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**Addis Ababa University**  
**College of Business and Economics**

**ANALYSIS OF CREDIT RISK MANAGEMENT PRACTICE:  
THE CASE OF BERHAN BANK S.C.**

**BY TSION TARIKU**

**Advisor: Meskerem Mitiku (PhD)**

**ANALYSIS OF CREDIT RISK MANAGEMENT PRACTICE:  
THE CASE OF BERHAN BANK S.C.**

**A THESIS SUBMITTED TO MBA COORDINATION OFFICE, COLLEGE OF BUSINESS  
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**BY TSION TARIKU**

**Under Guidance of Meskerem Mitiku (PhD)**

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**ADDIS ABABA, ETHIOPIA**

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

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## **Declaration**

I, the undersigned, declare that this work entitled “**ANALYSIS OF CREDIT RISK MANAGEMENT PRACTICE: THE CASE OF BERHAN BANK S.C.**” is the outcome of my own effort and has not been presented for the award of any degree in any other university or college 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 **Meskerem Mitiku (PhD)**. It is offered for partial fulfillment of the degree of Masters of Arts in Business Administration in Management.

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## **Statement of Certification**

This is to certify that, Tsion Tariku carried out her research work on the topic entitled “**ANALYSIS OF CREDIT RISK MANAGEMENT PRACTICE: THE CASE OF BERHAN BANK S.C.**” is original work and is suitable for submission for the award of Masters of Arts degree in Business Administration.

Advisor: **Meskerem Mitiku (PhD)**



January, 2021

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## **ABSTRACT**

*The main purpose of the study was to analyze the credit risk management practice of Berhan bank with specific objectives of assessing the alignment between the credit risk policy and procedures of the bank and its practice, bank specific factors that influence credit risk management practice and the mechanisms that the bank uses to handle credit risk. For the purpose of the study both primary and secondary data have been used. Primary data was collected using a structured questionnaire data collection method. The information related to the study problems was obtained through questionnaires from the Credit Analysis and Appraisal, Risk and Compliance Management and Credit Follow-up and Portfolio Management departments. Secondary data was collected from the bank's Credit policy and procedures, the annual reports of the bank, NBE directives and other documents regarding the bank's credit history. Based on the nature of the study the research design is descriptive with a qualitative and quantitative research method. Data collected using questionnaires was analyzed by the help of statistical package for the social sciences (SPSS) Descriptive statistical tools were used to analyze the data collected. The software was used in order to have the descriptive quantitative results which were in the form of percentages and frequencies. Hence, the nature of the Study is descriptive. Therefore, the findings of the study showed that the bank has credit risk management policy and procedures that aligns with the regulations of the NBE and this helps it to handle credit risks. However, there was a lack of communication of the policy and procedures to the staff that work on CRM practice and lack of training for the qualified staff in the department. So as to this the recommendation that was given to the concerned body of the bank is to create a suitable environment for the credit risk management practice of the bank to be implemented by equipping the staff with the proper training and also reviewing and updating the policy and procedures on a regular basis.*

*Key words: Credit risk, credit risk management practice, credit policy and procedure*

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## **Acronyms**

**CRM:** Credit Risk Management

**NBE:** National Bank of Ethiopia

**SC:** Share Company

**SPSS:** Statistical Package for Social Science

# CHAPTER ONE

## INTRODUCTION

### 1.1. Background of the study

Bank as the prominent financial service rendering facility, it plays a huge role in the growth and development of the economy. This puts the sector in a critical juncture as its success or failure has positive as well as negative impact on the overall performance of the economy of a given state. Among myriad of services banks managed to provide, loan package stands out as a main and fundamental principle behind an all-out need of the bank *per se*.

Loan service can invariably boost the economy in many ways as it provides consumers with the opportunity to borrow money to finance their economic needs. At personal or household level, loan help to fund one's own expenses that otherwise couldn't afford to realize and loan aid businesses finance their company. And since banks want the money, they lent back, they choose borrowers carefully and monitor their performance closely. This in turn creates the platform for healthy and efficient economy. Furthermore, by diversifying the loans, banks can easily lower risk that must be faced. These in turn makes bank deposits safer and encourages even more bank deposits and therefore even more loans (Encarta, 2009). Yet, issues of loan related possible risks can easily raise and summons a concerted action for a worthy administration of the package.

Nevertheless, Strahan (1999) argued that the risk of lending money depends partly on the firm's type of business and its behavior, experience of managers and the firm's track record. This must be assessed by banks prior to lending. One of the ways to decrease the risk is limiting the quantity they lend. After the loan is given, it is mandatory to check up on the doings of borrowers. Since neither limit on the size of the amount lent nor monitoring fully eliminate risks, banks price the remaining risks through interest charges and other kinds of fees. In addition, credit risk means that the agreed installment payments of the disbursed loans become delayed or unpaid. The agreed terms and tariffs consequently lead to arrears which finally cause a high cash flow problem and hurt the bank's profitability and liquidity position. In addition to this, due to the uncollected cash payments of the outstanding loans, the loan status changes to doubtful. This affects the overall image and profitability of the bank and hinders it not to easily deliver the financial services to its customers (Kyei-Baffour, 2016).

The ability of an organization to effectively manage and monitor credit risk would define the organization's success and survival (Altman, 2012). Girma (2011) states that Banks with good credit risk management policies have a lower loan default rate. Furthermore, Poudel (2012) stated how great focus has been given to credit risk management as inadequacy of policies being the main source of problem in the banking industry now days have been prominent. The key role of an effective credit risk management strategy is to optimize the risk-adjusted rate of return of a bank by keeping credit exposure under control at a reasonable limit. When designing a lending strategy, an overview of the nature and distribution of a bank's credit facilities and the way a credit portfolio is handled must be included. It is well established that all regulators specify minimum requirements for the

management of credit risk as a necessary procedure. Identifying current and future risks, identifying policies that address the risk management philosophy of the bank and setting standards for credit risk control are some of the norms that regulators expect banks to have (Greuning and Bratanovic 2009).

Nikolaidou and Vogiazas (2014) stated that, after the recent turmoil in the financial sector that brought up the global financial crisis, credit risk management has gained an important role in its contribution. They argued that special steps have been taken by the commercial banking sector, especially after the recent financial crisis, to minimize any forthcoming financial losses caused by mismanagement of loan allocation and credit recovery. Credit risk management provides solutions to such problems that are available.

Various studies that have been made concerning the credit risk management practices stated how the control of credit risk has a substantial effect on banks' performance. Additionally, studies suggest that the effectiveness of credit risk management regarding its policy and procedures can affect significantly and contributed to its survival and success of the banks. Among these, Altman (2012) on "Management Credit Risk, In A.C. Millennium", Girma (2011) on "Credit risk management and its impact on performance, on Ethiopian commercial banks", Kassahun (2017) on "Assessment of Credit Risk Management Practice of Awash Bank S.C." and other researchers have found and stated in their studies the crucial role of credit risk management policies and procedures in the profitability of the respective Banks.

Hence, this study will focus on credit risk management practice of Berhan Bank. The study will try to examine credit risk management framework in relation to the credit risks faced, specific factors that influence the practice and as well the mechanisms used by the bank to handle credit risk. Due to the short period existence of the bank, so far, no single research has carried out on this specific issue at this bank. And, this therefore, definitely created a research or knowledge gap that should otherwise be fulfilled. Consequently, this study will exclusively focus on credit risk management practice of Berhan Bank and tries to fulfill inquiry voids left by previous researchers.

### **1.1.1. Background of the Company**

Berhan Bank S.C. ("Berhan" or the "Bank") is a private commercial bank domicile in Ethiopia. The bank was registered and licensed by the National Bank of Ethiopia on 27 June 2009 in accordance with Article 304 of the Commercial Code of Ethiopia of 1960 and licensing and Supervision of Banking Business Proclamation No. 84/1994 and officially inaugurated for public services on October 10, 2009 with the objective of operating in the banking industry. The bank was established by more than 6700 shareholders, with approved capital of birr 300 million. The subscribed capital was 154.7 Million divided into shares of 1000 Birr par value each. The bank is principally engaged in the provision of diverse range of financial products and services to a wholesale, retail and SME client's base in Ethiopian market (Annual Report, 2019/20).

Risk is intrinsic to the operations of the bank, but is handled by an ongoing process of detection, assessment and monitoring, according to risk limits and other controls (Basel, 2011). "Risk management provides a comprehensive and dynamic framework for identifying, measuring, monitoring and managing financial and non-financial risks. The bank is exposed to credit risk,

liquidity risk and market risk; it is also subject to country risk and various operating risks. The bank's policy is to monitor those business risks through the bank's strategic planning process" (Annual Report, 2019/20, pp59-60).

Therefore, the principal concern of this paper will be to explore the credit risk management practice at Berhan Bank by examining alignment between the credit risk policy and procedures of the bank and its practice, evaluating the mechanisms used by the bank to handle credit risk by assessing how it is formulated and implemented and how it influence the credit risk management activity and to suggest possible solutions for those factors affecting the bank credit risk management process negatively.

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

The most significant assets owned by banks are loans (among many others). A decision relating to the credit worthiness of a borrower allows banks to go through the process of lending. Even though it is important, judgments do not always prove to be accurate. This is because of the fact that, various other factors may help to decline the credit worthiness of a borrower. Therefore, banks face credit risks (Bruke, 2018)

Credit risk refers to the possibility of default because of the inability of a borrower to make payments on some form of debt. Credit risk management, a method that has always been a problem for financial institutions, is the task of minimizing risks through recognizing the adequacy of the bank's capital and loan loss reserves at any given period.

Greuning and Bratanovic (2009) explained that financial analysts as well as bank supervisory agencies place considerable importance on formal policies laid down by the board of directors and implemented or administered by management. The scope and distribution of a bank's credit facilities and the way in which a credit portfolio is handled, that is, how investments and financing assets are developed, evaluated, monitored and collected, should be outlined in a lending or financing policy. Flexibility is needed to allow for fast reaction and early adaption to changing conditions in a bank's mix of assets and the market environment. They also argued that, in practice, all regulators set the least requirements for credit risk management as follows: the recognition of current and potential risks, the definition of policies reflecting the risk management philosophy of the bank, and the setting of parameters for regulating credit risk. Better control of credit risk also offers a chance to gently boost overall performance and secure a competitive edge. According to Alexander, 2018, in order to get a guarantee to smooth lending activities and loan repayments, financial institutions, are guided by strategies and measurements, which are credit policies. Unless the credit facilities are assessed properly, there is the likelihood of credit risk because borrowers would default in loan repayment.

Hable (2018) stated that the absence of credit management, which is an essential part of lending, can be the cause of good loans turning to bad loans. The establishment of sound credit policies, procedures and sticking to it and qualified personnel are the basic requirements of good credit management. If the loan is well managed the bank's profitability is bound to increase well, if not, it will be a major threat to their survival.

Numerous researchers that have long been carried out over Bank's credit risk management have come up with almost similar findings. These studies indicated that the Bank sector has been negatively impacted by incompetent or inefficient administration of credit risk management. Scholars such as Sufi and Qaisar (2015), conducted a study on Micro Finance Banks in Pakistan, found that credit terms and client evaluation have a positive and substantial effect on credit performance, whereas credit policy and credit risk management have a positive but insignificant impact on credit performance.

While Serwadda (2018), on the study titled 'Impact of Credit Risk Management Systems on the Financial Performance of Commercial Banks in Uganda' found that bank's performance was inversely influenced by non-performing loans which can expose them to large magnitudes of illiquidity and financial crisis. From this the researcher recommended enhancement of credit risk management techniques to maintain a qualitative asset portfolio and attention is given to non-performing loans, loan loss provision to total loans and growth in interest earnings.

Concerning Ethiopian banking sector, Hable (2018) and Hirut (2018) have assessed on credit risk management at United Bank and Bank of Abyssinia respectively. In their findings they stated that lack of credit follow-up by branches, lack of information system to support the credit risk grading system, information asymmetry on credit policy, weak credit analysis and poor credit monitoring influence the attainment of successful credit management. In a nutshell, the researchers shade a light on credit risk management practices and its impact on the profitability of the banks. Moreover, ranges of effective credit risk management policies and procedures have been reviewed and examined.

