world the bank must try to develop a credit policy in line with the existing situation of the market.
- The banks advisable develop different types of credit facilities to the borrower as per potential borrower preference.
- The bank is advisable assess borrowers past financial history, credit worthiness and perform detail financial analysis before extending loans to avoid non-performing loans. Requesting financial report is not enough by itself.
- Even though credit management is the first way to avoid bad debt still there would be loans that would surpass all the work out process and become a bad debt but because some branches do not apply the procedure of credit management it becomes hard to handle the case when it reaches legal measures. Branch managers should have the banks interest at heart at all times and apply the banks credit policy and procedure.

5.3. Area for future research

This study is under taken in United bank Share Company as a case study of credit management performance of the Bank it is only limited to one commercial bank in Ethiopia because of time limitation

but if the credit management process of other commercial bank in Ethiopia are considered a ell and a comparison analysis is done.

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APPENDIX

ADDIS ABAB UNIVERSITY COLLEGE OF BUSINESS AND ECONOMICS MBA PROGRAM

Dear respondents:

This is a questionnaire designed to collect data on the credit management practice of united bank S.C which will be used as an input for a thesis in a partial fulfillment of Masters of Degree in Business Administration. Your genuine response is solely used for academic purpose and the data will be treated utmost confidentiality. Therefore, your kindly cooperation is appreciated in advance.

I. GENERAL INFORMATION

(Tick the appropriate box)

1. Gender

Male Female

2. Age

20-30 years 31 -40 years 41 -50 years above 50

3. Marital status

Single Married

4. Educational back ground

Diploma Degree Masters PhD and above

5. Current position

Managerial professional clerical

6. Credit related experience within the bank

1-5 years

5-10 years

above 10 years

II. RESEARCH RELATED QUESTIONS

Please respond to the following statements by indicating the extent to which you agree or disagree

	1. Credit processing and appraisal	Strongly agree	Agree	Uncertain	Disagree	Strongly disagree
A.	The bank demands a business plan from all clients to identify risk exposure					
B.	The bank look at relevant experience of the loan applicant					
C.	The bank carries out credit processing activities independent of the appraisal					
D.	The banks credit granting and approval process establish accountability to decision makers					
E.	There are times the credit granting and monitoring of applicant's can be influences by directors, senior managers or influential staff of the bank					
F.	The bank look at collateral whenever granting any loan					
G.	The bank consider the past repayment track record of applicants					

	1. Credit Risk Management	Strongly agree	Agree	Uncertain	Disagree	Strongly disagree
A.	The loan portfolio is invested in different sectors of the economy					
B.	Does the bank loan portfolio concentrate in particular sectors of the economy					
C.	The bank has pre-set concentration limits in every sector					
D.	The bank quickly responds to market changes					

Details on manuals

8. Do you have a credit manual or policy?

a) Yes b) No

9. Do you think it is up to date & convenient for loan creation?

a) Yes b) No

10. If your answer to Q no, 9, is “No”, specify the impediments encountered

11. How can you see your institution’s credit policy and procedure?

a) Rigid b) Flexible c) Average

12. Do the policies and procedures exactly comply with regulations of national bank?

	2. Monitoring and control of credit	Strongly agree	Agree	Uncertain	Disagree	Strongly disagree
A.	Does collateral estimation regularly assessed & related to applicants financial health					
B.	Does the bank do pre audit before fund has been released to the applicant					
C.	The bank implement the condition & sanction set by different appraisal organs					
D.	The bank periodically prepare credit quality reports for signaling loan loss in any portfolio					
E.	Customers are given sufficient advice on the usage of loans.					

- a) Yes b) No

Credit creation and procedure

13. How long it takes to process and make a decision on a single credit request?

- a) Less than 15 days b) 15-30 c) above 30 days

14. Most of your current loan is created

- a) By approaching promoted clients b) By clients approached with request

15. How do you rate the credit analysis and procedure followed by the bank in Extending credit?

- a) Excellent b) Very good c) Good d) Fair e) Poor

16. Does the bank provide loan service that fit to the preference of the borrowers?

- a) Yes b) No

17. If your answer to Q no, 18, is “No” please specify the reasons

Follow-up collection

18. Which of the following credit collection technique/s/ are mostly adopted by your Bank?

- a) Cash/check payment
b) Debiting client account per pre undertaking
c) Using reminder letters
d) Transferring

e) All

19. Do you think the credit collection technique used by your bank is effective?

- a) Yes b) No

20. If your answer to Q19 is “No”, please specify the appropriate technique/s/ that you think is best?

21. How often does your institution visit clients business after fund has been released?

- a) Monthly b) quarterly c) Semi-annually d) in time of default

22. What do you think is/are the major reason/s/ for default in your Branch?

- a) Lack of follow-up
b) Lack of training
c) Willful default
d) Loan diversion
e) Lack of market for clients’ product

f) Others, (specify) _____

23. What measure/s is/are taken on the side of the bank to improve the repayment situation? (Hint: Check all answers that apply)

a) Loan rescheduling

b) Additional loan

c) Frequently insisting the client

d) Others,(specify) _____

24. What measures are taken by the bank to enforce repayment?

a. Foreclosure

b. Court proceedings

c. Others,(Specify) _____

25. How do you evaluate the loan enforcement mechanism?

a) Effective

b) Ineffective

26. If your answer to Q 25 is “Ineffective”, what is/are the reason/s/ behind this?

a) Buyers don't want to buy some on's property because of bank loan

b) Limited purchasing power of the society

c) High initial bid amounts

d) Others, (specify) _____

27. Would you please specify any problem/s/ of credit management that your institution faces so far apart from the above raised issues?

28. Would you please specify the major credit problems you assume?

29. For the problem/s/ that you mentioned above, please list out all the possible and better solution/s/ that can improve the credit management system of your bank

Thanks for your tim