Addis Ababa University
College of Business and Economics

Assessment of Credit Risk Management in Banking Business: The case of Bank of Abyssinia S.Co.

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Thesis submitted to the graduate studies of Addis Ababa University College of Business and Economics in partial Fulfillment of the requirements for the Award of Master of Arts Degree in Business Administration

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Declaration

I, Hirut Kassa, declare that this work entitled “Assessment of credit risk management in Abyssinia Bank” is the outcome of my own effort and has not been presented for the award of any degree in any other university and that all sources of materials used for the study have been duly acknowledged.

I have produced it independently except for the guidance and valuable suggestion of the research advisor Dr. AlemHagos. It is offered for partial fulfillment of the degree of Masters of Arts in Master of Business Administration.

Approved by Board of Examiners

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Advisor	Signature	Date
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Internal Examiner	Signature	Date
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External Examiner	Signature	Date

Statement of Certification

This is to certify that, HirutKassahas carried out her research work on the topic entitled "Assessment of Credit Risk Management in Bank of Abyssinia" is original work and is suitable for submission for the award of master's degree of Business Administration.

Advisor:Alem Hagos (PhD)

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Special thanks to my Advisor Dr. AlemHagos for his valuable and prompt advice, his tolerance guide and useful criticism all through the course in preparing the paper, his constructive corrections and insightful comments and encouragement are highly appreciated.

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ACRONYMS

BOA: Bank of Abyssinia

CRM: Credit Risk Management

NBE: National Bank of Ethiopia

BoD: Board of Directors

NPL: Non-Performing Loan

FI: Financial Institution

S.Co. Share Company

RM: Relation Manager

ABSTRACT

Credit risk is an essential factor that needs to be managed. Credit risk is the possibility that a borrower or counter party will fail to meet its obligations in accordance with agreed terms. Credit risk is one of the most vital risks for any commercial bank. Credit risk arises from non-performance by a borrower. Among the risks that face bank's credit risk is one of great concerns to most bank authorities and banking regulators. This is because credit risk is that can easily and most likely prompts bank failure. Managing credit risk is not a simple task comprehensive consideration and practices are needed for identifying, measuring, controlling and minimizing credit risk.The focus of this research is to assess the credit risk management of Abyssinia Bank S.Co. In this study, the researcher utilized purposive sampling technique in order to select participants of the study. For the purpose of this study, both primary and secondary data were used. Primary data were collected through questionnaires distributed to respondents that involve professionals working in the banks such as Department Managers and Senior Officers working on loan processing. Descriptive statistics such as average, percentages, frequencies and tables were used to analyze and present the data. The study found that factors such as information asymmetry on credit policy, weak credit analysis and poor credit monitoring areinfluence towards the attainment of successful credit risk management in BOA. Based on the findings, the paper recommends that the bank's credit policies should be designed and implemented with consideration for internal and external factors that enable the bank to maintain sound credit granting standards; monitor and control credit risk; to properly evaluate new business opportunities; and identify and administer problems of credits.

Key words: Credit, Credit Risk, Credit Risk Management

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

A bank is an institution, which deals in money. It draws surplus money from the people who are not using it at the time, and lend to those who are in a position to use it for productive purposes. People prefer to keep their money in a bank than at any other place because they are certain that their money is safe in a bank. This confidence of the people in a bank makes them to go to a bank and deposit their hard earned savings in it. With the deposits of the general public, the bank strengthens its business by lending money to the needy. So a bank deals with other peoples, money and makes lot of profit in the process(P. Suresh & J. Paul, 2010).

Credit creation is the main income generating activity for the banks. Bank loans are the largest and most obvious source of credit risk. Since exposure to credit risk continues to be the leading source of problems in banks and can greatly put at risk the smooth functioning of a bank's business. Thus, banks and their supervisors should be able to draw useful lessons from past experiences. Among the risk that face banks' credit risk is one of great concern to most bank authorities and banking regulators. This is because credit risk is that risk that can easily and most likely prompts bank failure (Conford A., 2000).

Credit risk management is an important part of any business. A company assesses the investments and loans the company is committing to. The manger must think long-term and look critically at the soundness of each investment and loan as the company's financial health depends on safe, profitable investments. These credit risk managers not only look at the business's loans, they must also review and determine the soundness of the credit the company is extending to customers (K. R.Upadhaya, 2009).

Credit management means the total process of lending starting from inquiring potential borrowers up to recovering the amount granted. In the sense of banking sector, credit management is concerned with activities such as accepting application, loan appraisal, loan approval, monitoring, and recovery of non-performing loans (Shekhar, 1985). Banks take into account many considerations as a factor of credit management, which helps them to minimize the risk of default that results in financial distress and bankruptcy. This is due to the reason that while banks providing credit they are exposed to risk of interest and principal repayment, which need to be managed effectively to acquire the required level of loan growth and performance. Credit Management is extremely important as granting credit is considered to be the equivalent of investing in a customer (Hettihewa, 1997).

1.2 Background of the Organization

The History of Banking in Ethiopia[1]

According to NBE, banking business in Ethiopia started in 1905 by foreign owned private bank called Bank of Abyssinia. In 1931 the Ethiopian government established nationally owned bank called State Bank of Ethiopia, which changed the foreign dominated structure of the banking industry. The banking activities were expanded by the involvement of Italian private banks during the five years of the Italian occupation (1936-1941). Until 1974 there were eight private foreign owned banks, three states owned, and one foreign and private owned banks operating in Ethiopia.

In 1974, all private banks were nationalized and the national bank of Ethiopia was set up at the peak of the banking structure to manage all the functions of a central bank. At the time, the three banks: Commercial Bank of Ethiopia (CBE), Development Bank of Ethiopia (DBE) and Construction and Business Bank (CBB) were the only banks in operation. CBE followed by the DBE were the most important banks in the country both before and after reform mainly to implement the economic plans outlined by the state. On average the CBE alone contains more than 90% of total deposit mobilization and 71% of the total lending, (AlemayehuGeda, 2009).

Subsequent to the downfall of the Derge's administration in 1991, the economic policy of Ethiopia was changed from socialist command economic policy to market-oriented economic policy. This new change in the political system and policy of the new government brought a significant change in the functioning of the banking industry. A new banking proclamation was introduced in 1995, which allowed Ethiopian private Banks to engage on the sector.And thus, the financial sector was allowed to serve the private sector (AlemayehuGeda, 2009).

[1] Source; www.nbe.gov.et/History/history.htmwww.nbe.gov.et/History/history.htm

As a result, new private banks were established. These banks started operation with more or less the same type of human capital, working culture and operational systems used by the existing dominant and experienced government banks, which have their impact in the operation of these new private Banks. The new banks provided retail banking (saving, transfers and payment instruments), lending (short, medium and long term loans) and international banking (import, export, guarantees, forex, treasury and transfer) services to the public.

History of Bank of Abyssinia[2]

The present-day Bank of Abyssinia was established on February 15, 1996 (90 years to the day after the first but defunct private bank was established in 1906 during Emperor Menelik II) in accordance with 1960 Ethiopian commercial code and the Licensing and Supervision of Banking Business Proclamation No. 84/1994.BOA started its operation with an authorized and paid up capital of Birr 50 million, and Birr 17.8 million respectively, and with only 131 shareholders and 32 staff.In two decades since its establishment Bank of Abyssinia has registered a significant growth in paid up capital and total asset. It also attracted many professional staff members, valuable shareholders and large customers from all walks of life. This performance indicates public confidence in the Bank and reliability and satisfaction in its services.

Nowadays, employing the state-of-art banking technology, the Bank provides excellence domestic, international and special banking services to its esteemed and valuable customers. It also strives to serve all economic and services sectors via its ever-increasing branch networks throughout the country.

The description of the logo icon consists of a diamond shaped six petals yellow colored flower (endemic) called “adeyabeba”, surrounded by a square with black color in the background.The flower: the logo is taken from an endemic six petals flower, locally known as “*adeyabeba.* The color connotes hope and peace, signifying bright future for the BoA in a growing and peaceful economic environment.

[2] http://www.bankofabyssinia.com

Authorized and paid up capital of BOA as at 30 June 2018 is Birr 4.24 billion and Birr 2.56 billion, respectively, a total deposit balance of Birr 25.79 Billion and a total loans and advances of Birr 17.99 billion, which in effect enhance the risk absorbing and the lendingcapacity of the Bank. It has more than 5,825 staffs and 1,012,177 account holders and works with known money transfer agents such as Western Union, Express Money, Ria International, Transfast, Dahabshiil, MoneyGram, Kaha and Eezreemit. Following a strong demand for better service and products from all directions on the one hand, and a ground-breaking development in ICT, on the other, BOA has replaced its in-house IT system with the state-of-the art technology called T24 and started ATM and POS services with Habesha card and mobile banking services. BOA also provides Internet banking services while Agent banking service will be readily available withinthe near future.

BOA has 2,176 shareholders who are successful businessmen, intellectuals, celebrities, etc. Which started banking services with only one branch in 1996, has 306 domestic branch networks, of which 145 branches are in Addis Ababa and the remaining 161 are established in bankable towns all over the country. Most branches work 10 hours a day 6 days a week (starting from 08:00 upto 06:00pm), while some other works upto 07:00pm in the evening. All city and outlying branches are interconnected with state-of-the art ICT. All branches offer both domestic and international banking services. Bank of Abyssinia still strives to identify bankable area every year and serve valuable customers by expanding its branch networks throughout the country.In this respect there are more branches on the pipeline to be opened in Addis Ababa and in the regional states this fiscal year(Annual report of the Bank,2018).

According to 2017/18 annual reports, bank of Abyssinia (BOA) operates in a rapidly growing and competitive market. It is the 3rd largest private bank In Ethiopia following Dashen Bank and Awash International Bank. It competes for market shares with 18 other banks. Its annual growth rate is regards to: deposits increased by 24%, and profit increases by (13.14%). Its customer deposit growth reaches to (34.89%) in the fiscal year end 2016/17 and its loans and advances increased by 28.25%. After the implementation of the five years strategic planning, it has undergone many change activities including business process reengineering, restructuring and acquisition of new technology.

