

Addis Ababa  
University  
(Since 1950)



## **CREDIT RISK MANAGEMENT AND PROFITABILITY - THE CASE OF UNITED BANK S.C.**

---

**A Thesis Submitted to Addis Ababa University College of Business  
and Economics, Graduate Studies in Partial Fulfilment of the  
Requirements for the Degree of Executive Master of Business  
Administration**

**By: Tesfaye Tadesse**

**Advisor: Dr. Yohanes Workaferahu**

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

**2019-08-11**

## DECLARATION

This project is my original work and has not been presented for a degree in any other university or for any other award.

Signature \_\_\_\_\_

Date \_\_\_\_\_

I confirm that the work in this project was done by the candidate under my supervision.

\_\_\_\_\_

\_\_\_\_\_

**Signature**

**Date**

## STATEMENT OF CERTIFICATION

This is to certify that Tesfaye Tadesse has carried out his research project work on the topic entitled “the effect of credit risk management on profitability - the Case of United Bank S.C.”. This work is original in nature and it is sufficient for submission for the partial fulfilment for the award of Executive Masters of Business Administration.

**Approved by:**

Internal Examiner: Dr. Yitbrak Takele Signature \_\_\_\_\_ Date \_\_\_\_\_

External Examiner: Dr. Baymot Tadesse Signature \_\_\_\_\_ Date \_\_\_\_\_

Advisor: Dr. Yohanes Workaferahu Signature \_\_\_\_\_ Date \_\_\_\_\_

---

**Chair of Department or Graduate Program Coordinator**

## **DEDICATION**

I dedicate this work to my family and friends

## **ACKNOWLEDGEMENT**

My sincere thanks go to God for this far He has enabled me to come. Much gratitude to my supervisors for their support and the criticisms they made to make this study a success. I also thank my family for their patience in the times I was busy conducting the study. My friends and colleagues gave me ideas, I thank you all. God bless you.

## TABLE OF CONTENT

<b>DECLARATION.....</b>	<b>i</b>
<b>DEDICATION.....</b>	<b>iii</b>
<b>ACKNOWLEDGEMENT.....</b>	<b>iv</b>
<b>LIST OF TABLES .....</b>	<b>viii</b>
<b>LIST OF FIGURE .....</b>	<b>ix</b>
<b>ABBREVIATIONS AND ACRONYM .....</b>	<b>x</b>
<b>ABSTRACT.....</b>	<b>xi</b>
<b>CHAPTER ONE .....</b>	<b>1</b>
<b>INTRODUCTION.....</b>	<b>1</b>
1.1 Background of the study .....	1
1.2 Statement of Problem.....	3
1.3 Research Question .....	4
1.4Objective of the Study .....	5
1.4.1 Overall objective.....	5
1.4.2 Specific objective.....	5
1.5 Hypothesis of Study .....	5
1.6 Scope of the Study .....	6
1.7 Limitations of the Study.....	6
1.8 Chapterization .....	6
1.9 Operational Definition of Terms.....	7
<b>CHAPTER TWO .....</b>	<b>8</b>
<b>LITERATURE REVIEW .....</b>	<b>8</b>
2.1 Introduction.....	8
2.1.1 Theoretical Review .....	8
2.1.2 Empirical Literature review .....	11
2.3 Gap in Literature review in this Research.....	17
2.4 Conceptual Framework.....	18
<b>CHAPTER THREE.....</b>	<b>19</b>
<b>METHODOLOGY OF THE RESEARCH .....</b>	<b>19</b>
3.1 Research Design.....	19
3.2 Target population and sampling.....	19
3.2.1Sampling Technique .....	20

3.2.2 Sample size .....	20
3.3 Data Collection method .....	21
3.4 Data Source .....	21
3.5 Data Collection Procedure .....	21
3.6 Data Analysis .....	21
<b>CHAPTER FOUR.....</b>	<b>23</b>
<b>DATA ANALYSIS, PRESENTATION AND INTERPRETATION .....</b>	<b>23</b>
4.1 Response Rate .....	23
4.2 Demographic Information.....	23
4.2.1 Gender of the Respondents .....	23
4.2.2 Respondents Length of Service in the Organization.....	24
4.2.3 Respondents Designation.....	24
4.2.4 Adoption of Credit Management Practices.....	24
4.2.5 Credit Risk Management Practices in Improving Performance .....	25
4.3 Descriptive Statistics.....	25
4.3.1 Client Appraisal .....	26
4.3.2 Credit Risk Control.....	27
4.3.3 Collection Policy.....	28
4.3.4 Terms of Credit .....	30
4.4 Inferential Statistics .....	31
4.4.1 Correlation Analysis .....	31
4.4.2 Multiple Regression Analysis .....	32
<b>CHAPTER FIVE .....</b>	<b>35</b>
<b>SUMMARY, CONCLUSION AND RECOMMENDATIONS.....</b>	<b>35</b>
5.1 Summary of Findings.....	35
5.1.1 Client Appraisal .....	35
5.1.2 Credit Risk Control.....	35
5.1.3 Collection Policy.....	36
5.1.4 Terms of Credit .....	36
5.2 Conclusions.....	36
5.3 Recommendations.....	37
5.4 Suggestion for Further Studies.....	38
<b>REFERENCES.....</b>	<b>39</b>
<b>APPENDICES .....</b>	<b>43</b>

Appendix I: Introduction Letter .....	43
Appendix II: Questionnaire .....	44



## LIST OF TABLES

<b>Table 3.1:</b> Target Population.....	19
<b>Table 3.2:</b> Sample size .....	20
<b>Table 4.1:</b> Response Rate.....	23
<b>Table 4.2:</b> Client Appraisal on Profitability.....	26
<b>Table 4.3:</b> Credit Risk Control on Profitability.....	27
<b>Table 4.4:</b> Collection Policy on Profitability .....	29
<b>Table 4.5:</b> Terms of Credit on Profitability.....	30
<b>Table 4.6:</b> Profitability .....	<b>Error! Bookmark not defined.</b>
<b>Table 4.7:</b> Correlations Coefficient.....	31
<b>Table 4.8:</b> Model Summary .....	32
<b>Table 4.9:</b> Analysis of variance.....	33
<b>Table 4.10:</b> Coefficients.....	33

## LIST OF FIGURE

<b>Figure 2.1:</b> Conceptual Framework .....	18
<b>Figure 4.1:</b> Gender of the Respondents .....	23
<b>Figure 4.2:</b> Respondents Length of Service in the Organization .....	24
<b>Figure 4.3:</b> Respondents Designation .....	24
<b>Figure 4.4:</b> Organizations' Adoption of Credit Management practices.....	24
<b>Figure 4.5:</b> Credit Risk Management Practices in Improving Performance.....	25

## **ABBREVIATIONS AND ACRONYM**

<b>CAR</b>	Capital Adequacy Ratio
<b>CRM</b>	Credit Risk Management
<b>EAR</b>	Earnings at Risk
<b>MPT</b>	Modern Portfolio Theory
<b>MU</b>	Marginal Utility
<b>NBE</b>	National Bank of Ethiopia
<b>NPLR</b>	Non Performing Loans Ratio
<b>ROA</b>	Return of Assets
<b>ROE</b>	Return of Equity
<b>SPSS</b>	Statistical Package for the Social Sciences
<b>UK</b>	United Kingdom
<b>VAR</b>	Value at Risk
<b>VC</b>	Venture Capitalist

## ABSTRACT

The overall objective of the study was to establish *the effect of credit risk management on profitability - the Case of United Bank S.C.* Specific objectives were to; to establish the effects of client appraisal, credit risk control, collection policy and terms of credit on profitability practice of United Bank S.C. A descriptive case-study and explanatory research method was adopted. 112 management level employees were the targeted population. The respondents used in the study were selected using the method of stratified sampling. The sample size was 88 respondents. Questionnaires were used in the study for collection of primary type information. Secondary data was used and was collected from financial reports and the internet. Collected data was analysed using descriptive statistics. It revealed that Client appraisal significantly and positively relate with profitability practice of private commercial banks; Credit risk control and profitability United Bank S.C. significantly and positively related; Collection policy and profitability practice of United Bank S.C. had significant and positive relation; Terms of credit and profitability United Bank S.C. had significant and positive association. Recommendation of the study is for united banks to improve methods of appraising clients to avoid clients who are not worthy of credit who might lead to delinquency of loans. The result will improve performance by having loan repayment and loan portfolios performing positively. It is therefore recommended that United Bank S.C. need to improve the way they deal with risk accruing from credit through improvement of credit risk control; this can be done by having databases that assesses profiles of creditors both current and prospective and guarantors which private commercial banks can share amongst themselves to lower levels of NPLs and therefore improving the performance of the banking institutions. The bank need to involve clients greatly in coming up with terms of credit, since they're individuals directly involved and understand better on what terms should be applied. Entities responsible for creation of policies need to come up with prudential guides that are effective and policies that will strengthen management of risks. The bank need to embrace stringent credit policies that help them develop a lasting association with clients, come up with information and requirements of the client. This will help in development of distinct strategies in the context of granting of credit, credit terms and client service that enable growth of sales. Management of the bank should consider formulating a universal credit policy document that will be adopted by all banks from which rating of their financial performance through credit risk management can be measured and regulated. Also stringent policies should always be useful in regulating the whole process of loan application, loan appraisal issue and loan repayment.