However, the credit risk management policy, procedures and practices of Berhan Bank has never been touched by previous researchers. Though significant number of studies conducted on credit risk management practices at different banks in Ethiopia, a review of literatures indicated that no single research has conducted related to Berhan Bank. This, by itself, left a huge research gap as Berhan Bank is one of the new and evolving banks that put up with the responsibility of transforming the country's financial sector. Therefore, filling this knowledge gap will customarily be the role of this study.

In addition, as many literatures signposted, proper application of the credit risk management policy and procedure has a significant impact on the performance of the bank. Subsequently, the result shown on the NPL ratio implies the extent of alignment the practice of credit risk management with the bank's policy and procedures. Accordingly, Berhan Bank, as its infant stage, has an increasing NPL ratio compared to other banks that are established in similar years, and if this rate continues the survival of the bank will be in question. Therefore, carrying out this study will be well-timed, sensible and rational choices at the expense of any other banks in the country.

Henceforth, the paper aims to assess the reason behind this problem and factors that account for this crisis. The study also will clearly sort out the bank credit risk management practices and mechanisms used to handle credit risk will be assessed in the research. This paper will be additional insight and a reference for future researches on related topic.

### **1.2.1. Basic research question**

Hence the study is mainly targeted to answer the following questions

- How does the credit risk management framework of the bank work in relation to the credit risks faced by the bank?
- What are the bank specific factors that influence credit risk management practice at Berhan Bank?
- What are the mechanisms used by the bank to handle credit risk?

### **1.3. Objective of the Study**

#### **1.3.1. General Objective**

The General Objective of the study is to analyze the credit risk management practice at Berhan Bank S.C.

#### **1.3.2. Specific Objectives**

1. To examine the alignment between the credit risk policy and procedures of the bank and its practice.
2. To assess bank specific factors that influence credit management practice of Berhan Bank.
3. To evaluate the mechanisms used by the bank to handle credit risk by assessing how it is formulated and implemented.

### **1.4. Significance of the study**

The study will help by providing information in regards of Berhan Bank's credit risk management practice. It will help the policy makers of the bank to make the appropriate and timely modifications if needed. The study will also help to give good insight to those who want to undertake further research on the area of credit risk management practices and can be utilized as a source of secondary information to fellow researchers.

### **1.5. Scope of the study**

As it is known credit by itself in banking sector is broad by its nature. To cover all the topics regardless of time and finance is rather hard to achieve. Therefore, the study only aims to assess the credit risk management practice in Berhan Bank S.C. among other private banks. The geographical scope of the study will cover mainly the head office which is stationed in Addis Ababa around Bole sub-city in front of the airport on TK building. While for additional information the researcher has also include 5 City branches that will be rated according to their loan disbursement ratio.

The bank has been established and had been in business from the year 2009G.C onwards, studying the whole data with this short time will rather be hard and very much time consuming. Therefore, the researcher intends to gather secondary and related data starting from the year 2017 up to date.

## **1.6. Limitation of the study**

Since the research topic involves a sensitive issue (credit), there will be limitation in getting information that is confidential to the bank. Additionally, time and budget will also be major constraints. So as to this, all the existing problems regarding risk management in banks cannot be covered. Because of the existing limitations, the research will be limited to only cover the credit risk management practice of only one private bank in Ethiopia that is Berhan Bank S.C.

## **1.7. Organization of the paper**

The paper consists of five chapters that analyses the credit risk management practice: the case study of Berhan bank. The first chapter deals with the introduction part and consists of the statement of the problem and research questions. The second chapter deals with literature review part that consists of both the theoretical as well as the empirical review. The third chapter is about the methodology of the study. The fourth chapter deals with the data analysis results and discussions. And the last chapter deals with conclusions and recommendation of the study

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1. Theoretical Review**

Banks' main business is to collect capital from those with surpluses and redistribute it to those that need it for different purposes at a higher price. In this context, a profitability determination process with a specified level of risk becomes a critical operation (Turgut, 2018).

In order to provide the funds needed to facilitate the commercial sector as well as the industry, lending, is one of the mainly important roles of banks. However, this importance of lending is not only due to its social responsibility to provide the needs of credit to different sectors. As the interest earnings on business loans have been always greater than the ones on investment, lending is the most profiting activity. This makes it in need of proper management because it is the principal source of income to the banks and usually it represents one of the core assets of the banks.

##### **2.1.1. Definition**

The word 'credit' was derived from Latin word 'credo' which means 'I believe' or 'I trust', this refers to a trust or trust in another person according to Nwanyanwu, (2010). The term credit implies restoring faith or trust in another. In other words, the meaning of credit can be defined as a contractual deal in which a borrower now receives some value and agrees to repay the lender at some later date (Elijah, 2019).

Credit or loans as defined by National Bank of Ethiopia means any financial asset of a development finance institution arising from a direct or indirect advance of funds (i.e. Unplanned overdrafts, loan syndication involvement, the acquisition of loans from another lender, etc.) or pledge by a development finance institution to advance funds to a person who is bound by the person's obligation to repay the funds, either on a specified date or on demand, usually with interest (NBE, 2012).

Risk is one of the most important good indicators of Bank's performance among many other factors that can be related to the assessment of financial institutions (Pastor, 1999).

##### **2.1.2. Types of Risks in Banking**

Mester, 1992 stated in his study, as banks are involved in both traditional activities – collecting money from depositors and lending it to the borrowers, and trading activities, they come to face different sorts of risks. Some of these risks are discussed as follows.

###### **i. Credit risk**

Credit risk is the risk of debt default that may result from the inability of a borrower to make the payments necessary. The risk is that of the lender in the first resort which involves lost principal and interest, damage to cash flows, and increased cost of collection. There could be three types of this level of risk.

- a. Credit default risk: - is the risk of loss arising from a debtor being unlikely to pay its loan obligations in full or the debtor is more than 90 days past due.
- b. Concentration risk: - is a risk associated with any single exposure or group of exposures with the potential to produce large enough losses to threaten a bank's core operations.
- c. Country risk: - is the risk of losses resulting from the freezing of foreign currency payments by a sovereign state or if it defaults on its obligations; this type of risk is closely linked to the macroeconomic performance and political stability of the country.

## **ii. Liquidity risk**

This type of risk arises due to the issue of solvency. As it is known banks collect deposit from their customers promising to pay an interest on the amount and give loan to other customers the collected money by charging more. The banks owe money to their depositors. Insolvency is created when the banks become unable to pay the money they owe to their depositors. Liquidity risk happens when banks face insufficient liquid assets to fulfill the cash needs or withdrawal of their depositors and loan demands.

## **iii. Default risk**

When bank management has a significant amount of bad loans in their credit account, or when its portfolio investments substantially decline in value and generate a severe capital loss, solvency problems may be caused. Massive withdrawals usually occur through bank runs, and this directly impacts the banks capacity to solve their problems and meet their obligations.

### **2.1.3. What is Credit Risk?**

As established by the Basel Committee on Banking Supervision (2001), credit risk is the probability of partial or complete loss of outstanding loans due to credit events (Default risk). It can also be characterized as the potential that, in accordance with the agreed terms, a contractual party will fail to fulfill its obligations. Credit risk is also known as default risk, performance risk or counterparty risk in different ways.

The Basel accord also stated the credit risk is the risk of loss that may arise as a result of any party's failure to comply with the terms and conditions of any financial contract, primarily the failure of the entity to make the required payments on loans. Credit risk is a financial exposure resulting from a Bank's dependence on another party (Counterparty) to perform an obligation as agreed (National Bank of Ethiopia, 2010).

Banks lend to the borrowers at a rate of interest higher than the rate of interest they pay to their depositors. The banks generate their earnings from the difference between the two. Even though lending money and collecting deposits – the traditional banking activities are the main activities for banks, they are also involved in trading activities (Mester, 1992)

The role banks play as a middleman in the process of providing financial services is generating many types of risks for the banks. Most of these risks are existent on their balance sheet activities which for

this fact contains the risks that have relation with the bank's traditional and trading activities. The writer elaborates that the concept of risk management starts with the reason behind the managing of risks. Maximizing the wealth of the shareholders' is one of the basic management principles. However, the mismanagement of the risks that happen in the business and losses that are incurred from the activities that affect the basic principle can and will directly affect the livelihood of the bank.

Credit risk can be reduced by ways such as;

- a. Efficiency of workers in the banking credit: crucial training on financial analysis of the customer and the knowhow of computer usage in the analysis process in addition to the moral and physical incentives provision will help the workers become efficient. And so, the bank must have department that is responsible for the management of banking risk.
- b. Loan diversification by the loan time duration, purpose of the loan and the banking sector to reduce credit risk
- c. Insurance and guarantees and the lives of borrowers through various insurance companies. Therefore, the following five elements of the resolution (a credit-based model of 5C's) have been formulated to study the credit client (Al-abedallat, 2016)

**Character:** this is basically meant to study the reputation the client has or his/her paying ability. It can be traced from the credit history of the client and also from the reputation in the market in which he/she operates

**Capacity:** this is the ability of the client to be granted a loan and it is based on the financial analysis of the financial statements, cash flows and also the legal form of the client

**Capital:** this is based on the capital of the company size, sales, cash flow and market share of the customer.

**Collateral:** This helps in reducing credit risk as in if the client defaults the collateral will be the first form of repayment for the loan. It could be in forms of Cash insurance, personal guarantee, land, vehicle, building or securities.

**Conditions:** all the terms of agreement about the credit containing the amount of loan, interest rate, guarantees, repayment schedule and all the necessary legal measures must be agreed upon by both parties and signed. (Musa et al., 2012)

In order to make sure that banks get their risk-adjusted return, it is quite necessary for them to have and implement risk measurement and risk management procedures and processes. Accordingly, the Basel Committees Publishing that emphasized on the basic principles of effective banking supervision can be a great tool in order to guarantee the banking industry's profitability and safety.

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

When theoretically defined risk management in banking is “the logical development and execution of a plan to deal with potential losses” and it focuses on management of the exposure to losses or risk in order to protect the value of assets of the institutions.

Atakelt (2015) described the practice of credit risk management as a process of multiple activities, including the analysis, renewal and review of credit risk management documents, in order to use a structured process of credit acceptance, administration, monitoring and control, with an acceptable credit risk setting. Credit risk management activity is further emphasized as a method of risk understanding and recognition to minimize the unfavorable impact of risk-taking activities. In general terms the researcher emphasized the need of establishing suitable credit risk environment for better credit performance and maintaining acceptable level of credit limit.

The renovation of risk management technologies has created tremendous possibilities for banks in the process of risk recognition, evaluation, managing and mitigating. Because of the swiftness of information and the complexity of the international financial market the banks have gained the ability to do the above-mentioned processes of credit the way that was not even possible some years before. For this fact Basel II Accord has been one of the credit modeling software that has helped in great instance to build applicable credit risk modeling and capital adequacy requirements. The competitive market enables the bank to have a competent risk transfer and portfolio optimization by compromising the risk. But in order to take part in these activities, appropriate knowledge about risk management is crucial (Poudel, 2012).

Various questions have been raised in the process of risk management in banking. Accordingly, Turgut, 2018 stated them as: i) “What kind of events can damage banking business and how much damage can be done?” the risk management process starts with the identification of the potential losses or risk and continues by assessing or measuring those issues; ii) “In order to mitigate these risks, what kind of steps can organizations take?” in order to address the potential risks, determining what action to take next after the risk identification and analyzing is concluded. This helps to have a sound and healthy institution. iii) “Did the institutions make the right decision?” checking and reporting the activities of bank risk management will be the last part of the process.

As the main purpose of risk management process is the evaluation of potential losses and taking care of the potential problems, risk management process can be summarized in three steps. The first is identifying and assessing the potential risk in the banking business. The second is developing and executing an action plan to deal with and manage the potential losses, while the third is, continuous reviewing and reporting of the risk management practices after they have been put into action (Turgut, 2018).