1.3 Statement of the problem

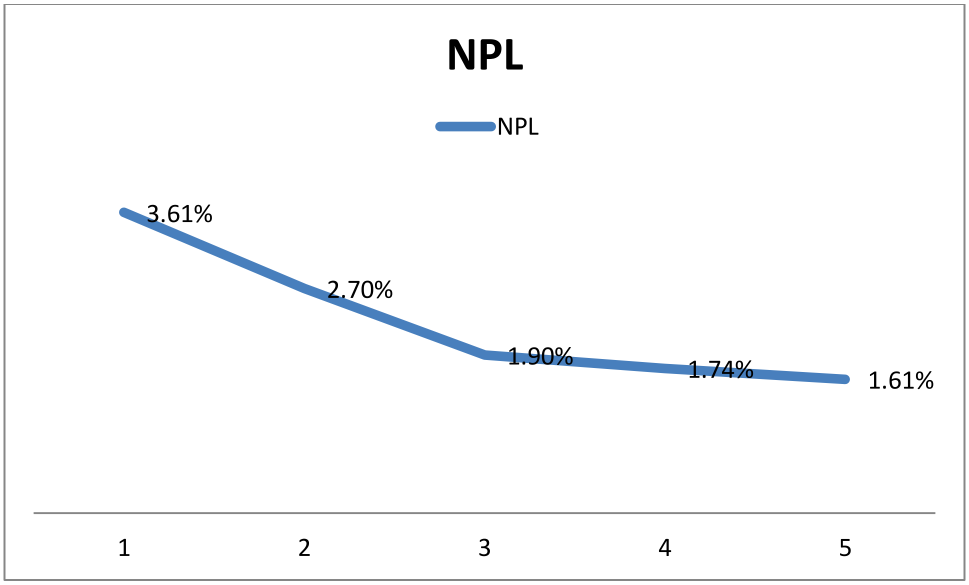
Banking service in Ethiopia is highly competitive, because of that many financial institution have designed ways to enable them compete with the credit market. Most of them especially the banks who used to lend to enterprises that are able to offer immovable assets as collateral are now lending to individuals, corporate bodies and enterprises without any form of collateral.The development and establishment of a system for credit risk management is extremely important from the viewpoint of ensuring the soundness and appropriateness of a financial institution's business. Therefore, the institution's management is charged with and responsible for taking the initiative in developing and establishing such a system(Solomon Gosheme, 2013).

The very nature of the banking business is so sensitive because more than 85% of their liability is deposits from depositors (Sounderrss, Cornett, 2005 cited in Sahlemichael M. 2009). Banks use these deposits to generate credit for their borrowers, which in fact it is a revenue generating activity for most banks. These credit creation processes expose the banks to high default risk, which might lead to financial distress. Credit assessment helps the banker to ensure selection of the right type of borrower. So responsibilities of the bankers to investigate the client from different perspectives 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 necessary to improve the borrowers' financial literacy, the lenders' process of transparency and to better assess loan product affordability and sustainability.

Due to diversified and intensified investments in the country there is an increase of loan demands among investors from commercial banks in the country. In addition to this NBE forced to diversify branches for commercial banks to access easily especially in rural area this has also continued to tap into new opportunities of mobilizing savings through expansion of branch networks and introduction of digital channels as well as new financial instruments.So it raised the demands for loan from commercial banks are highly busy in launching branches across the country. Nowadays, the commonest practice of most financial institutions is door-to-door banking for deposit mobilization purpose. However, these on-boarding customers come with requests about how to get the loan. These situations have created an environment in which commercial banks to encounter risks in credit management. Loans are becoming large and at the same time, bad loans have increased substantially during the past few years, Sallemicahel M.(2009), in his study emphasized on the following selected banks CBE, CBB, AW, DB, UB and NIB how can manage their credit risks, what tools or techniques are used to perform proper credit risk management policies and strategies.

Some researchers were conducted in Ethiopia mainly focused on credit risk management profitability of commercial banks. Solomon (2013) and Alebachew F.(2015) assessedon credit risk management technique and practice of NIB International Bank. Those studies made on such issues are not comprehensive and the system used on credit risk management may differ and change over time. The studies didn't focus onBank of Abyssinia' credit risk management policies and practices.Therefore, this existing situation calls for a study to assess the credit risk management policy and practices in Bank of Abyssinia.The negative relationship of credit risk to corporate profitability may be evident that the more commercial banks expose themselves to credit risk, the more accumulation of unpaid loans, implying that these loan losses have produced lower returns to the bank. The accumulation of non-performing loans caused by lack of proper credit risk management would have substantial adverse impact on the performance of the banks in particular and the overall economy in general(Sallemicahel M, 2009).

Under NBE directive banks' NPL must be less than 2%. Thus, NPL of Awash and Dashen banks have less than 1.5%. However, BoA has more than 1.5% in year 2018.Although NPL of BoA is less than 2% but when compared with Awash and Dashen bank still there is a room to decline and reach its peers.Thus, NPL emanating from lack or poor credit risk management this could hinder development and expansion of the bank. The following chart indicates NPL's position of the bank's during the last five years.



Source: BoA credit department data of NPL from year 2014 - 2018

Those studies made on this issue are not comprehensive and credit risk management system may differs and change over time. Nevertheless, the studies did not assess the risk management of Abyssinia bank.Therefore, the principal concern of this paper is to ascertain to what extent Abyssinia Bank can manage its credit risks, what tools or techniques are at its disposal and to what extent its current performance is supported by proper credit risk management policies and strategies.

1.4 Research Questions

1. Does the bank has appropriate credit risk management policies and procedures?
2. What kind of mechanisms used by the bank for credit risk measuring and monitoring?
3. What mechanisms are used to control the loan?

1.5 Objective of the Study

1.5.1 General Objectives

The main objective of the study is that to examinehow Bank of Abyssinia is efficient in practicingcredit risk management throughout its operations.

1.5.2Specific Objectives

1. To identify whether the bank has appropriate credit risk management polices and procedure.
2. To examine the mechanisms used by the bank to handle credit risk.
3. To examine the existence of adequate control over credit risk

1.6 Significance of the study

The study will provide information to Bank of Abyssinia to understand its credit risk exposure. This will inturn to put in place the necessary policies & practices to manage the risks. In addition to this the study will also provide good insight to those who want to undertake further research on the area of credit risk management practices and will utilize the study as a source of secondary information.

1.7 Scope and Limitation of BoA

This study was conducted only the Head office and selected branches of the bank. Since it is difficult to address all employees in the head office and selected branch, the study delimitsitself only sample respondents. In addition to this the study focuses only credit risk ignoring other area of bank risks. Even though credit risk management is a concern of all banks operating in the country; the paper is limited to cover only BoA's credit risk management practice.

This research is limited to Abyssinia Bank Credit Risk Management therefore the findings, analysis and recommendations do not represent the entire banking industry.Thus, the study focuses only on respondents residing at Head Office especially at credit & risk department, and some other selected city branches of BoA. The bank operates a centralized integrated which gives the indication that, what happens at the Head Office is a good measure of what happens at the bank wide level.Thus, the researcher focuses only questionnaire for primary data collection itis becauseeasy and saves time for collecting data.

1.8Organization of the study

The whole study is classified into five chapters. The opening part of the research covers the following: the background, statement of the problem, objective of the study, research questions, significance, scope and limitation of the study. The literature related and relevant to the research topic is reviewed in the second chapter. Chapter three deliberated on the methodology used for the study. Chapter four presents and discusses the empirical results of the study. The last chapter is chapter five, in this chapter the researcher summarizes the entire work, makes the summary, conclusions and recommendations.

CHAPTER TWO

LITERATURE REVIEW

General Introduction

This chapter focuses on the review of literature related to this research. It focused on a review of studies on credit risk management of Abyssinia bank. Emphasis was on the categories of credit risks and the activities that commercial banks undertake to manage these related risks. This chapter also presented a review of the theories guiding the study, meaning and importance of credit risk management to Abyssinia bank. The review also depended on theoretical literature that was books, research papers, annual report bulletins, financial reports and information from the Internet.

2.1 Theoretical Literature

2.1.1Banking and credit service

Bank is a financial intermediary. Banks typically trade in credit, thus, leading to economic growth. The funds mobilized from various sectors in the economy are deployed in to productive sectors of the economy. Bank is a financial institution, which deals with money. It plays an important role in the promotion of economic growth of a country. They mobilize deposits and grant loans and advances to businessmen and traders against the personal security of the borrowers or against the documents of title to goods, collaterals and marketable securities. They will be able to meet the demands of the complex and expanding economic activities. In one word, bank is a market where money is sold and money is purchased (P. Suresh & J. Paul, 2010).

The term" Credit" is derived from the Latin word "Credo" which simply means belief or trust. In the modern commercial world, credit refers to the faith or confidence of the creditor in the capacity of the debtor to fulfill his promise to pay some amount in a certain period of time.Credit is the ability of a customer to obtain goods or services before payment, based on the trust that payment will be made in the future (Ciby Joseph, 2005).

The role of credit is idle economic resources can be effectively put to use through credit. Borrowers who don’t have enough resources to pursue an activity can borrow the resources, which can be returned to the lender after having achieved the objective. There is a practical difficulty for those with surplus to identify potential borrowers. This is where financial intermediaries come in. broadly banks and other financial intermediaries collect economic resources mainly in the form of deposits from the public and engage in intelligent lending (A. Saunders &M.Cornett, 2006).

Essential feature of a credit istrust, which is a fundamental element of credit. The lender will lend his money or goods on the trust and confidence that the borrower or buyer will pay back the money in time and credit depends in a person's willingness and ability to pay the borrowed money. Banks provide large amount of credit for productive and socially desirable purpose, not for socially undesirable purpose(A. Saunders &M.Cornett, 2006).