Key Words: Client appraisal, Collection policy, Credit risk management, Credit risk, Profitability, Terms of credit

## CHAPTER ONE

### INTRODUCTION

#### 1.1 Background of the study

In the everchanging businesses environment, the banking sector is faced with issues such as competition, volatile economic conditions, increase in default rates and rise in commercial and consumer debts, the ability of an organization to effectively manage and monitor credit risk would define the organization's success and survival (Altman, 2012). Every organization aims at achieving profitability among other factors. Low level of profits may have negative impact of on long-run survival of the business. To ensure profitability in banks, the management should be able to incorporate credit risk management factors to ensure that the organization does not lose its funds to its lenders (Waweru&Kalani, 2009).

Credit risk is the uncertainty that the debtor may not pay the principal amount and the required interest in line with credit agreement terms. It may imply that the repayment may be delayed or the debtor may fail to repay, this results to problems in the bank's cash flows and liquidity (Greuning&Bratanovic, 2003). According to (Idarus, 2005) eighty percent of the balance sheet statements are mainly credit. Globally, banks' exposure to credit risk results to failure of majority banks. For instance in Switzerland, Spain, US, Sweden and Japan credit risk exposures has led to problems in banks operations (Basel, 2004). In early 1980, debt crises were very high in Latin American. In Mexico, indebtedness in banks increased to 230% between 1976 to 1982, 160% in Brazil, 330% in Venezuela, 550% in Argentina and 850% in Chile (Wessel, 1984). The Basel Committee which mainly concentrated on credit risk intervened. It advocated for the introduction of an eight percent capital ratio to risk weighted assets.

The most appropriate way of deal with credit risk is by focusing on credit risk management. CRM is very significant to companies and cannot be excluded in enterprise that deals with credit. It ensures that debtors fulfil their obligations through paying their debts. Brealey, Myers and Allen (2014) describe CRM as strategies devised by organizations to make sure that credit is repaid at the right time. It is further noted that CRM comprises analyzing, reporting, classification and rating of credit. CRM is the methods used by a firm to manage sales done by sales. CRM is necessary for all organizations that provide credit services to reduce the default rate (Nelson, 2012)

According to Lastra (2004) the goal of managing risks is to prevent an organization from suffering losses due to a high default rate. Commercial banks should study the business environment so as to ascertain risks and come up with methods of mitigating the risks. Developed nations are faced with high uncertainty in management of credit risk than developed nations. Banks in the developing nations face more credit risks. Hence, the need to manage risks, failure to do so in commercial banks will lead to failure of banks. Failure of an individual bank may affect other banks resulting to systematic failures of entire banking institutions in a nation; an example is the bank crises between 1997-1998 in Asia which affected banks in the whole region.

According to Van Horne (1995) the credit practices in an organization mainly determines the level of an organization's debt. This assists in ensuring that defaulters do not access credit hence minimizing the non-payment risk which increases the account receivable, ensures the continuation of firm's operations and maximization of investor's money. The financial health of a firm is influenced by the set credit policy. This further implies that proper credit policies ensures that investor's return and the value of shareholder's are maximized, the end goal is ensuring bank profitability.

In Ethiopia private commercial banks are 16 and they are under the supervision of the National Bank of Ethiopia. The main activity of the banks is provision of loan and advances; this is in line with Basel Committee about supervision banks. The increase in commercial bank increases competition in the banks business environment. This increases the urge of bank to be competitive and steer a consistent profitable course. Variations in the business environment leads to variations in risks faced by banks, this is a great concern to the management of commercial banks hence they engage in credit risk management. This study aimed to establish the effect of CRM on profitability of private commercial banks in Ethiopia-United Bank S.C

## **1.2 Statement of Problem**

Achieving profitability is the key goal of banking institutions. Profits supports bank operations and also assist in investing in other areas. However, profitability of banks may be affected by credit risks. Money lending exposes banks to credit risks; this has adverse effects on bank profitability. Credit activities are risky to the lenders and borrowers. The risk that a borrower may fail to fulfil their obligation at the required time have a great effect of smooth operations of banks. When the bank is exposed to high credit risks then it indicates awaited bankruptcy; this is also a great risk to depositor's money. Credit risk is very vital for banks; this is because it affects the bank's book value. The increase in number of loan defaulters in banking industry lowers the bank's profitability. Client appraisal and review of collection policy and terms of credit would help banks to recover most of their money. This may in turn ensure bank's profitability (Danielson, 2004).

According to a report by the National Bank of Ethiopia in 2018, private banks loan disbursement grew from 94.5 to 100.68 billion. While total assets grew from 485.7 to 565.50 billion. However, gross profit decreased from 14.6 billion to 10.32 billion. This implies that banks are not doing well in terms of profitability.

Empirical studies include; a study by Zou and Li (2014) on CRM and profitability of European commercial banks, Mwangi (2012) also aimed to establish how bank's performance and CRM relate. Ayodele, Thomas and Raphael (2014) did a research on impacts of policies of credit on how Nigerian Banks performance. Owizy (2013) did a study on impacts of management on Nigeria's banks financial performance, case of UBA Plc. Muturi (2016) was concerned on effects practices of managing credit on performance on loan in banks in Kenya. The studies were conducted in different countries Europe, Nigeria and Kenya. The studies also focused on list of commercial banks in the respective countries. The current study was specifically conducted at United Bank S.C. in Ethiopia. Since the bank regulatory environment differ in the various nations, the current study sought to establish the effect of credit risk management on profitability of private commercial banks in Ethiopia- The Case Of United Bank S.C.

### **1.3 Research Question**

- i. To what extent does client appraisal affect profitability of private commercial banks in Ethiopia-United Bank S.C?
- ii. How does credit risk control affect profitability of private commercial banks in Ethiopia-United Bank S.C?
- iii. To what extent does collection policy affect profitability of private commercial banks in Ethiopia-United Bank S.C?
- iv. How does a term of credit affect profitability of private commercial banks in Ethiopia-United Bank S.C?



## **1.4 Objective of the Study**

### **1.4.1 Overall objective**

The overall objective of the study was to establish the effect of credit risk management on profitability of private commercial banks in Ethiopia- The Case Of United Bank S.C.

### **1.4.2 Specific objective**

The study was guided by the following specific objectives;

- i. To establish the effects of client appraisal on profitability of private commercial banks in Ethiopia-United Bank S.C
- ii. To examine the effect of credit risk control on profitability of private commercial banks in Ethiopia-United Bank S.C.
- iii. To assess the effect of collection policy on profitability of private commercial banks in Ethiopia-United Bank S.C.
- iv. To determine the effect of terms of credit on profitability of private commercial banks in Ethiopia-United Bank S.C.

## **1.5 Hypothesis of Study**

H<sub>01</sub> Client appraisal doesn't significantly affect profitability practice of private commercial banks in Ethiopia-.United Bank S.C

H<sub>02</sub> Credit risk control doesn't significantly affect profitability of private commercial banks in EthiopiaUnited Bank S.C -.

H<sub>03</sub> Collection policy doesn't significantly affect profitability of private commercial banks in Ethiopia-.United Bank S.C

H<sub>04</sub> Terms of credit doesn't significantly affect profitability of private commercial banks in Ethiopia-.United Bank S.C

## **1.6 Scope of the Study**

The study sought to establish the effect of credit risk management on profitability. Research study was conducted in Ethiopia's private commercial banks specifically, United Bank S.C. The study focused on United Bank so as to collect data easily and also as a result of time limit the study ought to be conducted. The study targeted employees at United Bank S.C headquarters in Ethiopia. The study was conducted between March 2019 to July 2019.

## **1.7 Limitations of the Study**

The study extent is limited due to the confidentiality of the information requested from the respondents. However, assurance will be given through a letter from the University that the information obtained will only be used for academic purposes only. Besides, time limitation is another factor that would be handled through the appointment of a research assistant.

## **1.8 Chapterization**

The study is organized in five chapters. Chapter one covered background of the study, statement of problem, research questions, objectives of the study, hypothesis of the study, scope of the study and limitations of the study. Chapter two covered literature review which include; theoretical review, empirical literature, gap of literature reviewed and conceptual framework. Chapter three is the research methodology it discussed the research design, target population, sampling methods, data collection methods, data source, data collection procedure, validity and reliability and data analysis. Chapter four covered data analysis, presentation and interpretation. Chapter is summary, conclusion and recommendations.

## **1.9 Operational Definition of Terms**

**Client appraisal:** it is a systematic analysis of a customer's prior records on financial matters to determine their qualification to be given funds.

