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Assessment of Credit Risk Management System in Ethiopian Banking

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Abstract: *The main objective of this study is to assess credit risk management system in Ethiopian banking industry of some private and government commercial banks. Selection of banks for the study was done based on two criteria; it involves only government and private commercial banks and two those banks that operate during the period 1999-2014. Seven commercial banks out of eighteen banks operating at 2000 G.C are selected. These banks are Commercial Bank of Ethiopia, Awash International Bank S.C, Dashen Bank S.C, Bank of Abyssinia S.C, Wegagen Bank S.C, United Bank S.C and NIB International Bank S.C. From these seven commercial banks with so many branches nationwide, it can be difficult to be managed by the researcher due to time and resource constraints. Therefore, the researcher purposely limits in selecting banks at the head office. In this study, the researcher will utilize purposive sampling technique in order to select participants of the study. For the purpose of this study, both primary and secondary data is used. Primary data is collected through questionnaires distributed to respondents that involve professional working in the banks such as Department Managers and Senior Officers working on loan processing. Finding of this study will assist in forwarding recommendations to improve the problems the present credit management situation prevailing in the banking sector in Ethiopia by assessing commercial banks credit management activity. In addition to this, based on the implication of the research findings, the research also recommended areas for future research.*

Keywords: *Commercial banks, Credit risk, Managers, Management, Assessing.*
Article Type: *Research work*

I. INTRODUCTION

The issue of finance is major concern in modern time all over the world. The need for financial institution is unquestionable. Banks are financial institutions that are established for lending, borrowing, issuing, exchanging, taking deposits, safeguarding or handling money under the laws and guidelines of a respective country. Among their activities, credit provision is the main product, which banks provide to potential business entrepreneurs as a main source of generating income. They also provide loans, credit and payment services such as checking accounts, money orders, and cashier's checks. Banks also may offer investment and insurance products and a wide whole range of other financial services (Sahlemichael M, 2009).

Credit creation is the main income generating activity for the banks. But this activity involves huge risks to both the lender and the borrower. The risk of a trading partner not fulfilling his or her obligation as per the contract on due date or anytime thereafter can greatly jeopardize the smooth functioning of a bank's business. On the other hand, a bank with high credit risk has high bankruptcy risk that puts the depositors in jeopardy. Among the risk that face banks, credit risk is one of great concern to most bank authorities and banking regulators. This is because credit risk is that risk that can easily and most likely prompts bank failure (Conford A., 2000).

Credit management means the total process of lending starting from inquiring potential borrowers up to recovering the amount granted. In the sense of banking sector, credit management is concerned with activities such as accepting application, loan appraisal, loan approval, monitoring, and recovery of non-performing loans (Shekhar, 1985.)

Banks take into account many considerations as a factor of credit management, which helps them to minimize the risk of default that results in financial distress and bankruptcy. This is due to the reason that while banks providing credit they are exposed to risk of interest and principal repayment, which need to be managed effectively to acquire the required level of loan growth and performance. According to Hettihewa, 1997, Credit Management is extremely important as granting credit is considered to be the equivalent of investing in a customer.

Credit analysis is the first step in the process to tailor-make solution to fit the customer's needs. The assessment starts with an understanding of the customer's needs and capacities to ensure there is a good fit in terms of the financing solution. Credit assessment is the most important safeguard to ensure the underlying quality of the credit being granted and is considered an essential element of credit risk management (Cade, 1999).

The credit quality generally refers to the borrower's ability and willingness to meet the commitments of the facility granted. It also includes default probability and anticipated recovery rate (Saunders & Cornett, 2003). Credit assessment thus involves assessing the risks involved in financing and thereby anticipating the probability of default and recovery rate. A credit analysis is used by the credit official to evaluate a borrower's character, capital, capacity, collateral and the cyclical aspect of the economy (Strischek, 2000).

How long does it take business partners to pay their debts? Understanding the payment behavior of potential customers is vital in assessing credit management in every organization, since poor credit assessment can lead to major problems in financial planning, Atradius (2011), as cited in Emmanuel Y. (2012). Charles Mensah (1999) stressed the importance of credit management as follows: Credit management process deserves special emphasis because proper credit management greatly influences the success or failure of financial institutions.