Bank credit refers to the loans and advances granted by the banks. It is an important source of investment to exploit the available resources in a country. When credit is productively invested, the total employment and incomes of the people will also increase. During periods of depression more credit is created to stimulate the economic activity so that the economy may move into the phase of recovery and prosperity. Thus the total production and consumption of goods and services in a country can increase with the additional investment made available by bank credit, industrialists, traders and businessmen generally rely on bank credit, to promote and expand their enterprises. As credit increases consumption of goods and services, there will be encouragement for the development of large scale enterprises in a modern capitalist's economy. Credit enables the state to meet its expenditure over and above its revenue. Above all, credit is very important in an economy as it provides a convenient and economical medium of exchange in addition to other types of money. As changes in the quantity of credit lead to changes in the total money supply, it renders the monetary system of the country elastic. The credit created by commercial banks helps to bring a rapid economic development of a country by providing finances to agriculture, industry, etc. But too much credit creation should always under effective control by central bank(P. Suresh & J. Paul, 2010).

2.1.2Nature of risk

Risk is the condition in which there is a possibility of adverse deviant from desired outcome that is expected or hoped for. On the other hand, risks assumed have the potential to wipe out expected returns and may result into losses to the institutions. These losses could be either expected or unexpected. Expected losses are those that an institution knows with reasonable certainty will occur (e.g. the expected default rate of loan portfolio) and are typically reserved for in some manner. Unexpected losses are those associated with unforeseen events e.g. losses due to a sudden downturn in market conditions, falling interest rates, natural disasters resulting in major business failures, or human action that affects business(Peter H.&Keith B., 2008).

In such a volatile and dynamic environment, it has been essential for bank management to identify various types of risk the bank has been exposed. According to A. Saunders and M.Cornettbank’s typically identified and categorized risk as credit risk, liquidity risk, market risk,interest rate risk, off balance sheet risk, foreign exchange risk,operational risk,strategic risk and technology risk.

2.1.3 Credit risk

Credit risk is most simply defined as the probability that banks borrower or counter party will fail to meet its obligations in accordance with agreed terms. In economics, the term credit refers to a promise by one party to pay another for money borrowed or goods or services received. It’s a medium of exchange to receive money or good on demand at some future date or “it is the right to receive payments or the obligation to make payment on demand at some future time on account of the immediate transfer of goods.”(Padmaltha Suresh Justin Paul, 2005).

Credit risk can be defined as the probability of the loss (due to non recovery) emanating from the credit extended, as a result of the non fulfillment of contractual obligations arising from unwillingness or inability of the counter party or for any other reason.” If the probability of the loss is high, the credit risk involved is also high and vice versa(CibyJoseph 2005).

Credit risk has always been a primary concern for financial institutions. It is the risk of financial loss resulting from the failure of a debtor, for any reason, to fully honor its financial or contractual obligations to the institution(Padmaltha Suresh Justin Paul, 2010).

Credit risk is the chance or probability of loss to the bank through default of an obligor (borrower). And default is any breach (break) of the contractual obligation to repay the principal and interest. Default may be a result of many factors like failure of management, product market and technology. Therefore, failure to meet the contractual obligation on the part of the borrower is the major source of repayment or credit risk. Most of the times we tend to confuse risk and exposure. Risk is the variation of future return from the average (expected) return. It is the measure of probability or degree of dispersion of prospective returns from the average. On the other hand exposure is limited to the possible loss of principal less the chance of recovering a portion of the bank's capital through asset liquidation (disposal) and enforcement of guarantees (Saunders and Cornett, 2013).

Credit risk is calculated on the basis of possible losses from the credit portfolio. Potential losses in the credit business can be divided into expected losses and unexpected losses. Expected losses are derived from the borrower's expected probability of default and the predicated exposure at default less the recovery rate, i.e. all expected cash flows, especially from the realization of collateral. The expected losses should be accounted for in income planning and included as standard risk costs in the credit conditions. Unexpected losses result from deviations in losses from the expected loss. Unexpected losses are taken into account only indirectly via equity cost I the course of income planning and setting of credit conditions. They have to be secured by the risk coverage capital (Saunders and Cornett, 2003).

2.1.4 Types of credit risk

As indicated by Dima and Orzea (2010), there are two primary sorts of credit risk that a portfolio or position is presented to be specific, credit default risk and credit spread risk. Credit default risk is the risk happening when an issuer of debt, obligor, is not able to meet its financial commitments. Where an obligor defaults, an investor for the most part acquires a loss equivalent to the sum owed by the obligor less any recuperation sum, which the investor recoups as a consequence of abandonment, liquidation or rebuilding of the defaulted obligor. All portfolios with credit introduction display credit default risk. The extent of credit default risk is portrayed by an organization's credit rating. The credit rating is declared after a formal investigation of the borrower. This examination is embraced by rating offices. The most known rating organizations are Fitch Ratings, Moody's and Standard & Poor's. To evaluate the investigation a few issues are examined. Among these issues there are: the balance sheet position and expected cash flows and revenues, quality of management, company's ability to meet scheduled interest and principal and an outlook of the industry as a whole.

The credit spread risk is the overabundance premium over the management or risk free rate needed by the business sector for tackling a certain accepted credit disclosure. Notice that the higher the credit rating, the smaller the credit spread. Along these lines, the credit spread risk is the risk of money related misfortune coming about because of changes in the level of credit spreads utilized as a part of the marking to-market of a fixed income product. Changes in observed credit spreads influence the portfolio's estimation and can prompt misfortunes for brokers or underperformance for portfolio managers(Ketan R., 2009).

2.1.5Sources of credit risk[3]

There are two main sources of credit risk elements. These are external and internal risk factors. The external risk factors are economic conditions and competition. Economic conditions are change in national income and unemployment will have sway using a loan risk through change in business cycle, exchange rate, interest rate, credit accessibility and credit quality. Liquidity crunch or money related issues that affect borrowers' capacity to satisfy their commitment. What's more legitimate and administrative change could bring about financial organizations to change how they manage an exchange, and in addition the quality and capacity of obligation accumulation. Whereas competition means competition among financial establishments regarding development, gainfulness and the longing to be a business sector pioneer can bring about monetary organizations to bring down their gauges or dishonorably value their credit items. This could bring about higher expense of expanding non-performing credits (A. Saunders & M. Cornet, 2013).

[3] Financial Markets and institutions fourth edition, McGraw-Hll International ed. (2013)

As Fredrick L. (2012) states that internal risk factors are underwriting standards, competence of staff, management information system, inappropriate evaluation of credit quality, introduction of new products or services without proper risk assessment, and so on are discussed in detailed below;

2.1.5.1 Underwriting Standards

Underwriting Standardsis a procedure to figure out what sort of, to whom, for what reason and when credit ought to be allowed. Proper credit approbation procedure ought to include legitimate rules on both structure and philosophy in assessing borrowers' credit value, setting up of credit line and interest rate suitable to borrowers' risk and credits. Tolerant credit endorsing can bring about misfortunes to financial establishments particularly when obligation reimbursement can't be requested or security can't be seized in time. Numerous credit risks emerge from insufficiency in endorsing benchmarks and credit observing.

2.1.5.2 Competence of Staff

Competence of Staff is that credit officers without the important skill in the activities they are in charge of, be it credits, venture, management of problem assets or new products, can prompt poor loaning practice, incapable organization, and inevitably bring about loss to financial institutions.

2.1.5.3 Management Information System

Management Information System (MIS): Risk will increment if management does not consistently get precise and auspicious reports on credits. The reports might involve essential data identifying with endorsing process, for example, monetary patterns, change in the structure of industry, or piece of the overall industry, ware costs, trade rates, including past due credits, credit focuses, and examination of problem loans.

2.1.5.4 Inappropriate Evaluation of Credit Quality

This problem may come about because of aggressive weight and credit development as they tend to put a period imperative on getting precise information. Besides, quick development and/or entry into new markets can entice the management to lend without adequate financial and monetary investigation. To encourage snappier decision making, management may reinforce credit choices by using basic indicators of credit quality, which include borrowers' attributes, present and expected estimation of security or backing of a guardian organization or affiliated organizations.

2.1.5.5 Introduction of New Products or Services without Proper Risk Assessment

Financial organizationthat neglect to completely survey risk in the presentation of new credit products and don't introduce risk management framework preceding dispatch of new products speaks to another essential problem. With quick credit development and elevated rivalry, financial organizations are influenced to acquaint new products and services with the business without legitimate testing. Not in accordance with the standard of fitting credit endorsing, such practice can prompt many financial institutions to difficult problems. Financial institutions that practice legitimate credit endorsing typically test new products and services before acquainting with the general clients.

2.1.5.6 Subjective decision making

Subjective decisions making by management happens especially when the borrower appears to have met the credit approval criteria. However, subjective underwriting without proper consideration on supporting data can lead to credit risk. Credit approval over the limit or overriding the policy is another factor contributing to credit risk. In addition the beneficiaries of these credits are usually related to senior management such as the companies owned by or affiliated with the management, friends or persons with unverified financial standing or celebrities. Maintenance of credit quality depends on prudent credit underwriting which should be in accordance with the policy.

2.1.5.7 Lending over and above the value of collateral

When credits are granted for purchasing assets that are used as collateral, many financial institutions cannot assess the correlation between borrowers’ financial condition and income generating ability and price changes and liquidity of the market for the collateral. These types of credits such as commercial credits, hire purchase, and commercial real estate lending reveal high correlation between credit worthiness of borrowers and the quality of asset placed as collateral. This is because the borrowers' primary income, the principal source of repayment, is directly related to the quality of the associated asset. When the borrowers' income stream deteriorates, due to economic problems, the value of the asset placed as collateral is likely to decline.

2.1.5.7 Negligence of business cycle

Credit granted without taking into account of business cycle can cause an overly optimistic credit analysis. For example, businesses such as retail business, commercial real estate, real estate investment, and consumer lending tend to have strong cyclical effects. Nevertheless, the effect of business cycle is less than the effect of product cycle, especially new, rapidly growing products such as business related to telecommunication. Effective stress testing that incorporate the effect of business cycle and product cycle is one approach for credit decision process and should induce learner understanding in credit risk.