**Collection policy:** It is the steps followed by a company to ensure that borrowers make their timely payment

**Credit risk management:** It is loss mitigation process through an understanding of adequacy of capital in the banks' and reserves for loan that is lost at any particular time

**Credit risk:** It is uncertainty that a borrower may not comply with the obligations that were agreed on in the terms.

**Profitability:** this is company's ability to make use of its resources with the aim of generating revenue more than what their expenses are.

**Terms of credit:** It is an agreement between a borrower and lender that outlines the timing and amount of payment that the borrower should make within a stated period of time

## CHAPTER TWO

### LITERATURE REVIEW

#### 2.1 Introduction

This section reviews literature on the effect of CRM on profitability practice of private commercial banks. Theories related to CRM and profitability is review, the empirical literature from other researchers is also reviewed, gaps are identified from the empirical literature and then conceptual framework is presented.

##### 2.1.1 Theoretical Review

###### i. Modern Portfolio Theory

In the year 1952, Markowitz developed this theory. It puts together the process of effective formation of portfolio to individual asset pricing. The theory posits that individual assets risk sources can be mitigated, or diversified through matching various assets. MPT focuses on investments and finance (Markowitz, 1952). According to the theory it is not appropriate to focus on a specific risk-return of an asset rather it is advisable to invest in numerous assets to minimize the level of risk. This is referred to risk diversification. MPT states that investors are risk averse. This implies that investors prefer risky portfolios with high rate of return. The benefits of creating portfolios is that the selected combinations may result to high returns compare to individual securities. MPT determines risk-return relationships in securities.

The theory is based on assumptions that: venture capitalist is concerned with single time period risk, VC maximizes a period utility and the graphs show a diminishing MU, VC also approximates the risk on portfolio by expected returns inconsistencies. Decisions are mainly done on expected risk and return. In a certain risk level, high returns to lower

returns are preferred or when the expected return is small less risk is preferred (Brown& Reilley, 2012).

Since 1980, banks have highly made use of MPT in risk evaluation. However, most banks are utilizing EAR and VAR methods to deal with credit risks they are exposed to in case of interest rate changes. Moreover, default risk is the greatest vulnerability in many banks; the use of MPT does not fully mitigate the default risk (Margrabe, 2007). Credit provision by banks may have an adverse effect on bank profitability. Institutions are also adopting quantitative techniques in credit risk evaluation; however, the main obstacle is the availability of data. The best way of credit control risk is by use of the asset-by-asset method. In order have a better understanding of exposures on credit risks, banks gradually use the method with a quantifiable credit models in assessing risk of a portfolio.

## **ii. The Financial Economic Theory**

The basis of managing corporate risk in the approach of financial economics is Modigliani-Miller paradigm and it has been very prolific in regard to empirical research and extension of theoretic models(Klimczak, 2007). The theory states that hedging results in low cash flow volatility which translates to low volatility of company's value. It is argued in the theory that ultimate outcome of hedging, if it's beneficial to the company is high hedging premium value.Jin and Jorion (2006)critiqued the theory by indicating that despite management of risk not resulting to variability of corporate value which acts as the foundation of the rest of the impacts; there is no much proof of it being associated with those advantages that the theory mentions. The theory emphasizes on the importance of hedging in reducing the exposure of the company to credit risk.

### **iii. Standard Capital Market Theory**

This theory indicates that trade-off exists between returns and risks (Markowitz, 1952 and Sharpe, 1964). It explains that one will get more returns if they are willing to take more risks. This trade-off however is true for the risks that are not systematic but not for those risks that can be avoided theoretically through diversification. The theory therefore forecasts that a bank that is well diversified can expect to yield higher returns when compared to those banks that have low level of diversification. Financial theory whose basis is the idea of perfect market capitals cannot be applied in the banks' case. Based on this argument, this theory of financial intermediation takes into consideration the role of asymmetric information incorporating monitoring relevance. In the Diamond (1984) model- cost and quality of monitoring are said to be constant in all the banks. Therefore Diamond argued that diversification lowers the cost of monitoring by the bank and that the bank needs highest level of diversification.

### **iv. New Institutional Economists Theory**

The new institutional economists' shift their focus to processes of governing and socio-economic institutions which are responsible for guiding these process (Williamson, 1998). Klimczak (2007) notes that there lacks empirical studies carried out in regard to new approach of institutional economics to management of risks but the theory gives an alternate explanation on behaviour of corporations. Klimczak (2007) indicates that the prediction of this theory is that organizations can determine practices of managing risks or those practices that are acceptable within a particular market or business sector. According to Williamson (1987) adds that the theory provides a link between security and specific purchase of assets implying that management of risks can be important in contracts binding of two sides with diversification restrictions like large contracts or close corporation in a SC.

## **v. Information Theory**

Binner, Derban, and Mullineux (2005) did recommend that borrowers need to be screened more so by the financial organizations as a way of credit assessment. Collecting information that is reliable from borrowers is very important in order to accomplish screening that is effective this is in line with the theory of symmetric information theory. Assessment of borrowers can be done using qualitative as well as quantitative methods but subjective nature is the key challenge that is encountered if qualitative models are used. Derban, Binner and Mullineux (2005) on the other hand indicated that the character of borrowers assessed using qualitative models is assigned values and comparison of the average is made with a set threshold. The method significantly lowers the cost of processing, lowers subjective judgement and any biases. The system of rating is crucial if it shows change in loss levels expected on loan. Brown Bridge (1998) reached a conclusion that through quantitative model establishment of important factors is possible, those of importance in explanation of default risk, evaluate significance level of factors, better default risk pricing, and screen bad loans.

### **2.1.2 Empirical Literature review**

Tuladhar (2017) did an evaluation on CRM effects on Nepalese Commercial Banks profitability. The investigation was mainly about credit risk management impact and profitability. Data was obtained between 2011 and 2015 from commercial banks. Analysis was conducted in using regression and panel data. It was established that CRM and profitability in Nepalese banks had a significant association. It was further, indicated that bank size, coverage ratio and capital adequacy ratio with performance had positive relationships. Board gender composition, leverage ratios and NPLs with performance of the bank had negative associations. Cash reserve ratio, liquidity and quality of assets had significant effects to performance of banks.

A positive association was established between CRM and Sweden banks profitability (Ara, Bakaeva& Sun, 2009). In Indonesia, Ruziqa (2013) noted an adverse association between credit risk and profitability of financial institutions; a positive association amid credit risk and a firm's liquidity. In Nigeria Kolapo, Ayeni and Oke (2012) found that CRM was related to profits made by banks in the country. In Kenya, Kithinji (2010) noted that CRM had no association with profitability of banks.

Saeed and Zahid (2016) studied how credit risk impacted on commercial banks profitability. This was an investigation on profit making by commercial banks in the UK and how credit risk affects them. ROA and ROE were used in measuring profitability. Credit risks were measured using non-performing loans and impairments. Financial data for the banks was obtained for a period between 2007 to 2015. A multiple analysis was applied in analyzing the data collected. Indicators on credit risk positively influenced banks profitability. This is an implication that the aftermath of the 2008 credit crises, UK banks are involved in credit provision and are gaining interest rates and commissions. Bank's size and leverage were positively linked to performance.

Li and Zou (2014) did an evaluation on the effects of management of credit risk on profitability of Europe's commercial banks. The research study mainly purposed to establish the association between management of credit risk and Europe's bank profitability. Data used was gathered from 2007-2012 and was from a total of 47 banks. It aimed to establish whether there exist any form of relations between the variables, the study performed series of statistical tests and also performed other tests to establish stability of the relationship. Management of credit risk was found to positively affect profitability of the banks. Additionally, NPLR was found to significantly affect ROE and ROA. However for the duration of time that was considered all proxies fluctuated they were not stable.



Alshatti(2015)examinedimpacts of management of credit risk on the way commercial banks in Jordan performed financially. The key focus was examining impacts of management of credit risk on the way Jordanianbanks performed financially from 2005 to 2013. The study selected a sample of 13 banks. In order to measure the association, the researcher usedROA and ROEto measure performance. The findings showed that management of credit risk affected the way banks performed financially.

Isanzu (2017) researched on effects of credit risk on the financial performance of Banks inChina.Data was from the selected banks from 2008 to 2014. ROA was applied in measuring financial performance. The model of Panel data regression was applied in analysing the collected data and from the finding, it was evident that NPLs and capital adequacy significantly affects how commercial banks perform financially and it's very crucial to control credit risk for them to perform financially.

Al-shakrchy (2017) studied effects of managing profitability of credit risk on the bank case of commercial banks in Sweden. The study was an empirical study that was carried out before and after the mortgage crisis.Specifically, the study carried out an investigation on impacts of management of credit risk exposure on profitability of banks while specifically focusing on 2008's financial crisis. The study empirically tested if management of risks in techniques that substantially lowers probability that loan defaulting will take place and the way the banks can avoidcredit crisis in related activities. It purposed to establish the key issue that arises from the lending activities of the bank and that can have serious effects on the banking sector and instability financially. The study did a further exploration of whether exposure to credit changed during the crisis period. Management of credit risk that is successful in Sweden had a great likelihood of improving availability of banks credit.