### **2.1.5. Factors that affect credit risk management**

Credit risk, being among the prominent risk type faced by commercial banks, is based on the client's obligation to pay the amount loaned. Thus, the following factors have a significant impact on the credit risk and the management of it according to Al-abadallat, (2016)

- i. The efficiency of workers in the banking credit
- ii. The instructions of the central bank
- iii. The credit policy of the bank

The way in which the organization sees how to manage credit risk or other risk is reflected in the Strategy of risk management. This is considered in the aspects of policies, procedures or standards that will be used in order to pass through all the process of risk management. The strategic planning assumptions, drawbacks, the needed criteria and also other factors that influence risk management in the company including the context-specific and overall articulation of organizational risk tolerance are specified in the strategy (Stephen and Daniel, 2013)

The Basel Committee (1999) considered the following with respect to the management of credit risk.

I. Many credit problems show fundamental flaws in credit granting and monitoring processes.

II. Significant causes of bank losses are deficiencies in the subscription and management of market-related credit exposures. By doing so, a robust internal credit mechanism would have prevented or mitigated many credit issues.

III. Many banks find carrying out a thorough credit assessment (or basic due diligence) a substantial challenge. Competitive dynamics and the development of loan syndication strategies create time constraints for conventional bank lending that interfere with simple due diligence.

Nikhade et al., (2004) when describing the factors that affect credit risk management practice at banks, stated that subjective decision making by the higher level of the managerial stage in the bank is the major source of problem for the proper practice of credit risk management. Lending to their own companies, or lending to person they are related to or acquainted with or persons with a reputation for financial use or to satisfy their personal agenda.

Kingu, Macha and Gwahula (2018), described their finding in their article titled "Bank Specific Determinants of Non-Performing Loans: Empirical Evidence from Commercial Banks in Tanzania" by using panel data methods, that growth in total assets, higher loan-to-asset ratio are associated with the decrease in NPL thus refuting to the moral hazard theory while higher capital ratio is also associated with the decrease in NPLs thus supporting the moral hazard theory. On the other hand, higher cost to income ratio is associated with the increase in NPLs in Tanzania thus lending support to Asymmetry Theory, Adverse selection theory and bad management hypothesis linking this variable with the quality of bank management.

Information Asymmetry Theory notes that the existence of asymmetric information is due to the possession of more information on the transactional relationship of the transaction by one side of the parties involved. Asymmetric information literature looks at the impact of decisions in the financial

decision space, based on the disparity in the information available to both parties. Moral hazard in the banking sector is a concept with a variety of principal-agent problems. Therefore, bank managers make risky decisions in order to receive rewards and benefits because they stand to gain a large proportion of upside risk (profits, bonuses, market share) and a small proportion of downside risk on their part, but a high downside risk for depositors and shareholders. Moral hazard is normally linked to bank management behavior through balance sheet items such as bank size, loan growth, asset growth, deposit growth and capital adequacy ratio as, changes in all these items is associated with decisions made bank management (Kingu, Macha and Gwahula, 2018),

On the other hand, adverse selection is generated when bank managers lack the ability to subscribe, control credit risk and manage operating costs; this is related to the theory of bad management hypothesis. This theory explains that bank management continues to inject more capital into handling and tracking bad lending in response to the rise in non-performing loans arising from adverse selection (Muratbek, 2017).

#### **2.1.6. Risk Management Strategy**

This is the means of identifying, assessing and managing risk in a structured and coherent approach. This is built through a process of timely updating and reviewing the assessment based on new developments or actions taken. The process of identifying and reviewing risk is known as risk assessment. Risk assessment enables to be aware of the existence of uncertainties and identification of steps that can be taken in order to protect the organization, people and assets in question (Stephen and Daniel, 2013)

Usually formulated at the organizational level, the risk management strategy defines mechanisms and methodologies with which risk evaluation, risk response and risk monitoring activities are carried out by mission and business and information system risk managers. The risk management approach represents decisions on organizational governance in terms of risk assumptions, risk limits, risk goals, risk tiers (Stephen and Daniel, 2013)

According to Kassahun, 2017 the key problems facing financial institutions mainly emerge from the lack of appropriate concepts of credit risk management, proper implementation of borrower and counterparty standards and inadequate risk management of the portfolio or lack of attention to changes in economic or other circumstances that could lead to a deterioration of the credit status of the counterparty of a bank. And he stated five sound principles that help as guidance for the implementation of credit risk management as follows.

##### **a. Establishment of an appropriate credit risk environment:**

The level of profitability the bank assumes to gain by accepting different credit risks and the its tolerance against risks should be prioritized in the bank's strategy. Credit risk in all of the activities performed in the bank should be addressed in the policies and procedures. This will assist the bank in the detection and control of credit risk found in all goods and activities.

**b. Phase of Sound Credit Granting:** It is essential for the bank to operate under sound credit granting criteria that aims to hit the bank's core target market and a good understanding of the borrower or lender and also of the credit's intent and structure and its means of repayment.

**c. Appropriate maintenance of the method of credit administration, measuring and monitoring:** Banks are expected to control the status of individual loans, including the adequacy of guarantees and reserves with a consistent credit rating process, in terms of the reach, size and complexity of the information systems and analytical technology activities of the bank.

**d. Maintaining appropriate credit risk controls:** Banks must develop a system of independent, ongoing evaluation of the credit risk management processes of the bank and ensure proper management of the credit-granting role and the extent of their credit exposure.

**e. The position of supervisors:** supervisors should perform an unbiased review of the bank's credit granting strategies, policies, procedures and practices and the ongoing management of the portfolio and set realistic limits to restrict bank exposures to single borrowers or groups of similar counterparties (Kassahun, 2017)

According to Singapore's financial authority (2013) report, an establishment ought to verify the amount of credit risk that it will bear. It ought to develop a risk management strategy that's in step with its credit risk tolerance and business goals. In formulating this strategy, the establishment ought to think about the following:

- a. The business targets it has set for specific loaning segments.
- b. The character of its business franchise and its relevant credit market segments;
- c. The portfolio combination that balances its disposition connected concentration risk with ample diversification; and
- d. The trade cycle stage it is operating in.

### **2.1.7. Risk management structure**

Based on the proportion of their sizes and the sort of activities they get involved in, organizations should adopt a risk management structure. The framework should cover areas such as approval of business and credit risk strategy, review of the credit portfolio and profile, approval of credit policy, delegation of credit approving authority and evaluation of the credit processes (Ken and Brown, 2016).

The frame work ought to cover areas like approval of business and credit risk strategy, review of the credit portfolio and profile, approval of credit policy, delegation of credit approving authority and analysis of the credit processes. This committee ought to comprise senior management from the business line and control functions. Credit management serves the conception of credit readying that bank ought to observe that overall bank credit ought to be deployed in such way that each and every section of the economy benefits and this is often the one side of credit management. On the opposite hand, if disposition activity becomes fail, it adversely affects the entire economy (Ken and Brown, 2016).

## **2.2. Empirical Review**

Since the aim of risk management is to make efficient risk reward trade off, it does not necessarily mean to minimize risk as it is commonly perceived. Rather risk taking and risk management, is not to avoid completely or eliminate risk but it is about deciding which ones to take, which ones to exploit or which ones to hedge. “As risk is inherent particularly in financial institutions and banking organizations, risk management is important for banks” (Sabri, 2011 cited in Sirak 2019)

Poudel, 2012 explored various parameters pertinent to credit risk management and its effect of banks performance and found out that the parameters have inverse impact on the financial performance of banks. Default rate, however, is the most predictor of the financial performance of banks. The researcher recommended the banks to have a designed and formulated strategies that will not only minimize the exposure to the credit risk but also that will enhance profitability.

Tsefaye (2019) stated in his study how fellow customers especially the loan client’s involvement in the process of credit formation and setting of terms and conditions is highly important because they have direct involvement and needs to understand better what terms they are responsible for. And as well carefully thought, studied up on and effective policies must be created by the body that is responsible, in order to have a policy that strengthen the management of risk.

The researcher also concluded by his findings that the lack of assessment on the ability of the borrower to repay their loans results in defaulting of loans. Therefore, the researcher established in his study that appraisal of client is an appropriate strategy for managing credit. The study found out that client appraisal is statistically significant to the profitability of the bank (Tsefaye, 2019)

Mitiku (2014) studied the main determinants of commercial bank lending in Ethiopia and found that credit risk being one of the determinants of commercial bank lending, has a significant relationship. The researcher suggested that more emphasis be given to credit risk and liquidity ratio in order to not make the bank’s loan disbursement weaken and in order to save it from insolvency.

Accordingly, Thomas & Paolo (1994) stated in their study that not only lenders look for sound borrowers but in order to make sure that the lenders will be of help in hard times the borrowers also look for sound lenders.

Muhammed (2015) studied the Pakistani banks to examine empirically the effectiveness of risk management processes and their relationship with the performance of the banks. And by this the researcher found out that formulation of an active risk management process is quite necessary for the banks in Pakistan in order to identify, measure, monitor and control different risks. The researcher also stated that, for the Pakistani banks improvement of their performance, creating a comprehensive risk management system is more than just a mere regulatory requirement fulfillment.

Kassahun (2017) studied at Awash Bank aiming to analyze the credit risk management methods and techniques used in the bank and to what degree the bank's current output is assisted by acceptable credit risk management policy procedures and strategies. He found out that even though there is the existence of well-organized credit policy there is a difficulty of understanding it by the employees involved. He stated that this is due to the absence of training for the employees which in turn has an

effect on loan diversion, absence of training for the employees which in turn has an effect on loan diversion, absence of credit risk model and has the exposure to credit risk.

Singh (2013) stresses that, to list only a few, all management functions; credit risk exposure detection, assessment, monitoring and control are included in the credit risk management. Further elaborating the necessity of credit risk management practice for long term achievement of banking sector and current business environment and whereas, poor credit risk management policy will be a source of confusion for the banking industry.

Hable, (2018) found in the study made to assess the credit management practice at United bank, the lack of credit follow up by the branches, lack of information system to support the credit risk grading system of the bank, negligence to the credit policy procedure of the bank, will-full default by borrower, borrower lack of knowledge on loan usage, fund diversion for unintended purpose and centralized decision making by the bank influence the attainment of successful credit management at the bank.

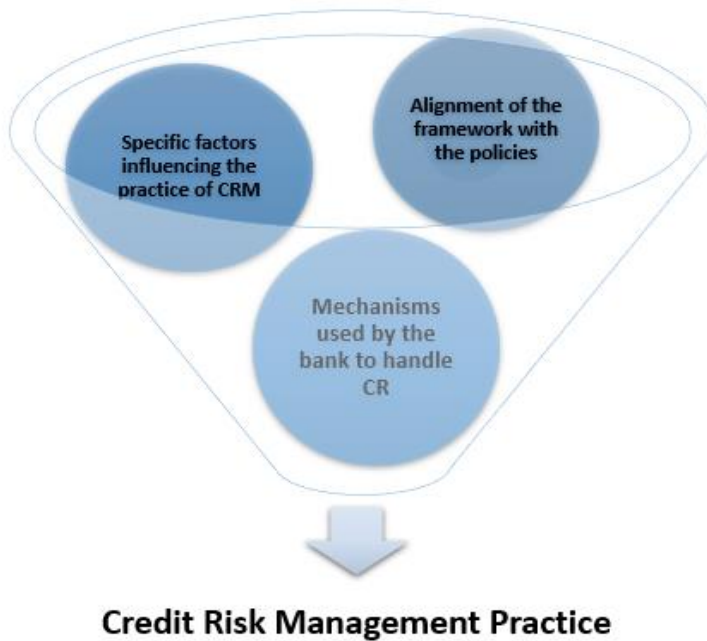
Fatemi and Fooladdi (2006) in their study titled Credit risk management: a survey of practices stated that the managerial risk aversion hypothesis that is based on agency argument holds that at the expense of the shareholders, managers can take part in risk management practices.

According to Greuning, & Bratanovic (2009) strengthening the accountability of directors and management and improving the incentives are the best strategies to create a more profitable and stable financial system. For this fact the quality of both the management team and the director's oversight of the bank can be reflected in many ways. Among these the strategic positioning of a bank, the nature of a bank's risk profile and the adequacy of the systems in order to identify, monitor and manage the profile are the main.