2.1.5.8 Credit review

Independent and on-going credit review with accurate credit grading, appropriate amount and scope, and reporting to the management comprise good credit review since it allows financial institutions to monitor risk management and solve credit problems in an appropriate and timely manner. Such will prevent loss from failure of borrowers or counterparties to fulfill their obligations.

2.1.5.9 Lending in excess

Lending in excess of the minimum required imposes risk. Lending in excess of borrowers' ability to repay will result in problem loans.

2.1.5.10 Too much emphasis on income

Too much emphasis on income from credits over the credit quality leads to the granting of credits with high risk. In the long run, such practice may result in problem credits and incur cost higher than the income initially received.

2.1.5.11 Self-Dealing

Self-dealings can cause serious problems to financial institutions, resulting in failure of financial institutions. Such practices can be found in the form of excessive credits to insiders, overriding the specified credit policy, and use of authority to improperly obtain credit without proper credit analysis, making it difficult for credit officers to appropriately assess the credits. Sometimes, insiders may apply for credits in the name of unrelated parties in order to conceal the self-dealing transactions.

2.1.5.12 Technical Incompetence

Technical Incompetence: Technical incompetence is evident when management cannot obtain and assess credit information in order to analyze the viability of credit products. Such management weakness can eventually lead to loan losses.

2.1.5.13 Lack of proper supervision

Lack of proper supervision: Part of credit risk arises when financial institutions' boards or management cannot oversee various units to ensure that they appropriately comply with the policy.

All banks in the present day volatile environment are facing a large number of risks, which may threaten a bank's survival and success. In other words banking is a business of risk. For this reason efficient risk management is absolutely required. Carey (2001) indicates that risk management is more important in the financial sector than in other parts of the economy. The purpose of financial institution is to maximize revenues and offer the most value to shareholders by offering a variety of financial service and especially by administering risks. The primary objective of the financial intermediary earns commission or interest income.

2.1.6 Credit Risk Management

Managing credit risk is a fundamental component in the safe and sound management of all licensed financial institutions. Sound credit risk management involves prudently managing the risk/reward relationship and controlling and minimizing credit risks across a variety of dimensions, such as quality, concentration, currency, maturity, security and type of credit facilityAssafa B., (2009).

For most banks, loans are the largest and most obvious source of credit risk; however, other sources of credit risk exist throughout the activities of a bank, including in the banking book and in the trading book, and both on and off the balance sheet. Banks are increasingly facing credit risk (or counterparty risk) in various financial instruments other than loans, including acceptances, interbank transactions, trade financing, foreign exchange transactions, financial futures, swaps, bonds, equities, options, and in the extension of commitments and guarantees, and the settlement of transactions (A. Saunders & M. Millon Cornett, 2006).

Risk management is the practice of defining the level of risk of an institution desire, identifying the risk level the institution has and using derivatives and such other financial instruments to control and adjust the level of risk that the institution is expected to bear.Risk management is the process by which managers identify, assess, monitor and control risk associated with a financial institution's activities(Geoffrey P., 2002).

The goal of credit risk management is to maximize a bank's risk-adjusted rate of return by maintain credit risk exposure within acceptable parameters. It may refer to numerous types of threats caused by environment, technology, humans, organizations and politics. On the other hand it involves all means available for humans, or in particular, for a risk management entity (person, staff, and organization).

The management of credit risk in banking industry follows the process of risk identification, measurement, assessment, monitoring and control. It involves identification of potential risk factors, estimate their consequences, monitor activities exposed to the identified risk factors and put in place control measures to prevent or reduce the undesirable effects.

2.1.4.1 Functions of credit risk management[4]

Risk management contains; identification, measurement, aggregation, planning & controlling and monitoring of the risk arising in a bank's overall business.

Risk management is thus a continuous process to increase transparency and to manage risks.

Each bank has to establish a long-term vision and strategy in respect of integrated risk

[4]Assafa, B, (2009). *A module for distance education material for Financial Market & Institutions in AAU*

management depending on its size, focus, positioning and resources earmarked with total commitment of senior management. Risk management is a complex process, which requires specialized skills and expertise.

2.1.5 Identification of credit risk

Identification of credit risk is the first step in the function of credit risk management. According toKetan R. (2009), it can be divided in to three categories default, exposure and recovery risk. Default risk is the probability of an event of default – which is driven by the potential failure of a borrower to make promised payments. The second one is exposure risks arise out of uncertainty attached to future amounts at risk. Exposure risk does not exist with all lines of credit. It may be considered negligible for all lines of credit for which there is a repayment schedule. Project financing implies uncertainty in the scheduling of outflows and repayments. All off-balance sheet items can generate future exposures. The third one is recovery risk arise the event of default not being predictable. The last one takes the form of collateral risk, third party guarantee risk and legal risk.

Collateral risk: refers to an uncertainty with respect to the ability to access the collateral, to dispose it off and to the costs required to sell it. The use of collateral to control credit risk transforms the credit risk into recovery risk plus an asset value risk.Third party guarantee risk: arises when a third party fails to commit to pay on behalf of the borrower. Also, there arises a joint default risk when the guarantees as well as the borrower default at the same time.Legal risk: arises when the legal procedure takes over in case of default(Ketan R. 2009).

The chosen method of identifying credit risk may depend on culture, industry practice and compliance. The credit risk of a bank portfolios arise from internal as well as external factors. The internal factors have been identified as deficiencies in loan policies or administration, lack of prudential credit concentration limits, inadequate setting of lending limits, deficiencies in appraisal of borrowers' financial position, inadequate risk pricing, lack of loan review mechanism etc. the external factors include state of economy, fluctuations in interest and foreign exchange rates, economic sanctions, government policies, trade restrictions etc(Ketan R. 2009).

According to J. Gardner, L.Mills and S.Cooperman (2005), stated that loan request procedures are followed and implemented by the bank's overall lending policy. The procedures make loan presentations uniform and accessible to loan committee members. The procedures include; the source of the business, the principal contacts for the loan, the participation structure (if other banks are participating in the loan), the amount and reason for the loan request, brief history and operations of the firm, optional industry analysis if needed, profile of managers and their experience and expertise, financial statement analysis, including historical and proformas and ratios focusing on the company's ability to repay its debt, collateral /risk analysis, summarizing collateral available and risks involved in the loan, such as barriers for entry into a particular industry, loan review and rating recommendation by the loan officer, which includes whether the loan would be categorized as A, B, or C from excellent to average or below ratings, based on the bank's classification of rating for loans and finally conclusion and opinion favorable or unfavorable factors for the loan.

Basically, the loan procedures focus on the risks inherent in the business of the loan applicant, how risks have been mitigated, the use and amount of the loan, the ability of the borrower to repay the loan interms of cash flow, and secondary sources of repayment including collateral.

2.1.6 Measurement of credit risk

Measurement of credit risk has been an important function of credit risk management, as if risk cannot be measured properly, it cannot be managed properly.

Chaubal R.P. in his article "Measuring credit risk" has explained that measurement of credit risk involves quantification of i) Expected loss(EL) and ii) unexpected loss(UL)

Expected loss is denoted by the formula:

EL = PD x LGD x EAD

UL = $EAD\sqrt{CPD} \times \delta^2\text{LGD} + LGD^2 \times \delta 2PD^3$

Thus, for the measurement of credit risk, quantification of the following components is necessary probability of default, expected exposure at default, loss given default, maturity or tenor of the exposure and degree of diversification in a bank credit portfolio. Some of the known models that are being used by banks include;

Saunders and Cornett explained Altman Z Score Model – A model developed by Altman, which measures the default risk. Z score model is a combination of key financial indicators measuring profitability, liquidity, asset utilization and solvency.

Credit Rating of a loan account is carried out with a basic objective to determine whether the account, after the expiry of a given period, would remain a performing asset and would not be in default. The NBE report has also issued necessary guidelines for banks to apply credit rating to their borrower accounts and classify them as per their rating category.

It has also advised banks to develop and maintain necessary data on loan defaults of borrowers as per their rating category as it would help to manage credit portfolio in an effective manager and to have a prior estimate of expected defaults, expected contribution and capital requirement to maintain the portfolio (Padmalatha S. & Justin P., 2010).

2.1.7 Aggregate: Assessment of the overall risk

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

Padmalatha S. and Justin P. (2003),explained that the 5Cs model is a traditional credit analysis model it is important for initial criteria directly related to the possibility of a future default.The 5Cs model character, capacity, capital, condition and collateral. These are used for analyzing the loan applicant's credit risk, thus loan officer must understand the customer's character, capacity, collateral, conditions and capital.

Character is the borrower's willingness and determination to meet the obligations of the loan. An evaluation must be conducted consisting of interviews and background checks, both personal (based on references supplied by the borrower) and business. Capacity is the borrower's ability to generate cash from its overall operations or from the project (standalone credit) and ii. The borrower's ability to manage cash, as reflected in previous projects. Capital is the borrower's equity position and the borrowers have to contribute equity to the project for which the loan is requested. The borrower must be willing and able to share project risk with the lending bank by providing an acceptable portion of equity capital. The borrower must show commitment. Condition is the current state and outlook of the local regional and national economy, and that of the borrower's industry. Different economic conditions and expectations for diverse industries often require different lending criteria as distinct times during the business cycle. Collateral is a security in the form of physical collateral or a guarantee may help to offset weakness in one or more of the above areas(Padmalatha S. & Justin P., 2010).

2.1.8Control and Monitoring of Credit Risk

Many credit losses occur because of failure to monitor credit risk. Gathering of some information from the customer and processing it through some minimal ratio analysis is frequently the way monitoring is handled.

Proactive management of credit risk before serious problems arise is the hallmark of credit risk monitoring. It requires understanding of the operating risks and financial risks in sufficient detail to recognize adverse development in any of the underlying factors. The hypothesis of credit risk monitoring should be that the deterioration in economic and other business conditions is inevitably reflected in the performance of obligors. Frontline credit risk management officers ought to be alert to adverse development viz. early warning signs(CibyJoseph, 2005).