Kaitibi (2018) evaluated effects of management of credit on banks profitability in Sierra Leone. Study's main objective was critically assessing the effects of effective management of credit on banks profit making. The study was a case study of Rokel Commercial Bank. Secondary data was used, collected mainly from the banks yearly report from 2010 to 2014. Data collected was analysed qualitatively and quantitatively with the use of charts and ratios analysis. The findings showed efficient management of credit significantly affected profitability of the bank.

Ntiamoah, Diana and Kwamega (2014) determined the association of CRM strategies and performance of loans in micro-banking organizations in Ghana. It was revealed that CRM and performance of loan were positively associated. Further, Ayodele, Thomas and Raphael (2014) determined impacts of credit policies on performance of Zenith Bank Plc in Nigeria. Data was collected using questionnaires. Zenith Bank adopted management of credit activities such as client appraisal hence reducing the rate of loan default.

Afriyie and Akotey (2012) did an examination on association between management of credit risk and Ghanaian bank profitability. The study did an examination on the effects of management of credit risk on profit making by rural as well as community banks in Ghana's region of BrongAhafo. The study selected a sample of 10 banks and data was collected from banks financial reports for 5 year period from 2006-2010. Model of panel regression was used in analysing the data. Profitability of the banks were measured using ROE and ROA while indicators of management of credit risk were CAR and NPLR. The results showed that NPLs and profitability of rural banks were significantly and positively related which implies that despite there being high losses from loans the banks still remain profitable.

Kaaya and Pastory (2013) did an examination on the association between credit risk and performance of Tanzania's commercial banks. The association of the measures of credit

risk and performance of the bank was developed using regression model. Indicators of credit risk were negatively correlated with performance this simply means the higher credit risk levels are the lower the performance of the bank. From the findings, the study suggested that banks should increase their reserve of capital this will prevent the bank from incurring losses in the future and increase the banks method of managing credit risk.

Serwadda (2018) researched effects of credit risk management systems on the financial performance of Uganda's commercial banks. It analysed impacts of managing credit on the way commercial banks in Uganda perform financially. A sample of 20 banks was selected and collected data for a period of 5 years from 2006-2012. ROA was used to measure banks performance while credit risk was measured using NPLs, interest earning growth and provision of loan loss to total loans. The study also used secondary information. The study employed descriptive and inferential analysis. Management of credit risk affected the way Uganda's commercial banks perform. From the results, performance of the bank was inversely affected by NPLs exposing them to great levels of illiquidity and crisis financially.

Kabudula (2015) investigated the effectiveness of CRM on Malawi commercial banks financial performance. Kabudula aimed at analyzing CRM efficiency in commercial banks in Malawi using performance duration of between 2011 to 2014. Questionnaires were selected tool for data collection and were administered to bank employees. To determine the association between the variables a regression analysis was conducted. The study revealed a significant relation among NPLs and bank profitability. A negative relationship was ascertained between loan advances and profitability of banks. Finally, there was no association between credit amount and profitability.

Mumbi and Omagwa (2017) did a study on CRM and financial performance of Kenyan banking institutions. The goal was to establish the association between CRM and banks

performance. A descriptive method was adopted and a sample of 42 employees participated in the study. Questionnaires were used in obtaining data. It was established that the process of recovering debt had no significant effect of performance of banks. Further, appraisal of loans, requirements on lending and policies on credit significantly influenced performance of banks. Conclusion was that banks should have parameters on measuring the acceptable level of risks so as to maximise the rate of return.

Saheb and Krishna (2018) evaluated CRM practices in Ethiopia banking sector. The Basel committee principles about supervision of banks were used in measuring the CRM practices. A mixed research method was used. Two banks were targeted. Purposive sampling was applied in selecting a sample. Sources of data were both primary and secondary. A comparison was made between Ethiopian two banks and Central bank of Malaysia in terms of their practices and a gap was identified. Results showed that the banks had a lot to learn from each other outside their best practices. The National Bank of Ethiopia (NBE) plays a great role in banks supervision. The rise of banks risks is a clear indication of inadequate knowledge and skills to come up with proper strategies on risk management. Rise in credit risk affects banks performance. It is critical that banks evaluate their policies on payback and appraise the borrower rather than the over reliance on collateral.

Awoke (2017) did an evaluation on impacts of credit risk on performance of Ethiopia commercial banks. It was empirical research focused on bank lending's of between 2008 to 2012. Econometrics and descriptive methods were adopted. Econometrics were used to assess the effects of internal variables, amount of loans provided on banks performance. Multiple regressions were applied in showing association between the study variables. From the study amount of loans, total asset of loan, administration of credit and size of

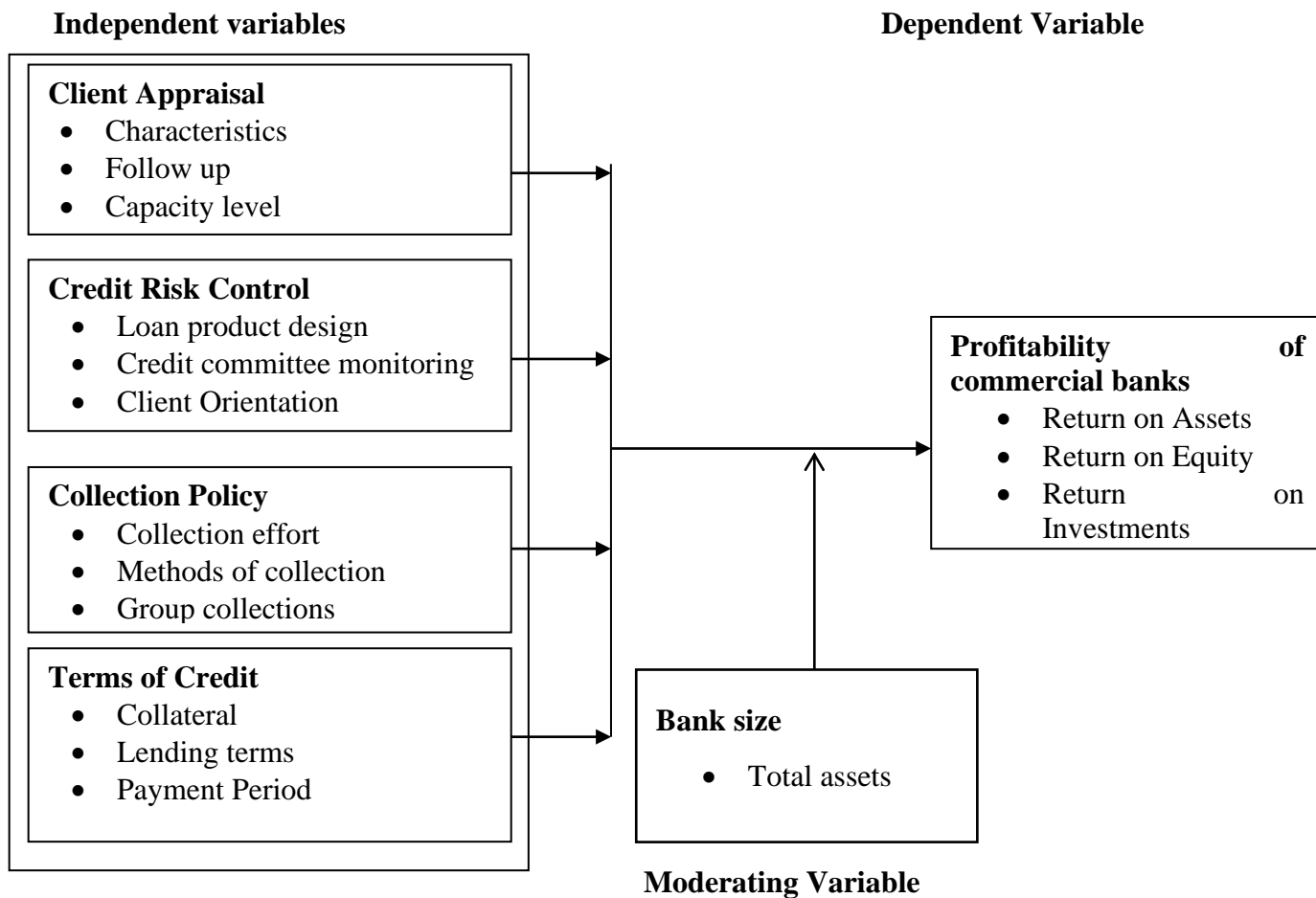
bank with performance were significantly related. Variations were found in the direct and magnitude of the impact on Return on Assets.