In the last few years, both public and private sectors in the economy underwent encouraging development in investment and business activities, thus becoming the fertile ground for the banking industry (Hagos, 2010). Following the free market economy of the country, loans are becoming large and at the same time, bad loans have increased substantially during the past few years. This appears as a problem and should be of interest to every commercial banker, Sahilemicael(2009).

The goal of Credit Risk Management is to maximize banks' risk- adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Banks should also consider the relationships between credit risk and other risks. Effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization (Basle committee on banking supervision, 2004).

Hence, the credit management is one of the major issues of banks that concern many stakeholders where better credit risk management results in better bank profitability. This research therefore, aims to assess credit risk management in Ethiopian banking industry.

1.1 Statement of the Problem

The goal of the credit management is to maximize the performing asset and the minimization of the nonperforming asset as well as ensuring the optimal point of loan and advance and their efficient management. The overall success in credit management depends on the banks credit policy, portfolio of credit, monitoring, supervision and follow-up of the loan and advance. Continuous supervision, monitoring and follow-up are highly required for ensuring the timely repayment and minimizing the default. Actually the credit portfolio not only constitutes the bank's asset structure but also is a vital factor of the bank's success. Only a proper credit analysis will bring to light the probability of credit loss arising out of genuine business factors and explore the possible mitigates regarding this ominous situation to put a check on it (Rana-Al-Mosharrafa 2013).

Adequately managing credit in financial institutions is critical for the survival and growth of the financial institutions. In the case of banks, the issue of credit management is of even greater concern because of the higher levels of perceived risks resulting from some of the characteristics of clients, business conditions, and economic environment in which they find themselves.

The very nature of the banking business is so sensitive because more than 85% of their liability is deposits mobilized from depositors, Saunders, Cornett, 2005 as cited in Hagos M. 2010. Banks use these deposits to generate credit for their borrowers, which in fact is a revenue generating activity for most banks.

Credit assessment helps the banker to ensure selection of right type of loan proposals and right type of borrower. For selecting the borrower, security should not the only thing to be relied upon. So responsibilities of the bankers to investigate the client from different view point i.e. the strength and weakness of the client so that the client will be able to repay the bank loan as repayment schedule with profit. To prevent future financial crises, it is necessary to improve the borrowers' financial literacy, the lenders' process of transparency and to better assess loan product affordability and suitability.

Due to diversified and intensified investments in the country in the last 10 and or above years there is an increase of loan demands among investors from commercial banks in the country. In addition to this high demands for loan from commercial banks are highly busy in launching branches across the country. These situations have created an environment in which commercial banks to encounter risks in credit management. Loans are becoming large and at the same time bad loans have increased substantially during the past few years, Sahlemichael M. (2009). Since commercial banks expansion and high demand for loans are a recent phenomenon, the challenge they encounter in the manner loans are managed a huge concern. Although there were some studies on commercial banks risk management conducted in Ethiopia (Sahlemichael, 2009) on credit risk management system in Ethiopian commercial banks (Case of public and private banks). Similar studies are also done by Charles Mensha (1999) as cited in Hagos M. (2010) on the importance of credit management in

Ethiopia. Those studies made on this issue are not comprehensive and credit risk management system may differs and change over time. Nevertheless, the studies did not assess the challenge they encounter in the manner loans are managed on the diversified and intensified investment in the country. Therefore, the study attempts to assess the credit risk management systems and practices in commercial banks of Ethiopia.

1.2 Objectives of the study

The main objective of this study is to assess credit risk management system in Ethiopian banking industry in some of public and private sector banks and specific objectives are:

- To assess the ability of the bank in creating credit
- To review the effectiveness of banks credit collection
- To identify whether the Banks are operating under appropriate credit management policy
- To assess the Banks credit administration, measurement and monitoring process
- To appraise non-performing loans

1.3 Significance of the Study

The expected benefit of this study is to make possible suggestions, which are believed to improve the present credit management situation prevailing in the banking sector in Ethiopia through the assessment of commercial banks credit management activity. In addition to this, based on the implication of the research findings, researcher is recommended for further research in this area.