As lending is the main and most important activity of a bank, the risk associated with it has a large share in the total risk exposure of the bank. Therefore, lending activity has to be supported by a very effective control and monitoring system. Bank undertakes lending activity at branch level system. Bank undertakes lending activity at branch level (transaction level) which, when aggregated at bank level, takes the form of portfolio (Sahlemicahel M. 2009).

In order to control and monitor credit risk, a detailed, well documented and well communicated credit policy at transaction level has become essential. At this juncture, it has to be considered that a well laid out credit information system plays a backbone of the effective credit risk management. Following are some of the instruments to control and monitor credit risk at transaction as well as portfolio level.

2.1.8.1 Credit Approving Authority

It has become necessary for banks to evolve a multi tier credit approval system when loan proposals are approved by an Approval Committee. The logic behind such system is that credit proposal should not be approved unless the entire committee members do not agree on the credit worthiness of the borrower.

2.1.8.2 Limit Setting

As important element of credit risk management is to establish exposure limits for individual borrowers and counterparties and group of connected counterparties that aggregate in a comparable and meaningful manner different types of exposures, both in the banking and trading book as well as on and off balance sheet. Institutions are expected to develop their own limit structure while remaining within the exposure limits set by NBE. The size of the limits should be based on the credit strength of the counterparty, genuine requirement of credit, economic conditions and the institution's risk tolerance. Limits should also be set for respective products, activities, specific industry, economic sectors and/or geographic regions to avoid concentration risk(TibebuTefera 2011).

2.1.8.3 Risk Based Pricing

According to Ciby Joseph, (2005), risk based pricing has become necessary for a bank to price their loan product linked to credit quality or risk rating of borrower. Risk return pricing has become fundamental principle of risk management. Large sized bans across the world have already adopted risk adjusted return on capital frameworkfor pricing of loan products. Banks have to scientific system to price credit risk, which should have bearing on the expected probability of default.

2.1.8.4 Portfolio Management

Credit control and monitoring at portfolio level deals with the risk of a given portfolio, expected losses, requirement of risk capital. In order to monitor the desired portfolio, there has to be periodic review of quantitative ceiling on aggregate exposure in specified category, evaluation of rating-wise distribution of borrowers in various industries, target rating-wise volume of loans, probable defaults and provisioning requirement, migration of borrowers from one rating scale to another, undertake rapid portfolio reviews, stress test and scenario analysis when entered environment undergoes rapid changes(Padmalatha S. & Justin P., 2010).

2.1.8.5 Loan Review Mechanism (LRM)

LRM is an effective tool for constantly evaluating the quality of loan book and to bring about qualitative improvements in credit administration. Banks should, therefore, put in place proper. Loan review mechanism for large value accounts for large value accounts with responsibilities assigned in various areas such as, evaluating the effectiveness of loan administration, maintaining the integrity of credit grading process, assessing the loan loss provision, portfolio quality, etc. the complexity and scope of LRM normally vary based on banks size, type of operations and management practices. It may be independent of the CRMD or even separate department in large banks. The main objectives of LRM could be to identify promptly loans, which develop credit weaknesses and initiate timely corrective actions and to evaluate portfolio quality and isolate potential problem areas (Padmalatha S. & Justin P., 2010).

2.1.9 Managing problem credits

Problem loan management is the area of credit monitoring which deals with the handling and eventual resolution of nonperforming loans. The activities of problem loan management starts with identifying early warning signals and classifications of credit after due process of credit review process. The institution should establish a system that helps identify problem loan ahead of time when there may be more options available for remedial measures. Once the loan is identified as problem, it should be managed under a dedicated remedial process. A problem loan management process encompasses the following basic elements negotiation and follow-up, workout remedial strategies, review of collateral and security documents and status report and review. To be more specific the task of problem loan management of credit monitoring includesloan provisioning and write-off (Padmalatha S. & Justin P., 2010).

Loan provisioning is the process of determining the amount of Non-Performing Loans (NPLs) losses which is to be provided by bank as allowance for doubtful loans. The provision is estimated based on the aging and risk class category of the loans. Where a review of loans reveals that the credit worthiness of a borrower has undergone a significant deterioration and that recovery of the loan is therefore in serious doubt, it is necessary to consider whether a specific provision should be made against the loan. Write-off when a loan has been identified as NPL and subjected to a certain amount of provision and the amount of provision may subsequently be increased or decreased to reflect changes in the possibility for recovery. If the prospects do not improve, a point will come when it may be concluded that there is no realistic prospect of recovery. When that point is reached, the amount of loan which is considered to be beyond prospects of recovery should be written off or write off occurs when the likelihood of recovery of a credit in part or whole is remote as a result of the borrowers failure to repay the debt(Padmalatha S. & Justin P., 2010).

According to National Bank of Ethiopia a loan is considered as nonperforming loan where the principal or interest of the loan is due according to the loan repayment and unpaid for ninety or more days, i.e., if the borrower doesn't pay either the principal or interest of the loan for ninety day starting from the day he takes the loan from the bank the loan be considered as NPL. Then each bank will be requested through national bank directive No SBB /18/ to set aside a certain amount of provision to keep the quality of the loan portfolio or to keep depositor money against losses.

2.1.10 Mitigation of Credit Risk

It is an important component of Credit Risk Management, which refers to the mechanism through which credit risk is reduced or transferred to counterparty. In order to mitigate credit risk at portfolio level, variety of tools and instruments have been evolved such as asset securitization, credit derivatives etc. such tools are used to achieve target portfolio with desired characteristics. However, it should be noted that adoption of such tools brings with them another categories of risk such as legal risk, operational risk, liquidity and market risk. Therefore, banks have to exercise precaution in their use and to ensure that overall risk profile of the bank is undisturbed(Padmalatha S. & Justin P., 2010).

2.1.11 Principles for assessment of credit risk management

The principles for assessment of credit risk management are establishing an appropriate credit risk environment,Operating under a sound credit granting process, Maintaining an appropriate credit administration, measurement and monitoring process and Ensuring adequate controls over credit risk(Anthony S.& Marcia M. Cornett, (2006).

2.2 Empirical literature

Alebachew F. (2015) in his paper entitled "Assessment of Credit Risk Management Policies and Practices in NIB International Bank S.C." the main objective of the study is to assess risk management policies & practice of NIB International Bank, he concluded that banks credit risk management & policy affected with problems both internal and external factors. Some of his recommendations are the bank needs to revise it is current credit and needs to implement information system and analytical techniques that enable management to measure the credit risk inherent in all on and off balance sheet activities and risk exposure of counter parties.

Sahlemichael M. (2015) has investigated credit management on Ethiopian Commercial Banks. The main objective ofthe study is to assess how banks manage their credit risk.He raised the following recommendations. Some of the recommendations is that inorder to maintain credit discipline and to enunciate credit risk management and control process, the banks are advised to establish a separate department unit independent of the loan origination function, inorder 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 circumstance and banks should diversify their credit portfolios by avoiding huge credit concentration on one or two sectors and/or on individuals or companies.

Solomon (2013) in his paper entitled "credit risk management techniques and practice of NIB International Bank" has conclude that credit risk management system of commercial banks should incorporate a check and balance for the extension of credit that integrate separation of credit risk management from credit sanction, credit processing/approval from credit administration and finally establishment of an independent credit audit and risk review function.

Frederick L. (2012) in his paper entitled "Evaluation of Credit Risk Management Practices in Ghana Commercial Bank Ltd." Emphasized that credit risk monitoring and supervision efforts should be intensified by the bank. The bank should ensure that credit officers perform periodic follow-ups on borrowers to ensure that loans are used for the intended purpose and the bank should adhere strictly to the loan policies and discourage any human intervention if necessary requirements are not met.

TibebuT.(2011) "Credit risk management and profitability of commercial banks in Ethiopia" emphasized that banks board of directors are responsible for each and every activities of the bank. So they need to conduct continuous training for their employees particularly for credit risk management department manager and employees as well. Policy maker of banks (NBE) need to set policy, and guidelines, which force banks to think over their credit policy, risk management policy and other related things.

Kosmas N. (2009) in his published journal entitled "The impact of effectivecredit risk management on bank survival" he found a result that clearly support the assertion poor credit risk management contributed to a greater extent to the bank failures. Therefore, effectivecredit risk management is important in banks and allows them to improve their performance and prevent bank stress. The success of the system depends critically upon a positive risk culture. Banks should have in place a comprehensive credit risk management process to identify, measure, monitor and control credit risk and all material risks and where appropriate, hold capital against these risks. Establishment of a comprehensive credit risk management system in banks should be a prerequisite as it contributes to the overall risk management system of the bank. There is also need for banks to adopt sound corporate governance practices, manage their risks in an integrated approach, focus on core banking activities and adhere to prudential banking practices.

Benjamin Agyepong (2015) has investigated a research on “An assessment of credit risk management practice of agricultural development bank Ltd” emphasized that management of ADP must come up with a credit risk management policy that is geared towards the granting of current loans whiles cutting down drastically the approval of loans which has the potency of becoming doubtful or loss in the long run and need to equip credit officers properly in order to reduce the risk of loan defaults.

Michael Donso Junior (2015), in his research “An assessment of credit risk management process of credit unions” emphasized on the credit unions will change the voluntary nature of the credit committee and get people with appreciable academic qualification who will be on salary, since the credit committee members are part of the team which is managing he greatest assets of the credit unions.

Onyango Jason Ochola (2010), conducted a research on “Assessment of the credit risk management practice of commercial banks in Kenya”and he recommended that banks should have an awareness of the need to identify, measure, monitor and control credit risk as well as to determine that they hold adequate capital against these risk and that they are adequately compensated for risks incurred.

The process of credit risk management includes understanding the risk, identifying the risk, classifying it analyzing it and then monitoring the effectiveness of the granting loan and to manage it efficiently and effectively. These processes have helpful in managing the various categories of risks. However, despite the numerous studies made but none of the reviewed studies has not researched on Bank of Abyssinia. This study aims at to assess the credit risk management of Abyssinia Bank.