### **2.3 Gap in Literature review in this Research**

Tuladhar (2017) investigated the association between CRM and profitability in Nepalese Commercial Banks. Saeed and Zahid (2016) studied impacts of credit risk on UK commercial banks profitability. The studies were conducted in Nepalese and UK, the findings may not be generalised to Ethiopian banks since banks operate under different bank regulations. Ntiamoah, Diana and Kwamega (2014) determined the association of credit management strategies and loans performance in micro banking firms in Ghana. The focus was MFIs, private commercial banks was the focus of the present study. Kabudula (2015) explored the effectiveness of CRM on Malawi's commercial banks financial performance. The study determined the general financial performance of banks, the current study focused on profitability of banks. Mumbi and Omagwa (2017) explored the association of CRM and financial performance of selected Kenyan commercial banks. This study sought to determine the general financial performance of banks, the current study focused on profitability of banks. Saheb and Krishna (2018) evaluated the CRM practices in banking sector in Ethiopia. This study generally determined the CRM used by banks. Awoke (2017) studied impacts of credit risk on Ethiopian commercial bank performance. This study sought to determine the general financial performance of banks, the current study focused on bank's profitability. The focus of the current study was filling the research gap by conducting a study to establish effect of credit risk management on profitability practice of private commercial banks in Ethiopia- The Case Of United Bank S.C.

## 2.4 Conceptual Framework

Conceptual framework is a structural representation of the study objectives. It aims at showing the relationship that exists between the study variables both response and predictor variables. Figure 2.1, shows the relationship between measures of credit management and profitability of commercial banks.



**Figure 2.1: Conceptual Framework**

## CHAPTER THREE

### METHODOLOGY OF THE RESEARCH

#### 3.1 Research Design

A descriptive case-study and explanatory research method was adopted. A descriptive research is one which the subject is observed and behaviour described in a natural way. Case study design is focused and provides details, whereby the propositions of a phenomenon are usually examined to achieve results. On the other hand explanatory research is conducted in order to identify the extent and nature of cause-and-effect relationships. Explanatory studies focus on an analysis of a situation or a specific problem to explain the patterns of relationships between variables. Hence, the designs were suitable in determining the effect of credit risk management on profitability of private commercial banks in Ethiopia-United Bank S.C.

#### 3.2 Target population and sampling

A group of elements with similar noticeable characteristics from which conclusions are made is referred to as population (Ngechu, 2004). The study was conducted United Bank S.C. headquarters in Ethiopia. Targeted population was employees of United Bank S.C. at their headquarters. The population comprised employees in the credit and loan departments. According to United Bank S.C. HR report (2018) there are 112 employees in the credit and loan departments.

**Table 3.1: Target Population**

Category/employees	Frequency	Percent
Credit Department	48	16
Loan Department	64	30
<b>Total</b>	<b>112</b>	<b>100</b>

### 3.2.1 Sampling Technique

It is the method used in selecting the study sample respondents (Babbie, 2015). The respondents were selected using the method of stratified sampling and they were selected from employees list. Cooper and Schindler(2011) indicated that the selected sampling method was most suitable because it facilitates the division of the population in two or more significant groups in line with certain features. Stratification was used in this study because it ensures that there is no biasness in respondent selection.

### 3.2.2 Sample size

The study established the sample size to be used in the study using Yamane (1967). This is as shown below;

$$n = \frac{N}{1 + N \cdot e^2}$$

Where n = study sample size,

N = the size of population

e = error term (0.05)

$$\text{Hence, } n = \frac{112}{1 + 112(0.05)^2} = 88$$

88 respondents were used

From the formula a sample size of 88 respondents was obtained and this was 79% of the population that was being studied.

**Table 3.2: Sample size**

Category	Target population	Sample size
Credit Department	48	38
Loan Department	64	50
<b>Total</b>	<b>112</b>	<b>88</b>



### **3.3 Data Collection method**

Primary information was gathered with the use of questionnaires. The advantage of using questionnaires as data collection tool is that using a short period of time, a large amount of information can be collected from individuals. The respondents have also adequate time to come up with their responses from each question. The anonymity of the participants is also ensured as they are not required to disclose their identity. Biasness is highly limited (Creswell, 2012). To provide secondary data, sources like the internet and financial statements were used. The data was for a period between 2014 to 2018,

### **3.4 Data Source**

The study used primary and secondary information. Questionnaires were the selected tool for primary data while secondary data on profitability was obtained from the bank's financial statements. The obtained data was used for analysis purposes

### **3.5 Data Collection Procedure**

Researcher and research assistants administered the questionnaires. Close ended questions were structured based on the specific study objectives. The method of data collection that was adopted is drop and pick later; this allowed the respondents to have sufficient time to go through the questionnaires and provide adequate answers. For optimal data collection all issued questionnaires were collected. Secondary data was obtained on published financial statements.

### **3.6 Data Analysis**

Cleaning of the gathered information was done and then coded in SPSS version 23. Descriptive statistics including SD, percentages, mean, and frequencies were applied in analysis. Presentation was done using tables, 2-D figures and pie charts. This ensured easy

understanding of the study results. Data whose nature is qualitative was analyzed using content analysis.

The significance of the association between management of credit risk and bank's profitability was assessed by computing correlation analysis. In establishing combined effect on the study variables multipleregressionswasapplied.

Below is the regression model presentation;

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon$$

Where

**Y** = Financial Performance

**$\beta_0$**  = regression constant,

**$\beta_1, - \beta_4$**  = Coefficients,

**$X_1$**  = Client appraisal,

**$X_2$**  = Credit risk control,

**$X_3$**  = Collection Policy

**$X_4$**  = Terms of Credit.

## CHAPTER FOUR

### DATA ANALYSIS, PRESENTATION AND INTERPRETATION

#### 4.1 Response Rate

The study selected a sample of 88 respondents and all of them were issued with questionnaires. The researcher was able to receive back only 78 questionnaires translating to 88.6% response rate. Mugenda and Mugenda (2008) mentioned that if response rate is 50% it can be said to be adequate, if it is 60% it is considered good if it is 70% and above then it is excellent. Therefore, our response rate of 78 out of 88 was excellent and suitable for making inferences and drawing conclusion.

**Table 4.1: Response Rate**

<b>Response</b>	<b>Frequency</b>	<b>Percent</b>
<b>Returned</b>	78	88.6
<b>Unreturned</b>	10	11.4
<b>Total</b>	<b>88</b>	<b>100.0</b>

#### 4.2 Demographic Information

##### 4.2.1 Gender of the Respondents

Respondents provided the gender to which they belonged to and the results were presented.

##### Gender of the Respondents

The findings show that 63% of study's respondents were of male gender while the remaining 37% were female. From these findings it is evident that there was no gender bias because representation of both genders was fair.

#### **4.2.2 Respondents Length of Service in the Organization**

The respondents provided their responses on the duration of time they have been employed by their banks and the results were presented.

#### **Respondents Length of Service in the Organization**

The findings show that 46.2% of study's respondents stated that they had been working with their bank for 0-5 years, 32.7% indicated 6-10 years, 13.5% 11-15 years and 7.7% for over 16 years. From the findings, it is clear that the respondents used in the study had worked in the organization for varied periods of time but long enough to provide needed information for this study. Most (46.2%) had served for 0-5 years.

#### **4.2.3 Respondents Designation**

The respondents indicated their designation in their organizations. The results were presented.

#### **Respondents Designation**

The findings show that 57.7% of study's respondents' designation in their organization was low level manager, 28.2% middle level manager and 14.1% top level manager. From the findings, it is evident that the study used respondents from different job levels. Majority (57.7%) of the respondents were from low level management.

#### **4.2.4 Adoption of Credit Management Practices**

Respondents provided their responses on whether their organization has embraced practices of managing credit. The results are presented.

#### **Organizations' Adoption of Credit Management practices**

The findings show that 91% of study's respondents stated that their organization has embraced practices of managing credit while only 9% have not yet adopted the practice.

This is an indication that majority of the organizations have adopted credit risk management practices as indicated by majority (91%) of the respondents.

#### **4.2.5 Credit Risk Management Practices in Improving Performance**

Respondents gave their responses on whether managing risk embraced by their organization have had positive effects on profitability of the bank and those results were presented.

##### **Credit Risk Management Practices in Improving Performance**

From the findings, 79% indicated that practices of managing credit risk have improved performance of their organization while 21% indicated that it has not resulted to improved performance. This showed that managing credit risk leads to improved performance as indicated by majority (79%) of the respondents.

#### **4.3 Descriptive Statistics**

In this section the responses provided by respondents, using a Likert scale comprising of 5-points with 5 being strongly agree, 4-agree, 3-neutral where; 2- disagree, and 1-strongly disagree, on various statements are presented. The statements were related with various practices of credit risk management and how they affect profitability of the bank. Mean is a measure of central tendency, it tries to show where the opinion of majority of respondent is. In the Likert scale, if the mean is between 1 to 1.49, it is interpreted in relation to the one given a scale of 1 in the Likert scale i.e. strongly disagree , if the mean is between 1.5 to 2.49, it is interpreted in relation to the one given a scale of 2 in the Likert scale i.e. disagree , if the mean is between 2.5 to 3.49, it is interpreted in relation to the one given a scale of 3 in the Likert scale i.e. moderate , if the mean is between 3.5 to 4.49, it is interpreted in relation to the one given a scale of 4 in the Likert scale i.e.

agree and if the if the mean is between 4.5 to 5 , it is interpreted in relation to the one given a scale of 5 in the Likert scale i.e. strongly agree .