1.4 Scope of the Study

The scope of this study covered the assessment of commercial banks' credit risk management under this investigation those that operated in between 1999-2014 having financial statements for consecutive fourteen years. Based on this criterion, upto December, 2014, there are eighteen banks in Ethiopia, out of them seven banks are selected for this study at head office level.

1.5 **Limitations of the study:** Researchers'' faced the following pains in this study. These are as follows:

1. time limitation is the main constraint in our study
2. meeting higher officials in the head offices of the commercials banks is another lacuna of our study
3. incurring costs also another barrier and waiting for meeting with higher authorities brings lot of stress in our study.

II. REVIEW OF LITERATURE

Credit management is a dynamic field where a certain standard of long-range planning is needed to allocate the fund in diverse fields to minimize the risk and maximizing the return on the invested fund. (Rana Al.Mashruf, 2013) The goal of the credit management is to maximize the performing asset and the minimization of the non-performing asset as well as ensuring the optimal point of loan and advance and their efficient management. Only a proper credit analysis will bring to light the probability of credit loss arising out of genuine business factors and explore the possible mitigates regarding this ominous situation to put a check on it. (Rana Al.Mashruf, 2013)

According to Jabatan (2001), several factors are used as part of the credit management process to evaluate and qualify a customer for the receipt of commercial credit. These factors include;

- Gathering data on the potential customer's current financial condition.
- The current ratio between income and outstanding financial obligations.
- Competent credit management seeks to not only protect the vendor from possible losses, but also protect the customer from creating more debt obligations.

The financial viability of any credit institution depends critically on selecting applicants who have a high probability of repayment and rejecting those who have a high probability of default Sewagudde (2000). In doing so loan officers in such financial institution is put at risk and the organization as a whole. As a way of scaling down loan, the default problem Gontaezjega (1996) added a risk premium to the price of the loan to cover loan losses. This risk premium results from the fact that at the time of the loan request, the lender is unable to clearly identify which borrower would repay and which borrower would default, as actual default losses are not known until a scheduled repayments are due.

2.1 Credit Management Process

Problem loans are at the end of the credit channel. Before a loan becomes bad, it needs to be granted. Moreover, as we referred to so far, the poor quality of a loan is sometimes due to factors not attributable to the lending bank such as adverse selection and moral hazard (Stiglitz and Weiss, 1981) or any other external shock that may alter the borrower's ability to repay the loan (Minsky, 1982 & 1985). Nevertheless, there are cases where the way banks grant and monitor credits can be responsible for the bad loan portfolio. In other terms,

weak credit risk management systems can also be sources of problem loans (Nishimura and al, 2001).
For these last reasons, it was essential to overview the credit risk management process of Banks in order to capture the framework of the bad loans management. Significant details related to the credit management processes are revealed here. Bank' credit management processes can be summarized in three main stages. These stages are:

i. Credit initiation
ii. Documentation and disbursement
iii. Credit administration

2.2 Empirical evidence of the study

Kwaku D. (2015) studied assessing credit risk management practices in the Banking Industry of Ghana: Processes and Challenges and obtained the following findings. Some of the key findings from the study revealed that the bank has documented policy guidelines on credit risk management with a senior manager having oversight responsibility for implementation. However, the study showed that there were some implementation challenges of the credit risk policies which have resulted to low quality of loan portfolio of the bank. It is being submitted that bank's risk policies should be reviewed frequently.

Chen J. and Shuping H(2012) conducted a Research on the Credit Management of Commercial Banks of Lianyungang City for the small scale and medium enterprises (SMEs). Investigators have found out that the risk management plan and operation method that really suit for credit demand for the SMEs is still not mature and it caused that the bad debts and dead loan were overstocked in lianyungang commercial bank, thus it seriously impact on the capital operation of commercial banks, and then it has caused some adverse impact to the development of local economy. Therefore, it is necessary for commercial banks in Lianyungang city to supervise and manage the whole process of credit of the small and medium-sized enterprises.