CHAPTER THREE

Research Design and Methodology

3.1 Introduction

This section of the study constitutes the study design and methodology. The methodology of a study involves the types of data used in undertaking the study as well as the process and procedures used in data collection. The chapter is categorized into the following sub-headings; research design, target population, sampling size and sampling techniques, data collection methods and finally data analysis and presentation.

3.2 Research Design

The study adopted a descriptive survey in trying to establish the extent to which Abyssinia Bank undertakes credit risk management. The aim is to describe and explain the phenomenon of interest. Since the study is interested in assessing credit risk management of Band of Abyssinia.

3.4 Research Method

The study used quantitative research methods to evaluate the credit risk management strategies being used by Abyssinia Bank. In order to achieve the objectives of the study the research used quantitative data. In doing so, the study intends to describe, and interpret the existing facts about credit risk management. A survey study approach was adopted to assess credit risk management of Abyssinia Bank S.Co. The choice of survey aimed to describe the responses. The tools used to gathered data by distributed a questionnaire to respondents that workon credit at Abyssinia bank especially Department Managers and Senior Officers.

The data source was primary & secondary data from the following source:
Primary data was collected through questionnaires distributed to respondents that involve professional working in the banks such as Department Managers and Senior Officers working on loan processing this is to elicit a wide range of baseline information about credit risk management. The secondary data collected from annual reports, directives, and bulletins of National Bank as well as different books. Secondary data was obtained from publications of banks and reference books.The advantage of gathering data through questionnaire is that it allows for easy and economical way of collecting data especially when using questionnaires

highly effective especially where large amounts of data is to be collected from a sizable population.

3.5 Target Population

The focus of this study is to evaluate credit risk management policy and practice of BoA, it has huge staff strength of more than 5000 staffs. To this effect all employees of the bank constitute the population of the study. The target population for this study 372 employees of the bank found in higher position, including directors, senior staffs at head office organs,managers, loan officers of the selected branches these branches are found in city and perform loanas well as relation managers of district found in Addis Ababa. The selection criterion for the target population on the basis of employeesmore involving in credit processing and granting. Therefore, the study provides questionnaire for the above selected staffs of BoA to extract responses for analysis.

3.6 Sampling techniques and sampling size

3.6.1 Sampling technique

In this study, the researcher utilized purposive sampling technique in order to select participants of the study. The idea behind purposive sampling is to concentrate on people who are directly involved in credit processing and administering because they would better be able to assist with the relevant research data.

3.6.2 Sample size

With regards to the sample size of this study, staff of credit and risk departments, some selected branches and Relation managers found at district of BoA used as a representative of the entireBoA. The purposive sampling technique is most appropriate personnel of the bank who has in-depth knowledge of the credit risk management practices of the bank and can therefore provide adequate information useful for research analysis purposes.

Sample Sizeselected from professionals working in the credit and risk department, city districts and some selected city branches, related to credit and credit related operations as a whole were taken as participants of the study. Out of the target population, Slovin‘s formula is used to calculate the sample size. Then, 192 employees selected from the target population using simple random sampling technique. At 95% confidence level, and $e = \pm 5\%$

$$n = \frac{N}{1+N(e)^2} = \frac{372}{1+372(0.05)^2} = \underline{\mathbf{192}}$$

Where:-

n = the sample size

N = the target population size

e = the level of confidence (Sampling error)

Hence, based on the above formula, the sample size is calculated as 192. The study limited to the Branch Managers, Directors, Relation Managers (RM) and Credit Officers. For this reason 4 Directors, 16 Relation Manager, 65 Branch Managers and 107 Credit Officers were selected for the research. It is expected that the sample size represented the whole population.

3.7 Data Analysis & Presentation

The data analyzed by using descriptive statistics. In this study descriptive analysis is chosen because of its simplicity & clarity to draw inferences by using descriptive. The data measured in percentages, frequencies and tables used foranalysis of the data and interpretations. Analysis measures the bank's performance as well as judge the effectiveness of its credit risk management.

3.8Validity & Reliability

Validity refers to the credibility of the research. It is concerned with the findings use really about what appears to be about.Validity defines as the extent of which data collection methods are accurately measured and what they were intended to measure (sounders, 2003). Inorder to achieve the objectives, the researcher was taken the survey question were prepared based on literature and empirical review and data were collected from reliable source from staffs of BoA who were working with credit administration.

Reliability estimates the consistency of the measurement or simply the degree to which an instrument measure the same way this time it is used under the same condition with the same subject. Thus, the reliability of data tested using the statistical methodsof describing the data average, percentages frequencies and tables used for the analysis of the data and assisted forinterpretations.Reliability is essential about consistency if we measure, something many times and the result is always the same. Then, we can say that our measure is reliable (William G. 2006).

CHAPTER FOUR

Data presentation, Analysis and Interpretation

Introduction

This chapter of the research describes how data collected from the respondents are analyzed and presented. The data are analyzed by using table, pie charts and bar charts are used to represent the data collected from respondents. The data collected are analyzed based on the objectives of the research with inferences drawn from the analysis of the data. The reason is to present the results of the research from structured questionnaires were sent to the selected departments, branches and districts. This chapter presents the data gathered as follows; the position of the respondents, qualification of credit administrators, experience, credit identification and assessment, measurement and monitoring and credit control process.Questionnaires were sent out to 192 staffs at BoA. A total of 153 questionnaires were received and analyzed. These questionnaires represented 80% of what was targeted which is considered to be a reasonably high response rate. Characteristics of the respondents are described in the ensuing sections.

I. Demographic Characteristics of Respondents

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

Table 4.1 Gender of Respondents

	Frequency	Percent
Male	89	58.17
Female	64	41.83
Total	**153**	**100.00**

Source: Primary Data

The mix of gender of the employee in the loan area is, 58.17 percent dominated by the male parts and 41.83 percent is female as it is shown in table 4.1. This is due to the education and experiences required to work in the loan area as loan officers or analysts is almost proportionally assigned to both male and female employees. Employees with high experience and qualification are needed to work in the loan area, as they have to understand the responsibility and accountability for prudent credit management and minimizing credit risks to the required level. Hence, in this regard the banks should be considered gender distribution smartly.

Table 4.2 Marital Status of Respondents		
	Frequency	Percent
Married	92	60.13
Single	61	39.87
Total	**153**	**100.00**

Source: Primary Data

The findings depicted in table 4.2 above showed that majority of the respondents (60.13 percent) are get married and39.87 percent are single. As far as the nature of banking industry is concerned, it is highly exposed to credit risk and this demands employees working there to be socially responsible to enable them to concentrate and exert their maximum professional experience and qualification for the good of the banks credit management practice, which leads to minimize credit risks. Therefore, the implications of the findings are as large numbers of the employees working in credit processing area are married.

Table 4.3 Current Position of Respondents		
No.	Position	Quantity
1	Directors	4
2	Relation Managers	16
3	Branch Managers	46
4	Credit Officers	87
Total		**153**

Source: Primary Data

In this regard, the respondents were directors, relation managers, branch managers and credit officers. Most of the respondents have an educational background of accounting, economics and business management with BA and above and have five to 18 years of work experience. The selected respondents are listed below, 80% of them have responded.

Table 4.4 Educational Level of Respondents

	Frequency	Percent
BA/BSc	93	60.78
MA/MSc	60	39.22
Total	**153**	**100.00**

Source: Primary Data, 2019

Educational background of employee is an important factor to be considered with regard to making business decision. Education improves the skill, capacity, communication, and access to development endeavors. As it can be revealed from table 4.4, on average 60.78% of the respondents have undergraduate degree and the remaining 39.22% possess a master's degree qualification. Hence, with respects to qualifications the findings implied that most of the employees working in the credit department are well qualified, this contributed a lot to the effectives, and efficiency in credit management practices of the banks.

Table 4.5 Work Experience of loan administrator

		Work experience	
No	Years of experience	Frequency	Percent
1	1 - 5 years	12	7.84
2	6 - 10 years	70	45.75
3	11 - 15 years	30	25.49
4	More than 15 years	32	20.92
Total		**153**	**100.00**

Source: Primary Data, 2019

According to chart 4.5 the longest serving credit officers on average have 6-10 years working experience across all the participating staff. This group constitutes 45.75.5% of the total respondents. Most of the credit administrators with the experience credit officers are credit department. This fact support the believe that a high experience level of credit management staff is a key factor to the success of the credit unions in terms of credit management.

Out of the total respondents 7.84% of them have 1-5 years working experience. According to the data presented in this chapter, it is obvious that the least number of working experience among the credit department staff are the officers who have two years' experience.

Commenting on the relevance of experience of credit management staff, respondents acknowledge that experience brings efficiency whereas literature on the topic adds more knowledge to the credit management process. Some respondents state that for effective and efficient credit management, the credit unions need experience credit management staff.

II. Credit Risk Assessment & Identification

The first question in the survey asks banks whether they have a credit risk management department. 100% of the respondents said that there was a credit risk management department. There must be a risk management department in banks in order to achieve their objectives properly. It is also the requirement of NBE to establish this department.

Table 4.6Loan proposal approval persons

	Frequency	Percent
Board	8	5.23
Loan Committee	121	79.08
Credit Department	24	15.69
Branch Manager	0	0
Total	**153**	**100.00**

Source: Primary Data

As the above table 4.6 depicts, 79.08 percent of employees agreed that loans and advances of the bank is recommended or approved by the loan committee at all levels. That is, both at branch and at head office as per the discretions provided. While very few number of respondents, 15.69%, and 5.23%, agreed that loan approval were made by credit departments and boards respectively. Thus, with respects to loan recommendation and approval, the bank did not follow uniform system in all branches although loan committee at level dominantly participated in the system.

Table 4.7 CRM Departmentindependent of loan origination		
	Frequency	Percent
Yes	121	79.08
No	32	20.92
Total	**153**	**100.00**

Source: Primary Data, 2019

Separation of duties and responsibilities with respects to credit risk management and loan origination function minimizes the information asymmetry and moral hazard problem before approving loan and collecting the loan provided to various classes of clients. To assess this, respondents were asked questions and their responses presented in table 4.7 accordingly, 79.08 percent replied that the function of credit risk management department independent of loan origination function while 20.92 percent agreed that both functions are overlapping and hence no need to assign them to different concerned departments and this might accepting default loan clients or rejecting innocent and prudent clients which adversely affects the banks credit risk management practices.