### 4.3.1 Client Appraisal

Respondents gave their responses on effects of client appraisal on profitability of Ethiopia's private commercial banks. The results were as shown in Table 4.2.

**Table 4.2: Client Appraisal on Profitability**

Statements	Mean	Std. Dev.
Appraisal of clients is an appropriate strategy for managing credit.	3.949	1.408
Bank is equipped with personnel competent enough to perform appraisal of clients.	3.910	1.322
The character of the customer seeking credit is considered during their appraisal.	3.859	1.435
During client appraisal collateral is another aspect that is considered.	4.103	1.326
Defaulting of loans arise from failing to assess the ability of the borrower to repay back their loan.	4.090	1.148
Appraisal of clients considers the ability of the client meet their financial obligations.	3.949	1.408

The findings show the respondents were in strong agreement that during client appraisal collateral is another aspect that is considered as shown by a mean of 4.103 and that defaulting of loans arise from failing to assess borrowers' ability to pay back their credit as indicated by mean value of 4.090. It was further established that appraisal of clients is an appropriate strategy for managing credit as indicated by mean value of 3.949, appraisal of clients puts into consideration client's ability to meet their financial obligations as shown by a mean of 3.949 and the bank is equipped with personnel competent enough to perform appraisal of clients as shown by a mean of 3.910. These findings and those of Further, Ayodele, Thomas and Raphael (2014) who established impacts of credit policies on performance of Zenith Bank Plc in Nigeria and established that Zenith Bank had

adopted credit management activities such as client appraisal hence reducing the rate of loan default are in agreement.

The respondents were further asked to indicate other effects of client appraisal on profitability practice of your bank. They indicated that; Client appraisal helps the organization to know their customer, to understand the customer’s ability to repay the loan and the nature and value of the collateral or guarantee in support of the credit so as to mitigate risk.

### 4.3.2 Credit Risk Control

Respondents gave their responses on effect of credit risk control on profitability of private commercial banks in Ethiopia-United Bank S.C. The results were as presented in Table 4.3.

**Table 4.3: Credit Risk Control on Profitability**

Statements	Mean	Std. Dev.
The performance of the bank can be improved by setting limits on size of loan	3.923	1.300
The performance of the bank is enhanced by using regularly credit checks.	3.872	1.299
Repayment of loans can be improved by having flexible plans for repayment.	3.795	1.277
Clients commitment to pay back their loan is enhanced by having penalties for lateness	3.885	1.382
Monitoring and management of credit is enhanced by using clients loan application form	3.974	1.458
To reduce default and credit risk, it’s important to in involve Credit committees in reaching decisions	3.949	1.309
The performance of the bank is affected by loans’ rates interest	3.949	1.513

The findings show that respondents agreed that Monitoring and management of credit is enhanced by using clients loan application form as shown by a mean of 3.974, To reduce default and credit risk, it's important to involve Credit committees in reaching decisions as shown by a mean of 3.949, The performance of the bank is affected by loans' rates interest as shown by a mean of 3.949, The performance of the bank can be improved by setting limits on size of loans as shown by a mean of 3.923, Clients commitment to pay back their loan is enhanced by having penalties for lateness as shown by a mean of 3.885, The performance of the bank is enhanced by using regularly credit checks as shown by a mean of 3.872 and Repayment of loans can be improved by having flexible plans for repayment as shown by a mean of 3.795. These agree with Isanzu (2017) who in his study found that NPLs and capital adequacy significantly affects how commercial banks perform financially and making it crucial for financial institutions to control credit risk for them to perform financially.

The respondents were further asked to indicate other effects of credit risk control on profitability. They indicated that; proper credit risk control improves the bank profitability since it reduces the loan default rate, improves the quality of its assets and minimizes loan losses and non-performing loan.

### **4.3.3 Collection Policy**

Respondents provided their responses on effect of collection policy on profitability of private commercial banks in Ethiopia United Bank S.C. The results were as shown in Table 4.4.



**Table 4.4: Collection Policy on Profitability**

Statements	Mean	Std. Dev.
Effective practices of managing credit were possible with availability of collection policies.	3.859	1.302
Banks find it challenging to formulate policies on collection.	3.936	1.380
Enforcing guarantee policies gives a chance to recover loan whenever loan is defaulted	3.936	1.298
In the recovery of delinquent loans, incentives to employees improve the process.	3.962	1.511
Reviewing regularly collection policies is important to better management of credit.	4.064	1.434
It is more effective to have stringent policies for recovering debt than lenient policies	3.949	1.259

The findings show respondents were in strong agreement that reviewing regularly collection policies is important to better management of credit as shown by a mean of 4.064. They also agreed that in the recovery of delinquent loans, incentives to employees improve the process as shown by a mean of 3.962, it is more effective to have stringent policies for recovering debt than lenient policies as shown by a mean of 3.949, Banks find it challenging to formulate policies on collection as shown by a mean of 3.936, Enforcing guarantee policy gives a chance to recover loan whenever loan is defaulted as shown by a mean of 3.936, and Effective practices of managing credit were possible with availability of collection policies as shown by a mean of 3.859. These findings agree with Van Horne (1995) who stated that proper credit policies ensures that investor's return and the value of shareholder's are maximized, the end goal is ensuring bank profitability.

The respondents were also asked to indicate others effects of collection policy on profitability of banks. They indicated that; the policy provides clear, written guidelines that set the terms and conditions on credit, customer qualification criteria, procedure for

making collections, and steps to be taken in case of customer delinquency, this helps in reducing default and improving profitability.

#### 4.3.4 Terms of Credit

Respondents indicated their opinions on statements on effect of terms of credit on profitability of private commercial banks in Ethiopia-United Bank S.C. The results were as presented in Table 4.5.

**Table 4.5: Terms of Credit on Profitability Statements**

	Mean	Std. Dev.
The credit period that clients receive is specified by credit terms.	3.795	1.195
The rate of interest on loans to borrowers is specified in credit terms.	3.846	1.275
The period of time taken to loan approval is included in terms of credit	3.744	1.224
Evaluation of terms of credit is done using client's position usually established in ratio analysis.	3.795	1.413
Cash flow trends are used in evaluating terms of credit.	3.846	1.275
Observing capital position is used in evaluating terms of credit.	3.769	1.331
Terms of credit are important in making sure that the customer doesn't default loan repayment.	3.782	1.223

The findings show that respondents agreed that the rate of interest on loans to borrowers is specified in credit terms as presented by mean value of 3.846, Cash flow trends are used in evaluating terms of credit as shown by a mean of 3.846, Evaluation of terms of credit is done using client's position usually established in ratio analysis as shown by a mean of 3.795, The credit period that clients receive is specified by credit terms represented by mean value of 3.795, Terms of credit are crucial in making sure that the customer doesn't default as represented by mean value of 3.782, Observing capital position is used in evaluating terms of credit as shown by a mean of 3.769 and The period of time taken to loan approval is included in terms of credit as shown by a mean of 3.744. These agree

with Danielson (2004) that appraisal of Client and review of collection policies and terms of credit would help banks to recover most of their money; this may in turn ensure bank's profitability.

The respondents were also asked to indicate other effects of terms of credit on profitability of banks. They indicated that; customers are able to understand the amount of installments they should pay and the duration of loan payment. This ensures that payments are made on time hence improving profitability of banks.

#### 4.4 Inferential Statistics

The study performed inferential statistics in order to establish how the variables being studied relate. Correlation and multiple regression analysis were performed and the results presented in subsections below.

##### 4.4.1 Correlation Analysis

PPMC was applied in establishing how the explanatory variables relate with the response variable and the findings were as presented in Table 4.6.

**Table 4.6: Correlations Coefficient**

		<b>Profitability</b>	<b>Client appraisal</b>	<b>Credit risk control</b>	<b>Collection policy</b>	<b>Terms of credit</b>
<b>Profitability</b>	Pearson Correlation	1				
	Sig. (2-tailed)					
<b>Client appraisal</b>	N	78				
	Pearson Correlation	.776**	1			
<b>Credit risk control</b>	Sig. (2-tailed)	.002				
	N	78	78			
<b>Collection policy</b>	Pearson Correlation	.785**	.344	1		
	Sig. (2-tailed)	.002	.062			
<b>Terms of credit</b>	N	78	78	78		
	Pearson Correlation	.802**	.510	.515	1	

	Sig. (2-tailed)	.001	.059	.069		
	N	78	78	78	78	
<b>Terms of credit</b>	Pearson Correlation	.772**	.284	.433	.277	1
	Sig. (2-tailed)	.002	.080	.058	.182	
	N	78	78	78	78	78

The findings established that client appraisal was strongly and positively correlated with adoption of profitability practice of Ethiopia's private commercial banks ( $r = 0.776$ ,  $p = 0.002 < 0.01$ ); credit risk control and profitability practice of Ethiopia's private commercial banks has a positive correlation ( $r = 0.785$ ,  $P = 0.002$ ); collection policy and profitability practice of Ethiopia's private commercial banks has a positive correlation ( $r = 0.802$ ,  $P = 0.001$ ); terms of credit and profitability practice of Ethiopia's private commercial banks are positively correlated ( $r = 0.772$ ,  $P = 0.002$ ).