Abdus (2004) has examined empirically the performance of Bahrain's commercial banks with respect to credit (loan), liquidity and profitability during the period 1994-2001. Nine financial ratios (Return on Asset, Return on Equity, Cost to Revenue, Net Loans to Total Asset, Net Loans to Deposit, Liquid Asset to Deposit, Equity to Asset, Equity to Loan and Non-performing loans to Gross Loan) were selected for measuring credit, liquidity and profitability performances. By applying these financial measures, this paper found that commercial banks' liquidity performance was not at par with the Bahrain banking industry. Commercial banks are relatively less profitable and less liquid and, are exposed to risk as compared to banking industry. With regard to asset quality or credit performance, this paper found no conclusive result.

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

The existing literatures indicate that several studies were carried out about credit risk management on commercial banks abroad and in Ethiopia. However**,** due to diversified and intensified investments in the country during last 10 and or above years there is an increase of loan demands among investors from commercial banks in the country. In addition to this, high demands for loan commercial banks are highly busy in launching branches across the country. These situations have created an environment in which commercial banks to encounter risks in credit management. Loans are becoming large and at the same time, bad loans have increased substantially during the past few years, Sahlemichael M. (2009). Therefore, this study investigated this newly emerging challenges in credit risk management process in commercial banks encounter in Ethiopia.

III. METHODOLOGY OF THE STUDY

In this area researcher wants to present the design and methodology of the study. It spells out the techniques and methods of data sampling, collection, processing, and analysis. The limitations and problems encountered while carrying out the study were also highlighted.

3.1 Research Design

In order to achieve the objectives of the study, the research undertake descriptive approach using both qualitative and quantitative data. In doing so, the study will intends to describe, and interpret the existing facts about credit management. Further, the researchers' utilizes a survey as a research method. Primary data was collected through interview and questionnaires distributed to respondents that involve loan clients of the commercial banks, Department Managers and Senior Officers working on loan processing. Secondary data was obtained from publications of private and governmental banks.

3.2 Population Size and Sampling Techniques

As to Dec of 2014, there are eighteen banks in Ethiopia. Out of them only 7 banks data have been taken. As noted by (Kothari, 2004) good sample design must be viable in the context of time and funds available for the research study. Besides, purposive sampling offers the researcher to deliberately select items for the sample concerning the choice of items as supreme based on the selection criteria set by the researcher. Accordingly, this study will employ purposive sampling technique to select the required sample of banks from the above listed banks

The selection criteria set by the researcher will be first, the required banks will be only commercial banks in Ethiopia. Second, those seven commercial banks, which are selected for study, should operate during 1999-2014 having financial statements for consecutive fourteen years.

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

3.3 Sample Size

Professionals working in the seven commercial banks out of 18 in Ethiopian banks, related to credit and credit related operations as a whole were taken as participants of the study. These are Commercial Bank of Ethiopia, Awash International Bank S.C, Dashen Bank S.C, Bank of Abyssinia S.C, Wegagen Bank S.C, United Bank S.C and NIB International Bank S.C.

3.4 Data Collection Instruments

For the purpose of the study, both primary and secondary data were used. Primary data was collected through questionnaires distributed to respondents that involve professional working in the banks such as Department Managers and Senior Officers working on loan processing. In addition, interview was employed on banks professionals as primary data sources to supplement the questionnaire. The secondary data will be collected from financial statements, annual reports, directives, and bulletins of the bank.

3.5 Method of Data Analysis

Due to qualitative and quantitative nature of data that were gathered, data analysis was carried out using descriptive statistics by applying Statistical Package for Social Scientist (SPSS) to present the data in well organized and convenient manner.