Table 4.8Credit risk policy, guidelines and procedures that explain objectives		
	Frequency	Percent
Yes	153	100.00
No	0	0
Total	**153**	**100.00**

Source: Primary Data, 2019

Producing and developing credit policy and procedures as well as other pertinent manuals and guidelines help to create common understanding and uniformity among all employees. Lending is the core product line, which contributes the biggest share to the profitability of a banking organization. In the table 4.8, 54.25 percent of the bank employee replied positively for having credit policy and procedure manuals. This implies, the bank have credit policy document to protect it against over exposure, mal-administration of credit arresting the creation of non-performing loans, and arrive at a trade-off between returns and risks if effectively implemented.

Table 4.9 Credit Manual Revision		
	Frequency	Percent
Yes	122	79.74
No	31	20.26
Total	**153**	**100.00**

Source: Primary Data, 2019

It is clear that, banking industry is highly affected by the changing social, economic, and technological environment. To adopt with these changing environment, the existing manual or policy requires periodical revision or change. Accordingly, in table 4.9, more than three quarters (79.74%) of the respondents replied that their banks revised the existing credit manual or policy.

Table 4.10Policy & Procedures approved by the BoD		
	Frequency	Percent
Yes	130	84.97
No	23	15.03
Total	**153**	**100.00**

Source: Primary Data, 2019

It is the overall responsibility of board of directors to approve bank's credit risk strategy and significant policies relating to credit risk and its management, which should be based on the bank's overall business strategy. Therefore, as seen in the above table 4.10, 84.97% of the respondents said that their bank's credit policy and procedures are approved by their board of directors. The remaining 15.03% said no, simply as they didn't know the responsible person who approves policy and procedures.

84.97% of the banks, which confirmed approval of their credit risk policy and procedures by BoD, have stated that bank's BoD have the following responsibilities:Defining the bank's overall risk tolerance in relation to credit risk, Ensuring the bank's overall credit risk exposure is maintained at prudent levels and consistent with the available capital, ensuring that top management as well as individuals responsible for credit risk management possesses sound expertise and knowledge to accomplish the risk management function, ensuring that the bank implement sound fundamental principles that facilitate the identification, measurement, monitoring and control of credit risk and ensuring that appropriate plans and procedures for credit risk management are in place.

As per the risk management guidelines of the Basel committee for banks supervisions which are mentioned in the literature reviews, senior management of banks should develop and establish credit policies and credit administration procedures as part of the overall credit risk management framework and get approved from board. Besides, such policies and procedures should provide guidance to the staff and aim to obtain an in-depth understanding of the bank's clients, their credentials and their businesses in order to fully know their customers on various types of lending.

Table 4.11Credit risk strategies and policies are effectively communicated thorough out the organization

	Frequency	Percent
Yes	73	47.71
No	80	52.29
Total	**153**	**100.00**

Source: Primary Data, 2019

Effectively communicated credit policy and procedures as well as other pertinent manuals and guidelines help to create common understanding and uniformity among all employees. According to table 4.11, more than half percent of the respondents are not agree for effective communication of the strategies among the staffs, this contributes for subjective decision making and bias to the uniformity of the implementation. This implies, the bank is in danger for credit policy document to protect it against default, mal-administration of credit leads to the creation of non-performing loans.

Lending limit refers to the period of time, which is given to borrowers to repay the loan. To ascertain the lending limit of BoA, a question is designed in the questionnaire, which intended to determine the maximum repayment is given to the customers of the bank.

Table 4.12Loan repayment period

	Frequency	Percent
2 – 5 years	115	75.16
6 – 10 years	30	19.61
11 -25 years	8	5.23
Total	**153**	**100.00**

Source: Primary Data, 2019

Table 4.12 depicts the response of the respondents regarding the credit limit, it is clearly shown that about 75.16% of the respondents have a maximum loan repayment of 2 – 5 years, 19.61% of the respondents have a maximum loan repayment of 6 – 10 years and only 5.23% of the respondents said that 11 - 25 years of repayment period.

III. Credit Measurement, Monitoring and Control

It is advisable for all banks to measure the credit risk of each loan requests made by clients before approval at least to minimize the risk of adverse selection. Theoretically, there are different tools can be used for this purpose.

Table 4.13Tools used to measure credit risk		
	Frequency	Percent
Internal Rating	88	57.52
Through the five C’s of credit	48	31.37
Through financial statement ratio	17	11.11
Human judgments through experience	0	0
Total	**153**	**100.00**

Source: Primary Data, 2019

In this regard, the findings showed in table 4.13, 57.52 percent of the respondents said that the bank’s internal credit rating is used as a primary tool while 31.37 percent stated that the five C’s of credit rating are used as a sound method. The remaining 11.11% agreed that various financial statement ratios of the loan applicants are used as a tool to measure their credit risk. This implies that each person have using their own best method of credit risk measurement although it recommended invarious literatures that combination of various methods can be used to minimize the credit risks.

Table 4.14Probability of default of customers		
	Frequency	Percent
We calculate	124	81.04
We don’t calculate	29	18.96
Total	**153**	**100.00**

Source: Primary Data, 2019

As far as the uncertainty of the future or loss contingency from default customers is concerned, estimation of probability of default of customers before approving loan to applicants can minimize the risk of adverse selection. The results of the survey findings in this respect are presented in table 4.14 and interpreted as 81.04 percent of respondents collectively agreed that their banks calculate probability of default of customers and only 18.96% replied that probability of default of customers are not calculated. Therefore, majority of the banks have used the probability theories and estimate the chance of existence of default of customers before loan approval.

After the credit assessment and disbursement is done, the credit customer is expected to payback the installment as per agreed schedule. Each bank has a different repayment mechanism. In order to ensure good repayment, Banks have to ensure proper monitoring and follow up actions. According to majority of the banks' credit policy manual, credit is transferred to the legal service when it fails to regularize or settle the loans in default and when all efforts used to kindly repay the loans fail and it is ascertained that legal action is to be the last alternative.

Table 4.15Recovery rate of a loan

	Frequency	Percent
Yes	119	77.78
No	34	22.22
Total	**153**	**100.00**

Source: Primary Data, 2019

In table 4.15, respondents were asked to state whether their banks calculate recovery rate of a loan or not. Accordingly, more than half (77.78%) said that their banks calculate recovery rate of a loan and this enable them to know performing and non-performing loan clients. However, still few respondents were negligent to calculate this rate as supported by 22.22% of the respondents and this implies that those administrators faced difficulties of determining performing and non-performing loan clients for a specific period.

Table 4.16Methods used by bank to mitigate credit risk		
Methods	Frequency	Percent
Credit limit	25	16.34
Taking collateral	70	45.75
Diversification	32	20.92
Credit insurance	14	9.15
Loan selling	12	7.84
Total	**153**	**100.00**

Source: Primary Data, 2019

There are different ways of mitigating credit risk used by banks and each of them have their own cons and pros. As indicated in table 4.16, credit limit, taking collaterals, diversification, credit insurance and loan selling, are used as a means of alleviating or at least minimizing the risks associated with providing loan to clients as agreed by 16.34%, 45.75%, 20.92%, 9.15%, and 7.84% of respondents respectively. Hence, the findings imply that credit limit, taking collaterals, and diversifications are the three most popular methods used to mitigate credit risk.

Table 4.17Procedures/policies in regard to credit exposure limits		
	Frequency	Percent
Single borrowers	91	59.48
Groups of connected counter parties	20	13.07
For particular industries or economic sectors	20	13.07
Geographic regions	13	8.50
Specific loan type	9	5.88
Total	**153**	**100.00**

Source: Primary Data, 2019

Setting different or diversified credit limits for different kinds of loan applicants is essential for each bank to include all categories of borrowers, diversify its credit risk and to increase the outstanding loan, which later on increase the expected interest income on the loan. Thus, as depicted in table 4.17, almost 60% of the respondents, agreed that their banks have procedures /polices concerning credit exposure limits, which is set for single borrower and groups of connected counter or economic parties. The remaining 40% of the respondents replied that their banks have procedures /polices concerning credit exposure limits, which is set for particular industries or economic sectors, geographic regions, specific loan type, and all the above mentioned loan clusters.

Table 4.18Maintain credit files by the bank of all borrowers

	Frequency	Percent
Yes	153	100.00
No	-	0.00
Total	**153**	**100.00**

Source: Primary Data, 2019

Maintaining credit files all borrowers visa-vis credit information, purpose of loan, loan approval document, insurance coverage, financial statement are necessary for banks to get access these information when needed and to make the agreement legally binding. In this regard, the findings presented in table 4.18clearly shows that all respondents (100%) said that their banks adequately keep credit files of all borrowers of all information and hence no problem of information which can be used as supporting evidences of why, to whom, when and for what purposes the loan was provided.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

Finally from the above study, researcher has given a proper conclusion and recommendations drawn based on the research findings that has been discussed and analyzed. These are as follows:

5.1Summary of findings

Based onthe results of the study obtained through the questionnaire distributed to 192 credit and risk related employees of the bank so as to assess credit risk management of the bank's credit policy and practice findings are summarized. Demographic characteristics of the bank revealed that the bank is in a good position in terms of the necessary educated manpower and experienced staffs as all staff whoare working on credit and risk related issue have at least BA degree and or above as well as work experience more than two years. With the qualifications the findings implied that most of the employees working in the credit department are well qualified, this contributed a lot to the effective and efficiency in credit management practices of the banks.

Regarding work experience most of the staffs have six to ten years of work experience this implies that experience brings efficiency and effectiveness. Based on the credit strategies and policies awareness, more than half percent of the respondents are not agree for effective communication of the strategies among the staffs this contributes subjective decision making and bias to the uniformity of the implementation.