#### 4.4.2 Multiple Regression Analysis

The study computed multiple regression analysis in order to establish the combined effect on the study variables. The results were presented in three tables in the subsections below.

##### 4.4.2.1 Model Summary

The change in the dependent variable as a result of changes in independent variables was determined by computing model summary.

**Table 4.7: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.808 <sup>a</sup>	0.653	0.589	0.02905

From the results, adjusted  $R^2$  was 0.653 implying that there was 65% change in profitability of United Bank S.C, because of changes in practices of managing credit risk. The other 35% remaining suggest there're factors influencing profitability practice of private commercial banks which weren't part of the model. R shows how that variables being investigated relate and from the results it was evident that the variables were positive and strongly related as indicated by the value of 0.808.

#### 4.4.2.2 Analysis of Variance

In order to establish whether the data applied in the study was significant, the study conducted analysis of variance.

**Table 4.8: Analysis of variance**

	<b>Model</b>	<b>Sum of Squares</b>	<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
1	Regression	143.868	4	35.967	43.823	.012 <sup>b</sup>
	Residual	59.913	73	0.821		
	<b>Total</b>	<b>203.781</b>	<b>77</b>			

The findings from ANOVA showed p-value was 0.012 which implies the data is ideal to make conclusion because p-value was less than the selected significance level of 0.05. The F critical was found to be smaller than F calculated ( $43.823 > 2.497$ ) suggesting that managing credit risk has significant influence on the profitability of private commercial banks.

#### 4.4.2.3 Beta Coefficients of the study Variables

The regression equation was

$$Y = 1.487 + 0.406 X_1 + 0.422 X_2 + 0.365 X_3 + 0.274 X_4 + e$$

From the equation, holding the four practices of managing credit risk constant, they will significantly affect the profitability of United Bank S.C as indicated by the constant value of 1.487 as shown in Table 4.12.

**Table 4.9: Coefficients**

<b>Model</b>	<b>Unstandardized Coefficients</b>		<b>Standardized Coefficients</b>	<b>t</b>	<b>Sig.</b>
	<b>B</b>	<b>Std. Error</b>	<b>Beta</b>		
<b>1 (Constant)</b>	1.487	0.312		4.766	0.003
<b>Client appraisal</b>	0.406	0.069	0.387	5.884	0.002
<b>Credit risk control</b>	0.422	0.089	0.409	4.742	0.003

<b>Collection policy</b>	0.365	0.092	0.355	3.967	0.006
<b>Terms of credit</b>	0.274	0.081	0.259	3.383	0.001

Client appraisal is statistically significant to profitability of United Bank S.C( $\beta = 0.406$ ,  $P = 0.002$ ). It implies that Client appraisal significantly and positively relate with profitability of United Bank S.C. This implies that increasing Client appraisal by a single unit will lead to an increase in profitability of United Bank S.Cby 0.406 units.

Credit risk control is statistically significant to profitability of United Bank S.C( $\beta = 0.422$ ,  $P = 0.003$ ). This suggests that Credit risk control and profitability of United Bank S.Chave significant and positive relations. Therefore, increasing Credit risk control by a single unit will lead to an increase in profitability of United Bank S.Cby 0.422 units.

Collection policy is statistically significant to profitability of United Bank S.C( $\beta = 0.365$ ,  $P = 0.006$ ). This implies that Collection policy and profitability of United Bank S.Care significantly and positively related. Therefore, increasing Collection policy by a single unit will lead to an increase in profitability of United Bank S.Cby 0.365 units.

Terms of credit is statistically significant to profitability of United Bank S.C( $\beta = 0.274$ ,  $P = 0.001$ ). This implies that Terms of credit and profitability of United Bank S.Care significantly and positively related. Therefore, increasing Terms of credit by a single unit will lead to an increase in profitability practice of private commercial banks by 0.274 units.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

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

##### **5.1.1 Client Appraisal**

The study established during client appraisal collateral is another aspect that is considered and that defaulting of loans arises from failing to assess the ability of the borrower to repay back their loan. The study further established that appraisal of clients is an appropriate strategy for managing credit, Appraisal of clients considers the ability of the client meet their financial obligations and the bank is equipped with personnel competent enough to perform appraisal of clients. These findings and those of Further, Ayodele, Thomas and Raphael (2014) in his study on impacts of credit policies that Zenith Bank had adopted credit management activities such as client appraisal hence reducing the rate of loan default are in agreement.

##### **5.1.2 Credit Risk Control**

The study found that monitoring and management of credit is enhanced by using clients loan application form, to reduce default and credit risk, it's important to in involve credit committees in reaching decisions, the performance of the bank is affected by loans' rates interest, the performance of the bank can be improved by setting limits on size of loan, clients commitment to pay back their loan is enhanced by having penalties for lateness, the performance of the bank is enhanced by using regularly credit checks and repayment of loans can be improved by having flexible plans for repayment. These agree with Isanzu (2017) who in his study found that NPLs and capital adequacy significantly affects how United Bank S.Cperform financially and making itcrucial for financial institutions to control credit risk for them to perform financially.

### **5.1.3 Collection Policy**

The study revealed that reviewing regularly collection policies is important to better management of credit. Also, in the recovery of delinquent loans, incentives to employees improve the process, it is more effective to have stringent policies for recovering debt than lenient policies, banks find it challenging to formulate policies on collection, enforcing guarantee policies gives a chance to recover loan whenever loan is defaulted, and effective of managing credit were possible with availability of collection policies. These findings agree with Van Horne (1995) who stated that proper credit policies ensures that investor's return and the value of shareholder's are maximized, the end goal is ensuring bank profitability.

### **5.1.4 Terms of Credit**

It was established that the rate of interest on loans to borrowers is specified in credit terms, cash flow trends are used in evaluating terms of credit, evaluation of terms of credit is done using client's position usually established in ratio analysis, the credit period that clients receive is specified by credit terms, terms of credit are important in making sure that the customer doesn't default loan repayment, observing capital position is used in evaluating terms of credit and the period of time taken to loan approval is included in terms of credit. These findings are in agreement with Danielson (2004) that appraisal of client and review of collection policies and terms of credit would help banks to recover most of their money; this may in turn ensure bank's profitability.

## **5.2 Conclusions**

The study found that Client appraisal is statistically significant to profitability of United Bank S.C. The study also found that Client appraisal significantly and positively relate



with profitability of United Bank S.C. Therefore it was concluded that client appraisal is positively related to profitability of United Bank S.C.

Regarding control of credit risk, the study found that Credit risk control is statistically significant to profitability of United Bank S.C. Also, it was found that Credit risk control and profitability of United Bank S.C. are significantly related. Therefore, it was concluded that credit risk control is positively related to profitability of United Bank S.C. The study revealed that Collection policy is statistically significant to profitability of United Bank S.C. The study further found that Collection policy and profitability of United Bank S.C. are significantly related. Therefore, the study concluded that collection policy is positively related to profitability of United Bank S.C.

The study found that term of credit is statistically significant to profitability practice of private commercial banks. Furthermore, Terms of credit and profitability of United Bank S.C. were found to be significantly related. Therefore, the study concludes that increasing terms of credit are positively related to profitability of United Bank S.C. by 0.274 units.

### **5.3 Recommendations**

Recommendation of the study is for united banks to improve methods of appraising clients to avoid clients who are not worthy of credit who might lead to delinquency of loans. The result will improve performance by having loan repayment and loan portfolios performing positively. It is therefore recommended that United Bank S.C. need to improve the way they deal with risk accruing from credit through improvement of credit risk control; this can be done by having databases that assess profiles of creditors both current and prospective and guarantors which United Bank S.C. can share amongst themselves to lower levels of NPLs and therefore improving the performance of the banking institutions.

The bank need to involve clients greatly in coming up with terms of credit, since they're individuals directly involved and understand better on what terms should be applied. Entities responsible for creation of policies need to come up with prudential guides that are effective and policies that will strengthen management of risks.

The bank need to embrace stringent credit policies that help them develop a lasting association with clients, come up with information and requirements of the client. This will help in development of distinct strategies in the context of granting of credit, credit terms and client service that enable growth of sales.

Management of the bank should consider formulating a universal credit policy document that will be adopted by all banks from which rating of their financial performance through credit risk management can be measured and regulated. Also stringent policies should always be useful in regulating the whole process of loan application, loan appraisal issue and loan repayment.

#### **5.4 Suggestion for Further Studies**

This study sought to establish the effect of credit risk management on profitability of private commercial banks in Ethiopia- The Case Of United Bank S.C. The study recommends further research to be carried out on effect of practices of managing credit risk on public commercial banks in Ethiopia; this will enable comparison between private and public banking institutions. The study also recommended research to be carried out on effectiveness of collection policies imposed by United Bank S.C.