In conclusion, the empirical analysis explicitly notes how most of the studies performed examined the effects of credit risk management on bank profitability and how its proper management has an impact on the bank's performance. Besides, most of the studies reviewed show that no research has been made on the credit risk management practice in the case of Berhan Bank. Therefore, this study is expected to fill the gap by assessing the credit risk management practice of Berhan Bank with the objective of examining the alignment of the credit risk management practice of the bank with the policies and procedures and identifying the bank specific factors that influence the credit risk management practice and as well assessing the mechanisms used by the bank to handle credit risk.

### 2.3. Conceptual Framework

The aim of the Study is to assess the credit risk management practice at Berhan Bank. The study's objectives will be examining the alignment of the Credit Risk Management (CRM) Practice of the bank with its Credit Risk Management policy and procedures, assessing the bank specific factors that influence the credit risk management practice and analyzing the mechanisms used by the bank to handle credit risk. Therefore, the following conceptual framework is designed to summaries the main target area and scope of the study.



Source: *Own conceptual frame work*

## **CHAPTER THREE**

### **METHODOLOGY**

#### **3.1. Research Approach**

The research was conducted on Berhan Bank S.C. as a case study, which was basically designed to examine the credit risk management practice at the Bank. Therefore, the data that was used to analyze this study was obtained from both primary and secondary data sources. While the primary data was collected using questionnaire method and the secondary data was collected from the bank's annual reports, bank directives, policy and procedures and the like. Qualitative and Quantitative approaches have been used to analyze the collected data. The qualitative approach helped in order to analyze documents that are gathered from the secondary sources, while the quantitative approach was used to analyze the primary data that was collected using the questionnaire.

#### **3.2. Research Method**

As the study intended to describe the existing practices, descriptive analytical methods were used for the study. This method is chosen to investigate the credit risk management practice at Berhan Bank S.C. Accordingly, the current credit policy and procedure and its implementation along with the challenge that hinder the credit risk management practice, the mechanisms used to handle credit risk and bank specific factors that influence credit management practice was assessed.

Questionnaire was distributed to the bank's employees that work at the head office level in the credit and risk related departments such as Credit Analysis and Appraisal, Risk and Compliance Management and Credit Follow-up and Portfolio Management departments.

#### **3.3. Data Type and Source**

##### **Primary Data**

Primary data was collected using a structured questionnaire data collection method. It was believed that primary data has greater and paramount role for the study. The information related to the study problems was obtained through questionnaires from the Credit Analysis and Appraisal, Risk and Compliance Management and Credit Follow-up and Portfolio Management departments.

##### **Secondary Data**

Secondary data was collected from the bank's Credit policy and procedures, the annual reports of the bank, NBE directives and other documents regarding the bank's credit history.

#### **3.4. Population of the study**

The population of the research is the members of Berhan Bank Credit and risk related departments. Since the experience of the officers in the departments is taken into consideration staffs that have direct involvement with credit risk management will be the main focus. On the other hand, staffs that

have a less involvement but work through the process of credit giving were taken as additional source of information as well.

And in order to strengthen the topic's argument and get the picture from the side of the branches, the managers and accountants and/or senior loan officers of selected branches were also considered. Since all the credit risk management practice is maintained and implemented at the department level, data gathered from the branch level helped as additional information.

Branches were selected according to purposive sampling. Accordingly, five branches found in Addis Ababa that are ranked from 1 up to 5, by their highest disbursement ratio were selected. The questionnaires were distributed to the branch manager and accountants and/or senior loan officers who worked at the branch levels.

### **3.5. Sampling size and technique**

Among the total staff of the bank that is 4,572, only 40 of the employees work in the credit and risk related departments and are directly involved in the process of credit risk management. In addition to the above departments, the study included five branches found in Addis Ababa that are ranked from 1 up to 5, by the highest disbursement ratio due to the time, cost, large number of staffs and least relevancy consideration. And also, because all the credit risk management practice is maintained and implemented at the department level, data gathered from the branch level will help as additional information.

Therefore, since the involvement of the employees at these departments in regards to the research topic is considered to have key role in the subject matter the sample size of 31 respondents meaning 21 from the departments and 10 from the selected five branches, was collected by calculating the sample size using sampling formula for finite population.

$$n = \frac{Z^2 * p * q * N}{e^2(N-1) + Z^2 * p * q}$$

Where: -

N=Population

p=probability of success

q=probability of failure

e=sampling error

Z=confidence interval

$$n = \frac{1.96^2 * 0.5 * 0.5 * 50}{0.05(50-1) + 1.96^2 * 0.5 * 0.5} = 30.529 \approx 31$$

### 3.6. Method of data analysis

Data collected using questionnaire was analyzed by the help of statistical package for the social sciences (SPSS). It is an analytical tool used to perform quantitative analysis and is used as a complete statistical package that is based on a point and click interface. The software was used in order to have the descriptive quantitative results which will be in the form of percentages and frequencies.

The close ended questions were processed and analyzed by SPSS version 20 and Frequencies, and Percentages were computed. The open-ended questions were analyzed according to the respondent's suggestions on the topic raised. So, the researcher used descriptive type of data analysis both quantitative and qualitative, to draw conclusion and inferences.

### 3.7. Reliability and Validity of the data gathering instruments

To check the questionnaires internal consistency reliability the Cronbach's alpha coefficient test was conducted.

**Table 1: Reliability Statistics**

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.914	.916	43

### 3.8. Ethical Issues

In order to secure the consent of the research, the details and aims of the study have been communicated at the study place to the fellow respondents. The participation of the respondents has also based on their willingness. So, as to this, they were assured that the information gathered from the respondents will be kept confidential and used for the purpose of the study only. Therefore, the research findings have been reported in a complete and honest manner in order to reveal the results properly.

## CHAPTER FOUR

### DATA ANALYSIS, RESULTS AND DISCUSSION

#### 4.1. Introduction

This chapter contains the presentation, analysis and interpretation of the data collected through questionnaire. The study has been carried out with the target of assessing the credit risk management practice at Berhan Bank using the questionnaires prepared to answer the credit risk management framework of the bank in relation to the credit risks faced, the bank specific factors that influence credit risk management and the mechanisms used by the bank to handle credit risk.

The personal profile of the respondents was covered in the first part explained in tabular form and with brief discussion. The second part discusses the results of the questionnaires according to three categories based on the basic research questions of the paper. Questionnaire with Likert scale ratings of five points ranging from Strongly Disagree to Strongly Agree has been distributed with open ended questions that gave the respondents chance to elaborate their answers in their own terms.

The results with respective interpretations have been discussed.

#### 4.2. Response Rate

Since the study was conducted mainly at the head office where all the three department's staff are found, and the distribution and collection of the questionnaires was managed by self and with the assistance and cooperation of fellow staffs, all the distributed questionnaires were retrieved. This has helped to get sufficient and reliable data.

#### 4.3. Respondent's Demography

The descriptive analysis of the demography for the credit risk management process department's staffs and the branch level staffs is as follows:

**Table 2: Gender**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Male	17	54.8	54.8	54.8
Female	14	45.2	45.2	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

According to the survey, more than half of the credit related staffs are male dominated at 54.8 percent while female staffs are 45.2 percent as it is shown in the table above.

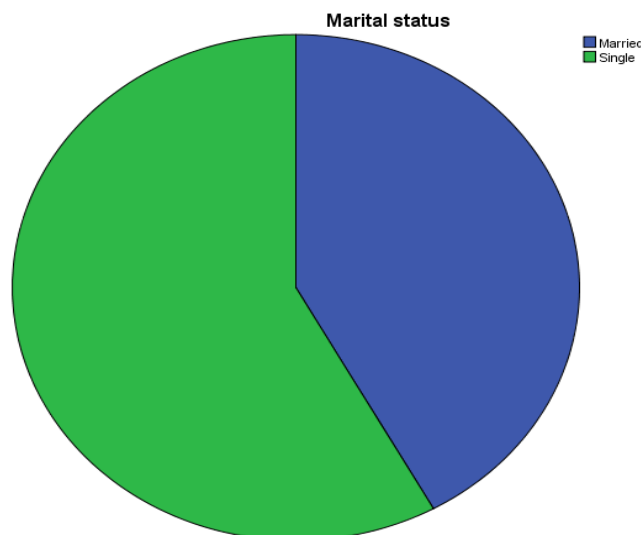
**Table 3: Age**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid 20-30yrs old	18	58.1	58.1	58.1
31-40yrs old	12	38.7	38.7	96.8
41-50yrs old	1	3.2	3.2	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

The respondent’s major age group covering 58.1 percent is the young age group ranging between 20-30 years of age. While the 38.7 percent of the respondent’s falls between the earlier middle age groups ranging from 31-40 years of age. And the last 3.2percent of the respondent lies between the 41-50 years of age. From this it can be observed that the bank staffs working in the credit and related departments are mostly at the age of young and energetic stage which can be an asset to the bank in terms of human resource utilization.

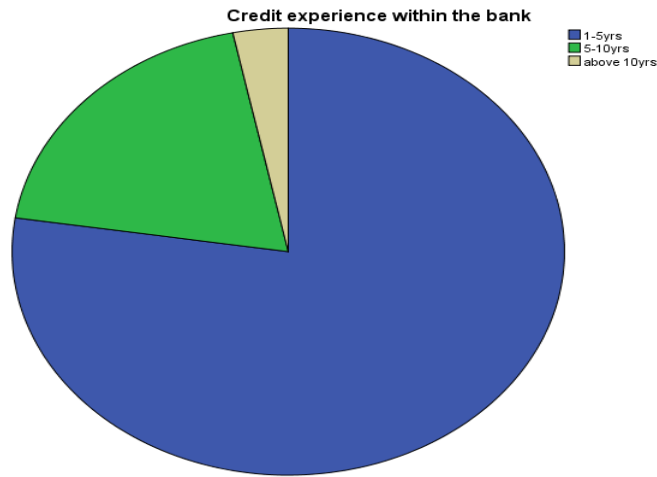
**Chart 4.1**



*Source: Own survey result from primary data sources, 2021*

The marital status of the respondent’s is dominated by single status holders at 58.1percent while the married respondents are at 41.9 percent.

**Chart 4.2**



*Source: Own survey result from primary data sources, 2021*

The respondent's credit experience within the bank is as shown in the above chart. Respondents who have 1-5yrs of working experience on credit are 77.4 percent of the overall respondents while 19.4 percent of the respondents have worked 5-10yrs on credit and the rest 3.2 percent has above 10yrs of credit experience within the bank. From this, it can be driven that there is lack of personnel with longer credit experience levels that work in the credit and related departments at the bank. Therefore, hiring more experienced staff or equipping the existing staff who has lower experience with the proper and adequate skill and knowledge is highly recommended to the bank, in order to facilitate the CRM practice of the bank

#### **4.4. Research related questions**

According to the objectives of the study, the questionnaire has been divided into three parts. The first part is concerned with the credit risk management framework of the bank in relation to the credit risks faced at the bank. Questions raised have been mainly about the policies and procedures of the bank and framework the bank uses to handle credit risk. The second part is concerned with bank specific factors that influence credit risk management practice at the bank. The questions that have been raised consisted of which factors influenced the practice of credit risk management in the bank. The third part is concerned with the mechanisms used by the bank to handle credit risk. This part was divided into four sub-parts that mentioned the topics such as risk identification, assessment and analysis, monitoring and evaluation practice of the bank in order to identify the mechanisms the bank uses to handle its credit risks. The following will be the analysis made from the survey and their respective interpretation of the findings.

#### 4.4.1 Credit risk management framework of the bank in relation to the credit risks faced at the bank

**Table 4: The use of credit risk management tools**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	1	3.2	3.2	3.2
Disagree	1	3.2	3.2	6.5
Neutral	4	12.9	12.9	19.4
Agree	21	67.7	67.7	87.1
Strongly Agree	4	12.9	12.9	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

Among the respondents, 67.7% of them stated that they agree on how the bank uses the credit risk management tools to handle credit risk effectively. 12.9 percent the respondents strongly agreed and another 12.9% responded neutral while 3.2 % each Strongly Disagreed and Disagreed that the bank uses credit risk management tools to handle credit risk effectively as shown in table 4.