IV. DATA ANALYSIS AND INTERPRETATION

In this part researcher presents the research findings and interpretations of the data gathered via questionnaires and interviews of respondents. The results of the study is as follows:

4.1 Demographic Characteristics of Respondents

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

Table 4.1 Gender of respondents

		Frequency	Percent	Valid %	Cumulative %
Valid	Male	41	58.6	58.6	58.6
	Female	29	41.4	41.4	100.0
	Total	70	100.0	100.0	

Source: Primary Data

The mix of gender of the employee in the loan area is, 58.6 percent dominated by the male parts and 41.4 percent is female as it is shown in table 4.1. This is due to the education and experiences required to work in the loan area as loan officers or analysts is almost proportionally assigned to both male and female employees. Employees with high experience and qualification are needed to work in the loan area, as they have to understand the responsibility and accountability for prudent credit management and minimizing credit risks to the required level. Hence, in this regard the banks should be considered gender distribution smartly.

Table 4.2 Age of the respondents

		Frequency	Percent	Valid Percent	Cumulative %
Valid	20-25	6	8.6	8.6	8.6
	26-35	47	67.1	67.1	75.7
	36-45	11	15.7	15.7	91.4
	>45	6	8.6	8.6	100.0
	Total	70	100.0	100.0	

Source: Primary Data

The age of the employee shows as indicated in table 4.2, 8.6 percent are in the range of age between 20 to 25; 67.1 percent are in the range of age between 26 to 35;15.7 percent are in the range of age between 36 to 45 and the remaining 8.6 percent are above 45 years age. This implies the banks' majorities of workforces are in their productive age and expected to work more to the best of their knowledge and experience and thereby they can make their organization efficient and effective in the credit management process.

Table 4.3 Marital status of respondents

		Frequency	Percent	Valid %	Cumulative %
Valid	Married	42	60.0	60.0	60.0
	Single	20	28.6	28.6	88.6
	Divorced	8	11.4	11.4	100.0
	Total	70	100.0	100.0	

Source: Primary Data

The findings depicted in table 4.3 above showed that majority of the respondents (60 percent) are get married, 28.6 percent are single and only 11.4 percent are divorced. As far as the nature of banking industry is concerned, it is highly exposed to credit risk and this demands employees working there to be socially responsible to enable them to concentrate and exert their maximum professional experience and qualification for the good of the banks' credit management practice, which leads to minimize credit risks. Therefore, the implications of the findings are in consistent with this argument, as large numbers of the employees working in credit processing area are married.

Table 4.4 Education levels of the respondent

		Frequency	Percent	Valid %	Cumulative %
Valid	Degree	13	18.6	18.6	18.6
	Master	50	71.4	71.4	90.0
	Diploma	7	10.0	10.0	100.0
	Total	70	100.0	100.0	

Source: Primary Data

Educational background of employee is an important factor to be considered with regard to making business decision. Education improves the skill, capacity, communication, and access to development endeavors. As it can be revealed from table 4.4, on average only 10% of the respondents have diploma where the majority of them at 71.4% have a master's degree qualification, as their highest qualification, and the remaining 18.6 % possess an undergraduate degree. Hence, with respects to qualifications the findings implied that most of the employees working in the credit department are well qualified, this contributed a lot to the effectives, and efficiency in credit management practices of the banks.

4.2 Credit Policy, Procedures, and Risks of the Banks

Table 4.5 Life of the bank since established and commencing operations

		Frequency	Percent	Valid %	Cumulative %
Valid	>10 years	39	55.7	55.7	55.7
	20	8	11.4	11.4	67.1
	21	10	14.3	14.3	81.4
	> 25 years	13	18.6	18.6	100.0
	Total	70	100.0	100.0	

Source: Primary Data

To arrive at good conclusions regarding the banks' credit managing practices, their lifetime from establishment to date should be considered as important factor. The findings presented in 4.5 above, disclosed that more than average number of the sampled banks (55.7 percent) have more than ten years' experience since established and began operation while 18.6 percent have more than 25 years' experience in the bank and the remaining banks (25.7 percent) have between 10 and 25 years in banking operation since their establishment. Thus, the selected banks are feasible enough to assess their credit management practices as far as their lifetime in banking operations are more than ten years.