The study evaluated the credit risk management of Abyssinia Bank S.Co designed to find answers to questions and understand the process of credit risk identification, the extent to which BoA classify and monitor credit risks, and to analyze how bank control credit risksassessing the policies and procedures adopted. The findings of the study indicate that the bank monitor the extent to which credit risk was managed during theduration of loan.

The literature review revealed that banks recognize the danger posed by credit risk concentrations on their financial performance and as a result have instituted strategies to tackle the phenomenon. The approach involves periodically evaluating the credit quality of loans and other credit exposures, applying measurement of credit risks, and aggregating the results of this analysis to identify a portfolio's expected losses.

In order to answer the research objectives, the survey study approach was employed where questionnaire conducted to collect the views of a senior credit officer at BoA on credit risk management. The results from the study showed that BoA has a clear written guideline on credit risk management with the board of directors having an oversight responsibility for implementation. Though having written guideline on credit risk management is good, the extent to which it is being implemented would determine the bank's level of success in curbing credit risk.

The process of credit risk management includes understanding the risk, identifying the risk, classifying it analyzing it and then monitoring the effectiveness of the granting loan and to manage it efficiently and effectively. These processes have helpful in managing the various categories of risks. However, despite the numerous studies made on such topics on the empirical review but none of the reviewed studies has not researched on Bank of Abyssinia. This study aims at to assess the credit risk management of Abyssinia Bank.

5.2 Conclusions

Credit risk is a major problem that bank face, thus bank's credit risk assessment is a hot research issue of the bank management. Credit risk management is a very important area for the banking sector and there are wide prospects of growth. Also, banking professionals have to maintain a balance between the risks and the returns. Giving loans is a risky affair for bank sometimes and certain risks may also come when banks offer securities and other forms of investments. Credit risk management must play its role in managing the risks in various securities and derivatives. Still progress has to be made for analyzing the credits and determining the probability of defaults and risks of losses. So credit risk management becomes a very important tool for the survival of banks.

Better credit risk management results in better bank performance. Thus, it is very importance that banks practice prudent credit risk management and safeguarding the assets of the banks and protect the investors' interests. The following conclusions are drawn:

Majority of employees of the bank working in credit department are by 1stdegree holders followed by 2ndDegree holders and highly experienced which might this enables the bank to accelerate its service delivery and become effective in the growing stiff competitive banking industry as qualified and experienced work force enhances competence and increase in operating results.

The findings of the study indicate that BoA has laid down policies to refer to in identifying credit risk and therefore, has clear-cut methods for identification. The research findings also show that there is poor communication to the loan personnel this can affecting its portfolios to the largest extent.

The study concluded that bank used different credit risk management tools, techniques and assessment models to manage its credit risk, and that has one main objective, i.e. to reduce the amount of loan default, which is the principal cause of bank failures.

The weaknesses in credit creation and procedure which most of the employees have agreed they don't have uniform knowledge on the credit risk managementthis implies that the bank needs awareness for its staffs about bank's policies and procedures of credit manuals due to this factmade subjective decision making by credit personnel's of the banks also had contributed for weak the credit risk management might adversely affect loan growth and client reputation. The study also reveals that banks with good or sound credit risk management policies have lower loan default ratios.

The findings of the study lack of coordination among the lending staffs with the procedures, failure of due diligence and independent monitoring are the major reasons given by the bank for the frequency of the credit risk occurrence. Thus, the research finding indicated that the extent of use of credit risk monitoring methods is quite low.

5.3 Recommendations

Based on the findings and conclusions of the study, the following recommendations are forwarded which are aimed at improving the credit management of the bank.

- 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 factors.
- The bank ensure that credit officers perform periodic follow-ups on borrowers to ensure that loans are used for the intended purpose.

- Establishing a good relationship with borrowers was found to be the most favorable strategy employed by banks in the effort of reducing non -performing loans. This will be done through assisting borrowers by advising them on how to solve their problems, attend some of borrowers' business meetings and deliver good services. These findings suggest that innovation on new ways of dealing with borrowers and follow-up and provide or assist them in how to grow their businesses is a necessary for banks to be able to recover their money; and
- Therefore, as bank moves into a new high-powered world of financial operations and trading, with new risks, the need is felt for more sophisticated and versatile instruments or models for risk assessment monitoring and controlling risk exposure. It is therefore, BoAequips fully to grapple with the demands of creating tools and systems capable of assessing, monitoring and controlling risk exposures in a more scientific manner.

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Addis Ababa University

College of Business & Economics

MBA Program

The purpose of this questionnaire is to carry out a research for the partial fulfillment of master's degree in MBA. The paper focuses on the topic of "Assessment of Credit Risk Management of Abyssinia Bank S.C." The outcome of the study will be used to suggest possible solutions for problems identified on the captioned topic. Thus, your free will and cooperation in giving the reliable information is very important. Any information provided by you will only be used for academic purpose. As a result it will be kept confidential and utmost anonymity.

Thank you in advance for taking your time to fill out this questionnaire

If you need any further assistance, please do not hesitate to contact me in the following address.

- Hirut Kassa Tel. 0911-183833
- Email address hirut.kassa.sha@gmail.com

Please use a **(✓)** mark and put the answer on the space provided.

I. Demographic information:

1. Gender: Male ☐ Female ☐
2. Years of service ______________
3. Marital status: Married ☐ Single ☐
4. What is your current position in BOA _____________________
5. Educational level: Diploma ☐ BSc/BA ☐ MSc/MA ☐ PhD ☐ Other ☐

II. Credit Risk Identification and Assessment

In this section provide a great understanding of the nature of the issue with regards to lending practices, procedures, and qualifications.

1. Do you have credit risk management department?

   Yes ☐ No ☐

2. Who approves procedures of credit proposal of client?

   ☐ Board of Directors

   ☐ Loan Committee

   ☐ Credit Department

   ☐ Branch Manager

3. Does function of your credit risk management department independent of the loan origination function?

   Yes ☐ No ☐

4. Do you have credit risk policy, guidelines and procedures that explain objectives and principles of credit risk management process?

   Yes ☐ No ☐

   If yes, has it been reviewed periodically and is helpful for processing credit request? ________

   ____

5. If your answer for question no. 3 is yes, is the policy and procedures approved by the Board of Directors?

   Yes ☐ No ☐

6. If your answer for question no. 4 is yes, what are the responsibilities of the board of directors?

   ☐ Defining the bank's overall risk tolerance in relation to credit risk

   ☐ Ensuring the bank's overall credit risk exposure is maintained at prudent levels and consistent with the available capital

   ☐ Ensuring that top management as well as individuals responsible for credit risk management possesses sound expertise and knowledge to accomplish the risk management function

   ☐ Ensuring that the bank implement sound fundamental principles that facilitate the identification, measurement, monitoring and control of credit risk

☐ Ensuring that appropriate plans and procedures for credit risk management are in place

☐ Others, please specify, ____

____

____

7. Does the credit risk strategy and policies be effectively communicated throughout the organization?

Yes ☐ No ☐

8. Rank the top three types of loans, which are mostly given out?

	Type
Business loan	☐
Housing loan	☐
Educational loan	☐
Car loan	☐
Personal loan	☐
Refinancing loan	☐

Other (please state) ________________________________

9. What is the longest duration given for repayment of your loans? __________

10. What method of payment is mostly use to repay loans? (Rank 1 to 3), where 1 is the most used method

Cash over the counter ( ) Standing order ( ) Direct debit ( )

III. Credit risk measuring and monitoring

In this section gather the nature of the issues with regards to credit administration, measuring and monitoring

1. What are the tools used by the bank to measure credit risk?

☐ Internal rating

☐ Through the five C's of credit (i.e. Character, Capacity, Capital, Conditions and Collateral)

☐ Through financial statement ratios

☐ Human judgments through experience

☐ Others, please specify, ____

____

2. Do you calculate probability of default of customers?

We calculate ☐ We don't calculate ☐ Other ____________________

3. Do you calculate recovery rate of a loan?

Yes ☐ No ☐

If yes, when do you calculate this (Hint: at the time loan is pass, special mention, or at all time) ____

____

4. In credit risk management banks use various methods to mitigate risks:

☐ Credit limit

☐ Taking collateral

☐ Diversification

☐ Credit insurance

☐ Loan selling

5. Does your bank has procedures/polices in regard to credit exposure limits, which is set for

☐ Single borrowers

☐ Groups of connected counter parties

☐ For particular industries or economic sectors

☐ Geographic regions

☐ Specific loan type

6. Does your bank maintain credit files of all borrowers, which contain information on?

Description	Yes	No
Purpose of the loan		
Loan approval documents		
Planned repayment schedule		
Loan contracts & other legal document		
Insurance coverage		
Financial statement		

7. Does the bank maintain up-dated list of problem loans & list of loans reviewed indicating the date of the review & the credit rating (hint pass, special mention etc)

Yes ☐ No ☐

IV. Control over credit risk

In this section gather the nature of the issues with regards to credit control

1. Do you have internal credit review and reporting systems, which are conducted by individual's independent from the credit function to evaluate the overall credit administration process, determine the accuracy of internal risk ratings and judge whether the credit officer(s) is (are) properly monitoring individual credits?

   Yes ☐ No ☐

2. If your answer for question no. 1 is yes to whom does the report addressed

   ☐ Board of director

   ☐ Senior management with no lending authority

   ☐ Control department

   ☐ Others, please specify, ______________________________

3. Is internal review conducted at least semi annually for problem loans and/or for loans of huge amount & at least annually for all lending areas?

   Yes ☐ No ☐

   If no, please specify the bank's trend ______________________________

4. Does your bank maintain credit files of all borrowers, which contain information on?

Description	Yes	No
Determines loan approvals to be in line with credit policy & procedures		
Determines loan approvals are within the limits of the bank's lending authority		
Determines documentation is satisfactory prior to disbursing loan proceeds		
Determines new loan have been posted accurately		
Examines entries & checks interest posting to various loan account		
Confirms collateral on a test basis		

5. Finally, please share any other issues or ideas that you may have in regard to bank's credit risk management policy and practice ______________________________

   ____

Thank you again for your patience in responding the question!