Table 5 below shows that 67.7% of the respondents agree with the statement ‘the bank has a credit risk management framework that helps reduce the credit risks faced by the bank’, while those who stated they strongly agree and those who chose neutral are 12.9% each among the respondents. This implies that, according to the stated figures, Berhan bank does use credit risk management tools to handle credit risk and that the CRM framework of the bank helps reduce the credit risks the bank face.

**Table 5: The bank’s credit risk management framework**

	Frequency	Percent	Valid Percent	Cumulative Percent
Disagree	2	6.5	6.5	6.5
Neutral	4	12.9	12.9	19.4
Agree	21	67.7	67.7	87.1
Strongly Agree	4	12.9	12.9	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

**Table 6: The bank’s policies and procedure and credit exposure limits**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Neutral	8	25.8	25.8	25.8
Agree	15	48.4	48.4	74.2
Strongly Agree	8	25.8	25.8	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

Regarding the policies and procedures in terms of credit exposure limits and its timely and appropriate updating, 48.4% of the respondents agreed. While the respondents who strongly agreed and who were neutral are 25.8% each, 0% disagreed. Therefore, the bank has policies and procedure in regards to credit exposure limits and it is timely and appropriately updated.

The respondents answer for whether the credit risk management policies and procedures of the bank enhances effectiveness of monitoring and controlling the credit risk were 58.1% agreed and 22.6% strongly agreed. While 16.1% of the respondents were neutral, the rest 3.2% of them disagreed. This implies that the CRM policy and procedure of the bank enhances effectiveness of monitoring and controlling of the credit risk and to that effect more than half of the respondents agreed as shown in table 7 below.

**Table 7: The CRM policies and procedures of the bank and effectiveness of monitoring and controlling the credit risk**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Disagree	1	3.2	3.2	3.2
Neutral	5	16.1	16.1	19.4
Agree	18	58.1	58.1	77.4
Strongly Agree	7	22.6	22.6	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

According to the bank’s annual report, the risk management policies and systems are reviewed regularly in order to reflect changes in market conditions and the bank’s activities. The bank through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations (Annual report, 2019/20).

On the following table 8, the respondents have answered to the statement, credit manuals are up-to-date and convenient for loan creation as 51.6% of which agreed and 22.6% strongly agreed, leaving 12.9% each to the neutral and disagree responses. Higher number of the respondents agreed that the bank’s manuals are up-to-date and convenient for loan creation.

**Table 8: The credit manuals are up-to-date and convenient for loan creation**

	Frequency	Percent	Valid Percent	Cumulative Percent
Disagree	4	12.9	12.9	12.9
Neutral	4	12.9	12.9	25.8
Valid Agree	16	51.6	51.6	77.4
Strongly Agree	7	22.6	22.6	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

As the National bank of Ethiopia’s guidelines on credit risk management states that it is the responsibility of the board of directors in the bank to review and approve the bank’s credit strategy and policies. It is also necessary for all the banks to develop a strategy that aligns with its objectives in credit-granting activities and adopting the necessary policy and procedures to conduct such activities.

In order to study the policy and procedures of Berhan bank, in terms of the general objectives of the bank and the framework it has in relation to the credit risk management, the following responses were given by the respondents for the next six questions regarding it.

**Table 9: Credit policy and procedures of the bank**

<b>The Bank’s credit policy and procedure is flexible and takes into account the changes in the market</b>	Frequency	Percent	Valid Percent	Cumulative Percent
Disagree	2	6.5	6.5	6.5
Neutral	8	25.8	25.8	32.3
Valid Agree	15	48.4	48.4	80.6
Strongly Agree	6	19.4	19.4	100.0
Total	31	100.0	100.0	

<b>The credit policy and procedure of the bank exactly comply with the regulations of National Bank</b>		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Neutral	4	12.9	12.9	12.9
	Agree	15	48.4	48.4	61.3
	Strongly Agree	12	38.7	38.7	100.0
	Total	31	100.0	100.0	
<b>The credit risk policy, guidelines and procedures explain objectives and principles of credit risk management process clearly</b>		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Neutral	5	16.1	16.1	16.1
	Agree	17	54.8	54.8	71.0
	Strongly Agree	9	29.0	29.0	100.0
	Total	31	100.0	100.0	
<b>The credit risk strategy and policies help the bank to better manage the credit risk</b>		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Disagree	1	3.2	3.2	3.2
	Neutral	4	12.9	12.9	16.1
	Agree	19	61.3	61.3	77.4
	Strongly Agree	7	22.6	22.6	100.0
	Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

Therefore, for the first statement 48.4% respondents agreed, 25.8% responded neutral, and 19.4% strongly agreed, while the rest 6.5% disagreed. On the second statement, 48.4% and 38.7% responded agree and strongly agree respectively while the rest 12.9% responded neutral. On the third statement, the 54.8% of respondents agreed while 29% strongly agreed and 16.1% were neutral. For the last statement on the table, 61.3 agreed with the statement, 22.6 strongly agreed and 12.9 were neutral while 3.2% disagreed with the statement.

It is evident that in the figure above though the percentage of the respondents that agreed and strongly agreed for each statement is higher in number than the rest, the percentage of the neutral and disagreed is also significant. Therefore, it is recommended for the bank to properly assess its policy and procedures of credit risk management in order to make it flexible according to changes in the market and in order to better manage the credit risk faced by the bank by complying with the proper guidelines of the National Bank's rules and regulations.

**Table 10: The supervision or administration and lack of adequate system of the CRM**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	2	6.5	6.5	6.5
Disagree	10	32.3	32.3	38.7
Neutral	12	38.7	38.7	77.4
Agree	6	19.4	19.4	96.8
Strongly Agree	1	3.2	3.2	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

In order to analyze the existence of ineffective supervision or administration and lack of adequate systems in performing the credit risk management mechanism the respondents' survey results were found as stated in table 10. For this statement 38.7% showed they neither agreed nor disagreed. And 32.3 % of the respondents disagreed, while 19.4% and 6.5% of the respondents agreed and strongly disagreed respectively. The rest 3.2% strongly agreed there is ineffective supervision or administration and lack of adequate system in performing the credit risk management mechanism. Even though there are a higher number of respondents who disagree that there is ineffective supervision or administration and lack of adequate system in performing the CRM mechanism, there are a number of significant respondents that agree with the statement. This calls for the bank to make proper amendments to the existing lack in effective supervision and administration and as well to the lack of adequate system in performing the credit risk management mechanisms.

**Table 11: Diversification of loans for different economic sectors**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	1	3.2	3.2	3.2
Disagree	2	6.5	6.5	9.7
Neutral	6	19.4	19.4	29.0
Agree	13	41.9	41.9	71.0
Strongly Agree	9	29.0	29.0	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

Table 11 shows the responses of the respondents for the statement, the bank diversifies the loan disbursed for different economic sectors based on their economic classification in order to minimize

the credit risk. Accordingly, 41.9% and 29% responded agree and strongly agree respectively. And 6.5% and 3.2% responded disagree and strongly disagree respectively, while the rest 19.4% were neutral.

#### 4.4.2. Bank specific factors that influence the CRM practice of the bank

The following analysis is made on the second part of the questionnaire that studied the bank specific factors that influences credit risk management practice at the bank. Thorough analysis has been listed on the table 12 and the discussion as follows.

**Table 12: Bank specific factors that influences the CRM practice of the bank**

Item No.	Questions	Strongly Disagree		Disagree		Neutral		Agree		Strongly Agree		Total	
		F	%	F	%	F	%	F	%	F	%	F	%
a	The credit risk policy and procedures are effectively communicated throughout the concerned departments/staffs	3	9.7	7	22.6	7	22.6	8	25.8	6	19.4	31	100
b	The credit granting and monitoring process can sometimes be influenced by directors, senior managers or influential staff of the bank	1	3.2	1	3.2	4	12.9	17	54.8	8	25.8	31	100
c	The bank's credit granting and approval process establishes accountability to decision makers	0	0	0	0	9	29.0	16	51.6	6	19.4	31	100
d	Lack of timely review is among the causes of high credit risk in the bank	1	3.2	7	22.6	6	19.4	12	38.7	5	16.1	31	100
e	Credit, risk and related department staffs play a great role for the effective implementation of the credit policy and procedures.	2	6.5	0	0	2	6.5	13	41.9	14	45.2	31	100
f	Lack of qualified staff and the right number of staff is a problem to implement the credit policies and procedures	4	12.9	2	6.5	1	3.2	16	51.6	8	25.8	31	100
g	There is lack of training for the staff about credit risk management	3	9.7	3	9.7	4	12.9	12	38.7	9	29.0	31	100
h	Existence of an appropriate policy and procedure is the main factor that influences the credit risk management practice at the bank	4	12.9	5	16.1	18	58.1	4	12.9	4	12.9	31	100

i	The Credit Policy and Procedures of the bank demands collateral whenever granting any loan	2	6.5	6	19.4	5	16.1	15	48.4	3	9.7	31	100
j	The bank has policies and procedure in regards to credit exposure limits	1	3.2	2	6.5	6	19.4	13	41.9	9	29.0	31	100
k	There is a difficulty in understanding the policy and procedure of the bank concerning credit risk management	0	0	14	45.2	8	25.8	7	22.6	2	6.5	31	100
l	The credit enforcement mechanism of the bank effective in terms of loan repayment	0	0	5	16.1	6	19.4	16	51.6	4	12.9	31	100

*Source: Own survey result from primary data sources, 2021*

Bank specific factors that influence the credit risk management process may vary from bank to bank. However, unless the bank identifies the possible factors and sort out the existing problem, the mismanagement of credit risk will create much bigger problems and in turn it will lead the bank to lose its stand in the market. The above statements were raised in order to grasp the specific factors that influence the bank in question. And the respondents have stated their answer on the scale from strongly disagree to strongly agree.

The first statement stated whether the credit risk policy and procedures of the bank are effectively communicated throughout the concerned departments/staffs. 25.8% and 19.4% responded agree and strongly agree respectively and the 22.6 and 9.7 disagreed and strongly disagreed, while 22.6% is indifferent. Even if the percentage of the agreeing side is a higher than the rest, there is a significant number of respondents that responded in disagreement and the other half is neutral. This clearly shows that the bank should work more on communicating the policy and procedures throughout the departments/staffs in order to gain its objectives with all on board.

The second statement studied whether the credit granting and monitoring process can sometimes be influenced by directors, senior managers or influential staff of the bank. 54.8% percent of the respondents agreed and 25.8% strongly agreed. While 3.2% each went to disagree and strongly disagree and the rest 12.9% of the respondents chose neutral. More than 75% of the respondents agreed there is involvement of higher-level officials of the bank in the credit granting and monitoring process. As this may hinder the proper practice and implementation of the policy and procedures of the bank, it must be taken seriously to amend the existing problem and limit the unnecessary involvement of individuals in the credit granting process.

For the third statement that asked if the bank's credit granting and approval process establishes accountability to decision makers, 51.6% agreed, 29% were neutral while 19.4% strongly agreed. This implies that more than half of the respondents agree that the credit granting and approval

process is accounted for by the decision makers. However, a significant number of 29% of the respondents neither agreed nor disagreed implying the bank needs to work more on the issue of accountability of the bank's decision makers.

The next statement on table 12 item 'd' stated lack of timely review is among the causes of high credit risk in the bank. As shown in the table 22.6% and 3.2% of the respondents chose disagree and strongly disagree respectively and 38.7% and 16.1% of the responses were agree and strongly agree respectively while the remaining 19.4% of the respondents were neutral.