Table 4.6: Credit risk faced by the Banks

		Frequency	Percent	Valid Percent	Cumulative %
Valid	Yes	47	67.1	67.1	67.1
	No	21	30.0	30.0	97.1
	3	1	1.4	1.4	98.6
	4	1	1.4	1.4	100.0
	Total	70	100.0	100.0	

Source: Primary Data

The findings depicted in table 4.6 above showed that, majority of the banks (67.1 percent) have faced at least one credit risk over the past ten years while 30 percent of them did not face any credit risk. This implies the impossibility to avoid credit risk regardless of the banks effectiveness in credit policy and collection effort albeit possible to reduce the severity of credit risk by having sound credit management system.

Table 4.7 Risk/s faced by the banks during the last ten years period

		Frequency	Percent	Valid Percent	Cumul. %
Valid	Credit risk	34	48.6	48.6	48.6
	Liquidity risk	20	28.6	28.6	77.1
	Operational risk	11	15.7	15.7	92.9
	Interest rate risk	2	2.9	2.9	95.7
	All are correct	3	4.3	4.3	100.0
	Total	70	100.0	100.0	

Source: Primary Data

As far as the theory is concerned, there are various types of risks, which the bank faces. Credit risk, liquidity risk, operational risk, and interest rate risk are among others. Table 4.7 showed that, 48.6 percent, 28.6 percent and 15.7 percent of the respondents agreed that, their banks had faced credit risk, liquidity risk, and operational risk, during the last ten years period respectively. Only 2.9 percent and 4.3 percent stated that their banks faced interest rate risk and all the mentioned risks respectively. Hence, as majority of the banks faced credit risk. So that, this study under consideration is demanding and its findings are important to get feedback. It is useful for the banks' to take remedial timely action to improve their credit management practices.

Table 4.8: Credit manual Possessing by Respondents

		Frequency	Percent	Valid Percent	Cumulative %
Valid	Yes	70	100.0	100.0	100.0
	No	0	0.0	0.0	0.0
	Total	70	100.0	100.0	

Source: Primary Data

Producing and developing credit policy and procedures as well as other pertinent manuals and guidelines help to create common understanding and uniformity among all employees. Lending is the core product line, which contributes the biggest share to the profitability of a banking organization. In the table 4.8, 100 percent of the bank employee replied positively for having credit policy and procedure manuals. This implies, the bank have credit policy document to protect it against over exposure, mal-administration of credit arresting the creation of non-performing loans, and arrive at a trade-off between returns and risks if effectively implemented.

Table 4.9 Period/year of credit manual/policy revision

	Year	Frequency	Percent	Valid Percent	Cumulative %
Valid	2000	56	80.0	80.0	80.0
	2013	12	17.1	17.1	97.1
	2014	2	2.9	2.9	100.0
	Total	70	100.0	100.0	

Source: Primary Data

It is clear for all that, banking industry is highly affected by the changing social, economic, and technological environment. To adopt with these changing environment, the existing manual or policy requires periodical revision or change. For this purpose, survey questions were asked to respondents to know period when the existing credit manual or policy was revised. Accordingly, in table 4.9, more than three quarters (80%) of the respondents replied that their banks revised the existing credit manual or policy during 2000, which indicates almost the year of their establishment to provide banking services. This implies, once the credit manual is developed it was consistently used without periodical revision taking in to account of the environmental factors.

Table 4.10: Upto date of Loan manual and convenient for loan creation

		Frequency	Percent	Valid Percent	Cumulative %
Valid	Yes	45	64.3	64.3	64.3
	No	22	31.4	31.4	95.7
	3	3	4.3	4.3	100.0
	Total	70	100.0	100.0	

Source: Primary Data

Table 4.10 revealed that, 64.3 percent of the employees have commented on the existing credit manuals that it is up to date and convenient for loan creation as so many amendments was made over it while 31.4 percent disagreed to this. This finding implies that there are still commercial banks that used outdated credit manual, which might not be in favor of customers and thus resulted in shift of loan clients to other banks that have up to date credit policy considering the customers' preference.