## REFERENCES

- Altman, E. I. (2012). *Management Credit Risk*. In A. C. Millennium., *Economic Notes* (31, 201-214). Blackwell Publishers.
- Ara, H., Bakaeva, M. & Sun, J. (2009). *Credit Risk Management and Profitability in Commercial Banks in Sweden*. Master thesis. University of Gothenburg.
- Awoke, E. T. (2014). *Impact of Credit Risk on the Performance of Commercial Banks in Ethiopia*. Addis Ababa: St. Mary's University School of Graduate Studies.
- Ayodele, U., Thomas, T. & Raphael A. R., (2014). Impact of Credit Policy on the Performance of Nigerian Commercial Banks using Zenith Bank Plc. *Internal finance and banking*, 1(2).
- Basel Committee for Banking Supervision (2004). *International Convergence of Capital Measurement and Capital Standards: A Revised Framework*, Basel Committee for Banking Supervision.
- Brealey, R.A., Myers, S.C. & Allen, F. (2014). *Principles of Corporate Finance*. 11th Edition. McGraw-Hill, Irwin, New York.
- Brown, K. C. & Reilly, F. K. (2012). *Analysis of Investments and Management of Portfolios*. 10th ed. Canada: South Western.
- Cooper, D. & Schindler, P. (2011). *Business Research Methods*. 11th Edition, McGraw Hill, Boston.
- Creswell, J. W. (2012). *Educational research: Planning, conducting, and evaluating quantitative and qualitative research* (4th ed.). Boston, MA: Pearson.
- Danielson, M.G. (2004). *Bank Loan Availability and Trade Credit Demand*. The Financial Review, 39: 579-600

- Greuning H. V. & Bratanovic, S. B. (2003). *Analyzing and Managing Risk: A framework for Assessing Corporate Governance and Financial Risk*. 2nd ed. Washington DC; the World Bank
- Idarus, Y. A. (2005). *A Survey of Operational Risk Management Practices by Commercial Banks in Kenya*. Unpublished MBA Thesis, University of Nairobi.
- Kabudula, C.V. (2015). *Analysis of the Credit Risk Management Efficiency on Financial Performance in Malawi's Commercial Banking Sector*, Unpublished thesis Blantyre International University.
- Kithinji, A.M. (2010). *Credit Risk Management and Profitability of Commercial Banks in Kenya*, School of Business, University of Nairobi, Nairobi.
- Kolapo, T. F., Ayeni, R. K. & Oke, M. O (2012). Credit risk and commercial banks' performance in Nigeria: A panel model approach. *Australian Journal of Business and Management Research*, 2(2), 31 –38.
- Kothari, C.R. & Garg, G. (2014). *Research Methodology, Third Edition*, New Age International Publishers, New Delhi
- Lastra, B.M. (2004). Risk-based capital requirements and their impact upon the banking industry, *Journal of Financial Regulation and Compliance*, 12(3), 225-39.
- Margrabe K, (2007). The incidence of secured debt: evidence from the small business community, *Journal of Financial and Quantitative Analysis*, 24(1), 379-94
- Markowitz, H. (1952). Portfolio Selection. *The Journal of Finance*, 7(1)
- Mumbi, W. M., & Omagwa, J. (2017). Credit Risk Management and Financial Performance of Selected Commercial Banks in Kenya, *Strategic Management Journal*, 19(11), 92–98.

- Muturi, E (2016).Effect of Credit Management Practices on Loan Performance in Deposit Taking Microfinance Banks in Kenya.*International Journal of Innovations, Business and Management (IJIBM)*.10, (1).
- Mwangi, K, M. (2012).*Effects risk management practices on financial performance of Commercial Banks in Kenya*, Unpublished MBA thesis, University of Nairobi.
- Nelson, L. (2012). *Solving Credit Problem*.Retrieved from <http://www.cfo.com> (23/04/12)
- Ngechu.M. (2004), *Understanding the research process and methods*.An introduction to research methods. Acts Press, Nairobi.
- Ntiamoah,P. E., Diana, F. &Kwamega, E. (2014). Assessment of the Relationship between Credit Management Practices and Loan Performance.*Journal of Risk Finance*, 8, 56-71
- Owizy, G. (2013). The Impact of Credit Management on Financial Performance of Nigerian Banks, With Particular Reference to UBA Plc. *Journal of Banking and Finance*, 3(2).
- Ruziqa, A. (2013). The impact of credit and liquidity risk on bank financial performance: the case of Indonesian Conventional Bank with total asset above 10 trillion Rupiah. *International Journal of Economic Policy in Emerging Economies*, 6 (2), 93--106.
- Saeed, M. S. & Zahid, N., 2016. The Impact of Credit Risk on Profitability of the Commercial Banks.*Journal of Business and Financial Affairs*, 5(2).
- Saheb, S.and Reddy, V.K. (2018). Credit Risk Management Practices in the Banking Sector in Ethiopia, *International Journal of Current Research*,10(4).

- Tuladhar, R. (2017). *Impact of Credit Risk Management on Profitability of Nepalese Commercial Banks*. Unpublished Thesis, Western Sydney University.
- Van Horne, K. (1995). *Modern money and Banking*: New York, McGraw-Hill Book Company
- Waweru N. M & Kalani V. M (2009). Commercial Banking Crises in Kenya: Causes and Remedies. *African Journal of accounting, Economics, Finance and Banking Research*, 4 (4),12 – 44.
- Yamane, T. (1967). *Statistics, An Introductory Analysis*, 2nd Ed., New York: Harper and Row.
- Zou & Li F.Y. (2014). *The impact of credit risk management on profitability of commercial banks in Europe*. Unpublished research project, Umea School of Business and Economics.

## APPENDICES

### Appendix I: Introduction Letter

Dear Respondent

#### **RE: DATA COLLECTION**

I am a post graduate student at Addis Ababa University. I am conducting a study on the **‘EFFECT OF CREDIT RISK MANAGEMENT ON PROFITABILITY OF** United Bank S.C. You are requested to kindly respond to the questionnaire attached. Your honesty will be highly appreciated.

Your responses will be used just for academic reasons and therefore confidentiality will be observed and won't be disclosed to any person.

Yours sincerely,

## Appendix II: Questionnaire

Kindly tick appropriately

### Section A: Demographic Information

1. Gender

Male  Female

2. For how long have you served in the bank?

0-5 years  6-10 years

11-15 years  above 16 years

3. What is your designation in the organization?

Top level manager  middle level manager

Low level manager

### Section B: Client Appraisal

4. Has the bank embraced practices of Credit Management?

Yes  No

5. Do practices credit management improve performance

Yes  No

6. What is your opinion on following statements relating to effects of client appraisal on profitability practice of private commercial banks in Ethiopia.

Statements	Strongly disagree (1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly agree (5)
Appraisal of clients is an appropriate strategy for					



managing credit.					
Bank is equipped with personnel competent enough to perform appraisal of clients.					
The character of the customer seeking credit is considered during their appraisal.					
During client appraisal collateral is another aspect that is considered.					
Defaulting of loans arise from failing to assess the ability of the borrower to repay back their loan.					
Appraisal of clients considers the ability of the client meet their financial obligations.					

### Section C: Credit Risk Control

7. Indicate your opinion about the statements on effect of credit risk control on profitability practice of private commercial banks in Ethiopia.

<b>Statements</b>	<b>Strongly disagree (1)</b>	<b>Disagree (2)</b>	<b>Neutral (3)</b>	<b>Agree (4)</b>	<b>Strongly agree (5)</b>
The performance of the bank can be improved by setting limits on size of loan					
The performance of the bank is enhanced by using regularly credit checks.					
Repayment of loans can be improved by having flexible plans for repayment.					
Clients commitment to pay back their loan is enhanced by having penalties for lateness					
Monitoring and management of credit is enhanced by using clients loan application form					
To reduce default and credit risk, it's important to involve Credit committees in reaching decisions					
The performance of the bank is affected by loans' rates interest					

### Section D: Collection Policy

8. What is your opinion on following statements relating to effect of collection policy on profitability practice of private commercial banks in Ethiopia.

Statements	Strongly disagree (1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly agree (5)
Effective practices of managing credit were possible with availability of collection policies.					
Banks find it challenging to formulate policies on collection.					
Enforcing guarantee policies gives a chance to recover loan whenever loan is defaulted					
In the recovery of delinquent loans, incentives to employees improve the process.					
Reviewing regularly collection policies is important to better management of credit.					
It is more effective to have stringent policies for recovering debt than lenient policies					

### Section E: Terms of Credit

9. What is your opinion on following statements on effect of terms of credit on profitability practice of private commercial banks in Ethiopia.

Statements	Strongly disagree (1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly agree (5)
The credit period that clients receive is specified by credit terms.					
The rate of interest on loans to borrowers is specified in credit terms.					
The period of time taken to loan approval is included					

in terms of credit					
Evaluation of terms of credit is done using client's position usually established in ratio analysis.					
Cash flow trends are used in evaluating terms of credit.					
Observing capital position is used in evaluating terms of credit.					
Terms of credit are important in making sure that the customer doesn't default loan repayment.					

**Thank you**