In order to analyze whether the credit, risk and related departments staff play a great role for the effective implementation of the credit policy and procedures statement item 'e' was presented to the respondents. When 45.2% of them responded strongly agree 41.9% of the respondents strongly agreed while 6.5% each responded strongly disagree and neutral as well. As it has been discussed in the literature review chapter of this paper, among the factors that have a significant impact on the credit risk management, the efficiency of the workers in the banking credit has been stated in the first place (Al-abadallat, 2016). Accordingly, the finding shows that more than 87% of the respondents showed their agreement. For as to this the bank must work in understanding of the significant role of the credit and related department workers and the impact they can have on the practice of CRM at the bank. The proper utilization of the human resource will enable the bank to get greater rewards and lower the credit risk.

Therefore, from the next statement it was founded that 51.6% and 25.8% of the respondents agreed and strongly agreed respectively that the lack of qualified staff and the right number of staff is a problem to implement the credit policies and procedures. While the 12.9% and 6.5% of the responses were strongly disagreed and disagree, the rest 3.2% is neutral. This implies that the bank needs to work on the lack of qualified and adequate staff numbers in order to enhance the CRM practice. Since the staff by itself is a major input for the needed practice to be fulfilled the bank has to give focus to the staff enhancement.

It can be observed from statement item 'g' how there is lack of training for the staff about credit risk management. 38.7% agreed while 29% of the responses were strongly agree and the rest 12.9%, 9.7% and again 9.7% responses were neutral, disagree and strongly disagree. Even though the main performers in the CRM practice process are the credit and related department, the study shows there is a lack of proper trainings for the staffs on credit risk management.

'Existence of an appropriate policy and procedure is the main factor that influences the credit risk management practice at the bank' for the statement the respondent's response was 58.1% neutral, 16.1% disagree and 12.9% each agree, strongly agree and strongly disagree. The next statement asks whether the credit policy and procedures of the bank demands collateral whenever granting any loan. And for this 48.4% agreed and 9.7% strongly agreed while 19.4% of the respondents disagreed, 16.1% were neutral and 6.5% strongly disagreed. According to the policy and procedure of the bank, collateral provides additional security and the bank generally requests collateral from the clients. Staff loans are even secured to the extent of the employee's continued employment in the bank and against the buildings or vehicles purchased (Annual report, 2019/20).

The next statement dealt with whether the bank has policy and procedures in regards to credit exposure limits. And as to this among the respondents 41.9% agree and 29% strongly agree while 19.4% were neutral the rest 6.5% and 3.2% of the respondents disagreed and strongly disagreed on the statement. Even though there is a higher number of the respondents that responded in agreement, still the number of respondents that are indifferent is significant, which implies the bank either needs to communicate the developed policy and procedures down to the individual level staff that are involved in the credit risk management process.

When answering the statement ‘there is a difficulty in understanding the policy and procedure of the bank concerning CRM’, the respondents 45.2% responded disagree while the 25.8% were neutral the remaining 22.6% and 6.5% of the respondents agreed and strongly agreed respectively. This indicates that even though the policy and procedure of the CRM practice of the bank are easily understandable, there are still quite a significant number of staff that have not fully comprehended it yet. And this, like all the above-mentioned factors will create hindrance on the bank’s CRM practice.

The last statement for this part states ‘the credit enforcement mechanism of the bank is effective in terms of loan repayment’. Among the respondents, 51.6% agree, 12.9% strongly agree, 16.1% disagree while the remaining 19.4 were neutral. From this it can be observed that more than half of the respondents agree on the enforcement mechanisms effectiveness in terms of loan repayment. And yet still a significant amount of the staffs disagrees and is neutral on the issue raised.

#### 4.4.3. Mechanisms used by the bank to handle credit risk

The following covers the third part of the questionnaire that emphasizes on the mechanisms used by the bank to handle credit risk. And this part has also been separated into four sub-groups according to credit risk management levels.

##### A. Risk Identification

**Table 13: Risk Identification**

<b>The bank identifies and prioritizes its main credit risks</b>		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	1	3.2	3.2	3.2
	Disagree	6	19.4	19.4	22.6
	Neutral	1	3.2	3.2	25.8
	Agree	19	61.3	61.3	87.1
	Strongly Agree	4	12.9	12.9	100.0
	Total	31	100.0	100.0	
<b>The bank registers the identified risk for further assessment</b>		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	2	6.5	6.5	6.5

	Disagree	4	12.9	12.9	19.4
	Neutral	10	32.3	32.3	51.6
	Agree	13	41.9	41.9	93.5
	Strongly Agree	2	6.5	6.5	100.0
	Total	31	100.0	100.0	
	<b>The bank involves different professionals to identify credit risk</b>	Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	3	9.7	9.7	9.7
	Disagree	6	19.4	19.4	29.0
	Neutral	11	35.5	35.5	64.5
	Agree	9	29.0	29.0	93.5
	Strongly Agree	2	6.5	6.5	100.0
	Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

According to the above table 13, on the first statement, 61.3% of the respondents agree on the bank identifies and prioritize its main credit risks. 19.4% of the respondents disagreed while 12.9% strongly agreed and 3.2% each strongly disagreed and were neutral. The second statement stated whether the bank registers the identified risk for further assessment and 48.4% of the respondents agreed while the 25.8% disagreed. On the third statement it was stated the bank identifies different professionals to identify credit risk and for this 29% and 6.5% agreed and strongly agreed respectively while 19.4 and 9.7 disagreed and strongly disagreed respectively. And the remaining 35.5% remained neutral. From these figures it can be observed that even if the bank identifies and prioritize its main risks then registers them for further assessment, there is a lack on the involvement of different professionals regarding credit risk. Lack of professional staff in the process is a drawback that must be corrected.

The core and basic thing for in order to get an effective CRM process is to first identify and analyze the existing and potential risks that can be found in any product or activity. In order to grasp this process in terms of risk identification the following statements were presented.

**Table 14: Risk Identification on brainstorming and documentations**

<b>The bank gives due consideration to formal brainstorming credit risk identification</b>	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	1	3.2	3.2	3.2
Disagree	7	22.6	22.6	25.8
Neutral	9	29.0	29.0	54.8
Agree	11	35.5	35.5	90.3
Strongly Agree	3	9.7	9.7	100.0
Total	31	100.0	100.0	
<b>The bank gives due attention to the quality of documents submitted by borrowers with respect to the business</b>	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	4	12.9	12.9	12.9
Disagree	3	9.7	9.7	22.6
Neutral	2	6.5	6.5	29.0
Agree	16	51.6	51.6	80.6
Strongly Agree	6	19.4	19.4	100.0
Total	31	100.0	100.0	
<b>The bank demands a business plan from all clients to identify risk exposure</b>	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	3	9.7	9.7	9.7
Disagree	10	32.3	32.3	41.9
Neutral	7	22.6	22.6	64.5
Agree	8	25.8	25.8	90.3
Strongly Agree	3	9.7	9.7	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

From table 14 the first statement stated whether the bank gives due consideration to formal brainstorming credit risk identification and from the respondents 35.5% and 9.7% showed their agreement on the statement while the 22.6% and 3.2% disagreed the rest 29% were neutral. From the second statement, ‘the bank gives due attention to the quality of documents submitted by borrowers with respect to the business’ 71% agreed with the statement while 22.6% disagreed and the rest 6.5% were neutral. And on the last statement the respondents were asked whether the bank demands a business plan from all clients to identify risk exposures. 42% of the responses were in disagreement while 35.5% agreed and the rest 22.6% were neutral.

Therefore, the above figures imply that the bank uses formal brainstorming as a means of credit risk identification and quality of the documents the borrowers submit for their loan process is taken due consideration. However, the bank does not request business plans from all the clients that need loan as the type of loan client may vary and not all are business oriented.

## B. Risk Assessment and Analysis

Questions regarding the assessment and analysis of risk at the bank are discussed here below.

The first table 15 stated whether the bank uses numerical methods to assess credit risks, and the answers were as follows: 48.4% and 12.9% agreed and strongly agreed respectively while 12.9% and 9.7% of the respondents disagreed and strongly disagreed leaving the rest 16.1% to neutral responses. The implication of this figure is among the methods the bank uses to assess credit risk numerical method is prominent.

**Table 15: The bank uses numerical methods to assess credit risks**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	3	9.7	9.7	9.7
Disagree	4	12.9	12.9	22.6
Neutral	5	16.1	16.1	38.7
Agree	15	48.4	48.4	87.1
Strongly Agree	4	12.9	12.9	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

Table 16 on the other hand stated whether the bank uses qualitative methods to assess credit risk and the responses were similar with the above statement implying that more than half of the respondents agree that the bank also uses qualitative methods to assess credit risk.

**Table 16: The bank uses qualitative methods to assess credit risks**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	2	6.5	6.5	6.5
Disagree	2	6.5	6.5	12.9
Neutral	7	22.6	22.6	35.5
Agree	15	48.4	48.4	83.9
Strongly Agree	5	16.1	16.1	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

**Table 17: The bank effectively assesses the likelihood of different risks occurring**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Disagree	3	9.7	9.7	9.7
Disagree	3	9.7	9.7	19.4
Neutral	10	32.3	32.3	51.6
Agree	12	38.7	38.7	90.3
Strongly Agree	3	9.7	9.7	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

The above statement on table 17 assessed if the bank assesses the likelihood of different risks occurring and 19.4% disagreed and 32.3 were neutral responses while the rest 48.4% agreed that the bank effectively assesses the likelihood of different risks occurring. This enables the bank to get a fore start in the credit risk management process.

**Table 18: Developing action plans for implementing the decisions**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Disagree	3	9.7	9.7	9.7
Disagree	3	9.7	9.7	19.4
Neutral	5	16.1	16.1	35.5
Agree	17	54.8	54.8	90.3
Strongly Agree	3	9.7	9.7	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

The above table stated ‘the bank develops action plans for implementing decisions and management plans for identified risks. Among the respondents the total of 64.5 agreed while 19.4 disagreed while the rest 16.1 were neutral, implying that a significant number of the respondents clearly agreed that the bank develops action plans for implementing decisions and management plans for identified risks. This helps a great deal in the process of credit risk management practice of the bank.

**Table 19: The documentation of the bank’s risk management processes**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	1	3.2	3.2	3.2
Disagree	6	19.4	19.4	22.6
Neutral	9	29.0	29.0	51.6
Agree	13	41.9	41.9	93.5
Strongly Agree	2	6.5	6.5	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

Regarding the documentation of the risk management guidance of the bank to the staff, the statement in the table 19 stated ‘the bank’s risk management processes are well documented and provide guidance to staff about management risk’. And to this 41.9% and 6.5% agreed and strongly agreed respectively while 19.4% and 3.2% disagreed and strongly agreed and the rest 29% were neutral. This implied that the bank has a guidance documents well prepared for the staffs to use in order to know about the credit risk management practice of the bank.

### **C. Risk Monitoring**

**Table 20: Action plans in implementing decisions about identified risk**

	Frequency	Percent	Valid Percent	Cumulative Percent
Disagree	8	25.8	25.8	25.8
Neutral	4	12.9	12.9	38.7
Agree	16	51.6	51.6	90.3
Strongly Agree	3	9.7	9.7	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

Regarding the statement on table 20 on ‘the bank’s response to risk includes action plans in implementing decisions about identified risk’ 51.6% and 9.7% of the respondents agreed and strongly agreed respectively while 25.8% and 12.9% were disagree and neutral respectively. Even though more than half of the respondents agreed with the statement, there is a significant number of respondents that disagree. This calls for the bank to focus more on the action plans that could

facilitate the implementations of decisions on the identified risks in order to minimize the potential risks.

On the below table 21 it was stated whether monitoring the effectiveness of risk management is an integral part of routine management reporting and 67.8% agreed while 9.7% disagreed and the rest 22.6 were neutral. This implies that among the routine management reporting of the bank, monitoring of the effectiveness of risk management in the main.

**Table 21: Monitoring the effectiveness of risk management and reporting**

	Frequency	Percent	Valid Percent	Cumulative Percent
Disagree	3	9.7	9.7	9.7
Neutral	7	22.6	22.6	32.3
Agree	18	58.1	58.1	90.3
Strongly Agree	3	9.7	9.7	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

**Table 22: The bank does strict follow-up on repayment of the loan**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	3	9.7	9.7	9.7
Disagree	4	12.9	12.9	22.6
Neutral	8	25.8	25.8	48.4
Agree	10	32.3	32.3	80.6
Strongly Agree	6	19.4	19.4	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

Table 22 stated whether the bank do strict follow-up on repayment of the loan and 32.3% and 19.4% of the respondents agree and strongly agreed respectively while 12.9% and 9.7% disagreed and strongly disagreed and the remaining 25.8% were neutral. This figure implies, even if the number of the agreeing respondents is higher than the rest, there is a significant amount that did not agree that the bank followed strict follow-up method for loan repayment process

Table 23 assessed whether the bank monitors the allocation of the loan to the intended purpose and its progress. And to this 29% each agreed and was neutral while 12.9% strongly agreed and the rest 29% disagreed. This implies that the bank lack in monitoring the allocation of the disbursed loan to the intended purpose and its ongoing progress.

**Table 23: The bank monitors the allocation of the loan to the intended purpose and its progress**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	5	16.1	16.1	16.1
Disagree	4	12.9	12.9	29.0
Valid Neutral	9	29.0	29.0	58.1
Agree	9	29.0	29.0	87.1
Strongly Agree	4	12.9	12.9	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

**Table 24: Monitoring results communicated to credit performers for further actions**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	3	9.7	9.7	9.7
Disagree	7	22.6	22.6	32.3
Valid Neutral	8	25.8	25.8	58.1
Agree	11	35.5	35.5	93.5
Strongly Agree	2	6.5	6.5	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

The above statement assessed whether the monitoring results communicated to credit performers for further actions and 35.5% and 6.5% responded agree and strongly agree respectively while 22.6% and 9.7% disagreed and strongly disagreed respectively and the rest 25.8% were neutral. This implies

that the bank needs to work more on the results of monitoring being communicated to the credit performers so that misinformation and miscommunication will not be created.

#### D. Risk Evaluation

**Table 25: Continuous review and evaluation of the techniques used in risk management**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	1	3.2	3.2	3.2
Disagree	4	12.9	12.9	16.1
Valid Neutral	9	29.0	29.0	45.2
Agree	13	41.9	41.9	87.1
Strongly Agree	4	12.9	12.9	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

To assess the risk evaluation process of the bank the statement ‘the bank emphasizes on continuous review and evaluation of the techniques used in risk management’ has been stated. And for this 54.8% of the respondents agreed, while 16.1% of the respondents disagreed leaving the 29% of the respondents to be indifferent. This figure implies that continuous review and evaluation of the techniques that are used in risk management are given a greater emphasis at Berhan bank.

**Table 26: The bank is able to accurately evaluate the costs and benefits of taking risks**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	1	3.2	3.2	3.2
Disagree	5	16.1	16.1	19.4
Valid Neutral	5	16.1	16.1	35.5
Agree	13	41.9	41.9	77.4
Strongly Agree	7	22.6	22.6	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

It is any organizations obligation to accurately evaluate the costs and benefits of taking risks to avoid any unwanted occurrences. On the above table it is stated whether Berhan bank does an accurate evaluation of the costs and benefits of taking risks and as to this 64.5% agreed while 19.3 disagreed

and the remaining 16.1 were neutral. These shows that a significant number of respondents agree that the bank is able to accurately evaluate the costs and benefits of taking risk.

**Table 27: The bank is able to accurately evaluate and prioritize different risk treatments**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	1	3.2	3.2	3.2
Disagree	5	16.1	16.1	19.4
Valid Neutral	5	16.1	16.1	35.5
Agree	17	54.8	54.8	90.3
Strongly Agree	3	9.7	9.7	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

From the above table figures, the total of 64.5% agree with the statement ‘the bank is able to accurately evaluate and prioritize different risk treatments’ while the 19.3% disagrees. Therefore, this indicates that the accurate evaluation and prioritization of risk treatments exist in the banks CRM process.

**Table 28: Evaluation of the effectiveness of the existing controls and risk management responses**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	2	6.5	6.5	6.5
Disagree	5	16.1	16.1	22.6
Valid Neutral	3	9.7	9.7	32.3
Agree	18	58.1	58.1	90.3
Strongly Agree	3	9.7	9.7	100.0
Total	31	100.0	100.0	

*Source: Own survey result from primary data sources, 2021*

The respondents answer for the statement ‘the bank’s response to risk includes an evaluation of the effectiveness of the existing controls and risk management responses’, 58.1% chose agree and 9.7% strongly agree, while 16.1% and 6.5% disagree and strongly disagree respectively, the remaining 9.7

were indifferent. This indicates that Berhan bank's response to risk is based on evaluations of the existing controls and risk management responses.

#### **4.4.4. Discussion of the analysis and summary of the open ended questions**

##### **A. Discussion of the analysis**

According to the finding shown on the above table the mean values from the collected data shows that for the first part of the questionnaire data

The first part of the questionnaire discussed on the first objective of the study that is credit risk management framework of the bank in relation to the credit risks faced at the bank. The following is the discussion based on the findings stated in the study.

It has been stated in the finding that majority of the respondents agree that the bank uses the CRM tools to handle credit risk effectively and also the bank has a CRM framework that helps reduce the credit risks faced by the bank. As CRM tools can help the bank fight against risks that it faces while processing credit, the bank's status in giving a priority to having this tools and using the framework will enable it to have an environment that is safe against credit risk or at least in the minimum. It has been stated also, in the finding of this paper, that the bank has policies and procedures in regards to credit exposure limits and that is timely and appropriately updated. This implies that when the bank has a credit policy and procedure that is timely and appropriately updated, it can compete in the current market and will also protect its livelihood from failure due to lack of updated tool to handle credit risk.

The other point the survey analyzed was whether the policies and procedures of the bank enhances effectiveness of monitoring and controlling of the credit risk. As the finding stated more than average of the respondents agreed with the statement, implying that the policies and procedure of the bank enhances effectiveness in helping to monitor and control the credit risks faced. This by itself can facilitate in reduction of unnecessary risks the bank tends to face. As it has been discussed in the introduction part of this study, the main tools against credit risk is the existence and proper use of policy and procedures of the bank similarly throughout the departments responsible in handling credit process.

The other part of the finding dealt with the policy and procedure's flexibility, its complying ability with the NBE's regulations and guidelines and its ability to explain the objectives and principles of CRM processes clearly. The finding implied that the policy and procedure are flexible and also comply with the guidelines and directives of the NBE.

The second part of the questionnaire dealt with bank specific factors that influence the CRM practice of the bank. As factors that influence the CRM practice of a bank are various in numbers, the questions were designed to address the major parts which are discussed below.

Thorough communication of the bank's credit risk management policy and procedures and all other guidelines and directives to the staff enable the creation of uniform understanding and help as a guidance in order to avoid mismanagement created in the practice and limits a biased judgment based

decisions that directly or indirectly is concerned with the CRM practice. However the finding of the study shows that the bank has a lack in this regards. This in turn implies there is a negative impact on the process or credit risk management unless it is fixed quickly.

In the process of credit risk management practice, there are times the involvement of higher managerial levels becomes either important or sometimes biased and unnecessary. As long as their involvement comply with the procedures of the credit risk management of the bank and it does not base on their personal judgment, this can be used as an input for the bank in minimizing credit risks faced by the bank. However the finding of the study showed that there is an involvement of the higher management which influences the bank's credit granting and monitoring process.

It has been identified in the study that even though the staff should be given priority because the work force is the one behind the wheel in the process of practicing CRM, there is lack of qualified staff and the right number of staff, which in turn affects the effective implementation of the credit policy and procedures. It has also been founded that there is a lack of training given for the staff members on the CRM. This implies that unless the bank starts to work on improving this problem it will turn to create further riskier problems for the bank. Since the well-equipped and trained staff will be a great input for the implementation of the CRM practice in the bank, the bank must work towards equipping its staff with necessary knowledge and also hiring the appropriate number of staff will reduce the error and stress created due to work overload per person.

The third part of the questionnaire focused on the third objective of the study that is mechanisms used by the bank to handle credit risk. As it has been explained in the findings, this part was separated into four sub-groups namely risk identification, risk assessment and analysis, risk monitoring and risk evaluation.

Risk identification dealt with issues that related with the banks practice in identifying and prioritizing its main risk, registration of the identified risks, and the involvement of different professionals in the identification process. The finding showed that the bank uses identification and prioritization method as mechanisms to handle credit risk. It was also founded that the involvement of different professionals is less than expected. On the other hand it was founded that the bank gives due concideration to the quality of documents accepted from the borrowers which is a very good point since the main process of the practice is mainly based on proper handling of documents focusing on the quality of the documents enable the bank to handle its credit risks by keeping it to the minimum.

Risk assessment and analysis part covered all the mechanisms the bank uses to assess and analyze its credit risks. The finding showed that the bank uses both qualitative and quantitative methods to assess the credit risks. And the finding also showed that the bank effectively assesses the likelihood of different risk occurring.

Risk monitoring identified the issues relating with the practicability of the CRM within the bank. Even though the banks response to risk has been identified that it includes action plans in implementing decisions about the identified risk, the study findings have shown that that there is lack of routine management reporting for the monitoring of effectiveness of risk management. And also

the monitoring of the allocation of the loan for the intended purpose and its progress lacks follow-up on the side of the bank.

Risk evaluation involved the issues concerning the evaluation process after identification, assessment and monitoring part is done. The finding of the study showed that the bank emphasizes the continuous review and evaluation of the techniques used in the risk management, the bank is able to accurately evaluate and prioritize different risk treatments. If the risks the bank will face are properly evaluated and the better choice is identified, the CRM practice of the bank will enable the bank to get higher payoffs.

Therefore the findings of the study as discussed above showed that the bank clearly has CRM framework that works in relation to its credit risks and specific factors that influence the bank in the implementation of the practice are among many others lack of thorough communication of the policy and procedures of the CRM to the staff, involvement of higher level managements, lack of qualified staff, lack of training for the staff and while the mechanisms the bank uses to handle credit risk are risk identification, risk assessment and analysis, risk monitoring and risk evaluation methods.

## **B. Summary of the open ended questions**

The open ended questions have given the respondents the opportunity to elaborately address the issues raised in the close ended section. The points raised here address the effectiveness of the CRM practice, mechanisms that can be used to improve the practice, challenges faced by the bank to while implementing the practice and the specific strategies the bank uses in order to attain the implementation of the CRM policies and procedures of the bank. The respondent's answers and as well their respective implications have been summarized as follows:

### **1. Do you think the credit risk management practice is effective at the bank?**

A significant number of the respondents answered 'Yes'. And when they reasoned out why the respondents answered this rather very similarly and they stated that the current credit risk management of the bank is at a good stage however, there is a lot that can be done in order to improve it and get the results needed to make it effective. Therefore the respondents informed points that need attention by listing the drawbacks the bank is facing. To mention few:

- Lack of communication of the policies and procedures to the front-line workers in the credit departments
- Lack of adequate professional's training on the subject matter
- Because most of the risk management practice is done after the loan is disbursed
- Proper implementation lacks coherence
- Insufficient management follow-up

This implies that even though there is an effective credit risk management practice at the bank the existence of drawbacks mentioned above limits the practice to be more effective in handling the credit risks faced by the bank. Therefore proper analysis and amendment should be made in order to safe keep the bank from incurring further mismanagement problem of the credit risk management

practice and also to help establish an environment where proper communication about the policies and procedures throughout the departments is established, professional staff are added to the work force and also sufficient management follow-up is performed

## **2. What are the possible and better mechanisms that the bank can use to improve the credit risk management practice at the bank?**

The bank has credit risk management policies and procedures that have been formulated by the bank's separate department that reports to the bank credit committee that is responsible for managing credit risks. The respondents gave the following suggestions on better mechanisms that can be useful to the bank to improve the credit risk management practice at the bank.

- Equipping the staff with the proper knowledge by giving trainings routinely
- Reviewing and updating the policy and procedures according to their need in the market
- Establishing a good credit risk management environment in the bank.
- Routine based follow-up on the clients

When the respondents answer to the above question is analyzed, proper equipment of the staff with the necessary skills on the CRM practice will enable the bank to facilitate a practice that serves well for the proper management of the credit risks before they occur. And similarly, reviewing and updating of the policy and procedures by themselves gives the bank a chance to compete in the current market with tools that are timely and appropriate. For the radical changes and new innovations taking place in the financial sector, flexibility of institutions plays a critical role. Therefore the bank benefits more by establishing a good CRM environment.

## **3. What are the main challenges of credit management faced at the bank?**

In order to implement the proper credit risk management practice, the bank faces the following challenges as mentioned by the respondents.

- Inefficiency in data management
- Insufficient trainings for the staff
- Lack of strict follow-up
- Purposefully misleading documentations
- Geo-political risk

According to the survey, the above mentioned are the challenges faced at the bank that hinders proper credit risk management practice. Credit risk management involves proper data management. However, study shows the existence of inefficient data management practice in the bank. This can be connected to the second point raised that is insufficiency of trainings for the staff. Unless and otherwise the staff are given proper training, the occurrence of inefficiency in data management is inevitable. The study also shows that there is lack of strict follow-up, purposeful misleading documentation and geo-political risks.

#### **4. What strategies can be taken to attain implementation of the credit risk management policies and procedures?**

The respondent's suggestion on strategies that can be taken to attain implementation of the credit risk management policies and procedures of the bank are the follows:

- The board and senior management oversight
- Proper and timely updating of the policies and procedures
- Giving trainings to the credit and related department staffs
- Establishing credit grading systems to minimize credit risk
- Establishing regular reporting mechanisms

The main strategy that can be used effectively in the practice of CRM within the bank is an oversight of the board and senior management. As mentioned in the above analysis, this will help solve the problem of lack of strict follow-up and also facilitate the proper application of the policies and procedures keeping their timely reviewing and updating. It has also been analyzed from the study that another strategy that can be taken to attain the implementation of the CRM policies and procedure of the bank is equipping the staff with proper trainings about the policies and procedures. Another point mentioned was the establishment of credit grading system that minimizes the credit risks faced by the bank. This helps the bank to identify the state and nature of the risks the bank faces through the process of credit. And also enables the bank to differentiate the risks that should be avoided and the risks that should be taken.

## **CHAPTER FIVE**

### **CONCLUSION AND RECOMMENDATION**

In this chapter the conclusions of the findings of the paper and as well the recommendations given in line to the findings of the paper are stated.

#### **5.1. Conclusion**

The banking industry in general, is the back bone for the growth and development of a country. Credit services rendered by the bank's acts like a catalyst in the development process, since funds are the basic inputs for any activity. Therefore, when the bank's credit risk management practice is developed and implementation of proper policy and procedures are facilitated, the returns will be helpful not only for the bank, but also for the economy of the country in general.

As this paper analyzed the credit risk management of Berhan bank, the basic research questions that have been discussed were credit risk management framework of the bank in relation to the credit risks faced at the bank, bank specific factors that influence credit risk management and possible mechanisms that help in reduction of credit risk.

According to the analysis, the credit and related department staff are found at younger age group and their education level is mostly degree holders and some updating. Most of them are single and their credit related work experience showed more than 75% of the Credit and related department staffs have 1-5yrs of experience. This implied that the more than half of the bank staffs at the credit and related departments have lower work experience on credit.

As for the CRM policy and procedures of the bank, majority of the respondents agreed that the bank uses credit risk management tools to handle credit risks effectively and that the bank has a credit risk management framework that helps in the reduction of credit risks, while the remaining few were neutral or disagreed.

In regards to the CRM policy and procedures of the bank agreeing with the NBE's regulation, the majority agreed that it comply with the regulations stated by the NBE. And also, the majority agreed on how the credit risk policy, guidelines and procedures explain the objectives and principles of the credit risk management process clearly while the rest responded neutral and none disagreed.

The same is true about the diversification of the loans disbursed for different economic sectors that is based on their economic classification in order to minimize the credit risk. The bank uses diversification of the loans in order to keep its credit risks at lower level. And so, the majority of the respondents showed their agreement while the rest were neutral and in disagreement.

Therefore, from this analysis it can be concluded that the bank's CRM framework complies with the regulations of the NBE and the bank uses this framework to handle its credit risks properly.

For the bank specific factors that influence credit risk management, lack of thorough communication of the policy and procedures throughout the concerned departments/staffs and lack of timely review on the credit granting and monitoring process have been stated as a drawback on the credit risk management practice at the bank and majority of the respondents has shown their agreement.

Lack of qualified staff and lack of proper trainings for the staff about the CRM practice policy and procedures of the bank have been founded to be the bank specific factors that influence the credit risk management.

As for the mechanisms used by the bank to handle credit risk the paper sub grouped the process of credit risk into risk identification, risk assessment and analysis, risk monitoring and risk evaluation. From the analysis it can be concluded that the bank identifies and registers the identified risks in order to take further action before the loan disbursement starts. And this also supported by proper documentation of the guidelines that gives a guidance to the staff. However, the bank needs to work more on the risk monitoring mechanisms, as the finding shows that there is lack of routine management reporting on the monitoring the effectiveness of the risk management as an integral part of the reports. And also, strict follow-up measures are insufficient towards helping the repayment of loans which creates higher risks for the bank.

## **5.2. Recommendation**

While the credit risk management practice at Berhan bank is at a fairly good state despite the risks the bank is facing, I would like to recommend few points to consider for the bank's credit risk and related departments and other concerned bodies.

- To get the result needed from the CRM practice the bank should have to make continuous review, updates and evaluations on the way credit risk is managed. The proper reviewing and timely updating and also evaluation of the methods the bank is currently using to handle risk can be a good method to handle the risks faced by the bank. As the bank already has a framework that helps it to manage its credit risks appropriately, the continuity of the practice will enable the bank to reap more profit from the process.
- In order to effectively manage the credit risks faced by the bank timely review of the credit follow-up and routine reporting of the action plans should be done on regular basis. For this reason the involvement of the board and senior management oversight is recommended in order to facilitate the practice of the CRM to go smoothly. And creating a system of routine reporting and reviewing for the set action plans will help the bank to practice efficient credit risk management.
- The bank should make frequent credit risk assessments and monitoring of the risk evaluation, and weigh the risks it should take and/or avoid in line with its strategies of risk evaluation and take corrections where necessary. Analyzing the strategies the bank is currently using to handle its credit risks and sorting out better strategies that have been analyzed as mentioned

in this paper analysis and putting much effort to implement them is recommended for the bank to improve its CRM practice.

- The bank management should give more emphasis to equip the staffs with proper training of the policies and procedures of the CRM in order to help the staff have the bank's interest at heart and implement the policy and procedures properly.
- The bank should develop credit policy that is in line with the current situation of the market. It is evident that the bank must know about the practices that are taken by other competitors in the market in general and formulate a strategy that helps it compete. And this strategy should be in line with the situation of the market

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## Appendix: Research Questionnaire

**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 **“ANALYSIS OF CREDIT RISK MANAGEMENT PRACTICE: THE CASE OF BERHAN 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 cooperation in giving the reliable information is very important. Any information provided by you will only be used for academic purposes and 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.

Tsion Tariku Tel. 0913-847317

Email address: [tsiontariku4@gmail.com](mailto:tsiontariku4@gmail.com)

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

### I. General Information:

1. Gender: Male:  Female:

2. Age:

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

3. Years of service: \_\_\_\_\_

4. Marital status: Married:  Single:

5. Educational level:

Diploma:  BSc/BA:  MSc/MA:

PhD:  Other \_\_\_\_\_

6. What is your current position in Berhan Bank S.C. \_\_\_\_\_

7. Credit related experience within the bank

1-5 years                       5-10 years                       above 10 years

**II. Research related question**

Please tick (✓) mark on scale ranging from Strongly Agree to Strongly Disagree. Where, SD = Strongly Disagree, DA=Disagree, N=Neutral, A=Agree, SA=Strongly Agree.

	<b>Credit risk management framework of the bank in relation to the credit risks faced at the bank</b>	SD	D	N	A	SA
a	The bank uses the credit risk management tools to handle the credit risk effectively					
b	The bank has a credit risk management framework that helps to reduce the credit risks faced by the bank					
c	The bank has policies and procedure in regards to credit exposure limits and that is timely and appropriately updated					
d	The credit risk management policies and procedures of the bank enhance effectiveness of monitoring and controlling the credit risk					
e	The credit manuals are up-to-date and convenient for loan creation					
f	The Bank’s credit policy and procedure is flexible and takes into account the changes in the market					
g	The credit policy and procedure of the bank exactly comply with the regulations of National Bank					
h	The credit risk policy, guidelines and procedures explain objectives and principles of credit risk management process clearly					
i	The credit risk strategy and policies help the bank to better manage the credit risk					
j	There is ineffective supervision or administration and lack of adequate system in performing the credit risk management mechanism					
k	The bank diversifies the loan disbursed for different economic sectors based on their economic classification in order to minimize the credit risk					

	<b>Bank Specific factors that influence credit risk management</b>	SD	D	N	A	SA
a	The credit risk policy and procedures are effectively communicated throughout the concerned departments/staffs					
b	The credit granting and monitoring process can sometimes be influenced by directors, senior managers or influential staff of the bank					

c	The bank's credit granting and approval process establishes accountability to decision makers					
d	Lack of timely review is among the causes of high credit risk in the bank					
e	Credit, risk and related department staffs play a great role for the effective implementation of the credit policy and procedures.					
f	Lack of qualified staff and the right number of staff is a problem to implement the credit policies and procedures.					
g	There is lack of training for the staff about credit risk management					
h	Existence of an appropriate policy and procedure is the main factor that influences the credit risk management practice at the bank					
i	The Credit Policy and Procedures of the bank demands collateral whenever granting any loan					
j	The bank has policies and procedure in regards to credit exposure limits					
k	The bank uses the credit risk management tools to handle the credit risk effectively					
l	There is a difficulty in understanding the policy and procedure of the bank concerning credit risk management					
m	The credit enforcement mechanism of the bank effective in terms of loan repayment					

	<b>Mechanisms used by the bank to handle credit risk</b>	<b>SD</b>	<b>D</b>	<b>N</b>	<b>A</b>	<b>SA</b>
<b>1.</b>	<b>Risk Identification</b>					
a	The bank identifies and prioritizes its main credit risks					
b	The bank registers the identified risk for further assessment					
c	The bank involves different professionals to identify credit risk					
d	The bank gives due consideration to formal brainstorming credit risk identification					
e	The bank gives due attention to the quality of documents submitted by borrowers with respect to the business					
f	The bank demands a business plan from all clients to identify risk exposure					
<b>2.</b>	<b>Risk Assessment and Analysis</b>					

a	The bank uses numerical methods to assess credit risks					
b	The bank uses qualitative methods to assess credit risks					
c	The bank effectively assesses the likelihood of different risks occurring					
d	The bank develops action plans for implementing decisions and management plans for identified risks					
e	The bank's risk management processes are well documented and provide guidance to staff about the management risk					
<b>3.</b>	<b>Risk Monitoring</b>					
a	The bank's response to risk includes action plans in implementing decisions about identified risk					
b	Monitoring the effectiveness of risk management is an integral part of routine management reporting					
c	The bank does strict follow-up on repayment of the loan					
d	The bank monitors the allocation of the loan to the intended purpose and its progress					
e	Monitoring results communicated to credit performers for further actions					
<b>4.</b>	<b>Risk Evaluation</b>					
a	The bank emphasizes on continuous review and evaluation of the techniques used in risk management					
b	The bank is able to accurately evaluate the costs and benefits of taking risks					
c	The bank is able to accurately evaluate and prioritize different risk treatments					
d	The bank's response to risk includes an evaluation of the effectiveness of the existing controls and risk management responses					

**III. Open ended questions**

1. Do you think the credit risk management practice is effective at the Bank? Please reason out why/why not.

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2. What are the possible and better mechanisms that the bank can use to improve the credit risk management practice at the bank?

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3. What are the main challenges of credit risk management faced at the bank?

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4. What strategies can be taken to attain effective implementation of the credit risk management policies and procedures?

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Thank you!