Table 4.11 Nature of the banks' Credit policy and procedures

		Frequency	Percent	Valid Percent	Cumulative %
Valid	Rigid	28	40.0	40.0	40.0
	Flexible	21	30.0	30.0	70.0
	Average	21	30.0	30.0	100.0
	Total	70	100.0	100.0	

Source: Primary Data

From table 4.11 above, empirical findings revealed 30 percent of the respondents said the credit policy, and procedures of the banks are flexible enough and consider the stiff completion in banking industry and the loan clients' diversified need. The other 30 percent of the respondents responded that the credit policy and procedures are on average in its workability and 40 percent claimed, as it is rigid. Therefore, believing on the importance, attractiveness, and convenience of flexible credit policies and procedures as it assists for loan creation and growth; the findings implied the bank's top management to take immediate action and need to revise the rigid credit policy, and procedures.

Table 4.12 Policy and procedures exactly comply with regulations of the National Bank of Ethiopia

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	yes	47	67.1	67.1	67.1
	no	23	32.9	32.9	100.0
	Total	70	100.0	100.0	

Source: Primary Data

It is known that, all commercial banks and insurance companies operating in Ethiopia are regulated by National Bank of Ethiopia (NBE) with respects to the banking services they perform including the credit policy and procedures they use. To verify this, respondents were asked whether the policy and procedures being used are exactly complying with regulations of the national bank. The findings presented in table 4.12, clearly depicted that 67.1 percent of the respondents stated that their banks existing credit policy and procedures are in comply with the rules and regulations of the NBE. Nevertheless, there still banks whose credit policy, procedures are not in line with the rules, and regulations of the national bank of Ethiopia as 32.9 percent of the respondents confirmed the same. This finding from the study leaves big assignment for the NBE. So there is need to closely monitor each bank along with their branches to ensure the compliance of their credit policy and credit procedures to the regulation and directions of NBE, which is the regulatory body of the Nation.

Table 4.13 Means of loan is creation

		Frequency	Percent	Valid Percent	Cumulative %
Valid	By approaching promoted clients	37	52.9	52.9	52.9
	By approaching with request	32	45.7	45.7	98.6
	Both	1	1.4	1.4	100.0
	Total	70	100.0	100.0	

Source: Primary Data

As it is shown in the table 4.13, 52.9 percent of the loan is created by the employees approaching potential loan clients while 45.7 percent is created by new applicants approaching the bank with credit request and only 1.4 percent of the loan is created by both methods. These shows the banks employees' exerts their efforts to approach potential loan clients as it is the best way of creating quality loans as well as to overcome the prevailing stiff competition from other banks.

4.3 Credit Analysis of the Banks

Table 4.14: Rating of Credit analysis and procedures followed by bank in extending credit					
		Frequency	Percent	Valid Percent	Cumulative %
Valid	Excellent	32	45.7	45.7	45.7
	Very good	22	31.4	31.4	77.1
	Good	15	21.4	21.4	98.6
	Fair	1	1.4	1.4	100.0
	Total	70	100.0	100.0	

Source: Primary Data

Table 4.14 showed that 45.7 percent, 31.4 percent, 21.4 percent, and 1.4 percent of the bank employees have rated the credit analysis of the bank as excellent, very god, good, and fair respectively. Over all, the majority of employees rated good about the quality of credit analysis and loan processing used by their banks albeit few banks still need to work hard to improve the quality of their credit analysis and loan processing and thereby maximize their client's creditworthiness and increase performing loans.

Table 4.15: Bank provide loan that fit to the preference in extending credit					
		Frequency	Percent	Valid Percent	Cumulative %
Valid	Yes	47	67.1	67.1	67.1
	No	20	28.6	28.6	95.7
	Not know	3	4.3	4.3	100.0
	Total	70	100.0	100.0	

Source: Primary Data

Providing loan in line with the preferences and needs of loan clients is one of the strategies used by successful financial institutions like banks. In this respect, the findings shown on the above table 4.15, reveals that 67.1 percent of the respondents collectively agreed that the selected banks provide loan that fit to the preference in extending credit while 28.6 percent did not consider clients' preferences while providing loan.

Table 4.16: Evaluation of banks' credit providing procedure					
		Frequency	Percent	Valid Percent	Cumulative %
Valid	Based on creativity	33	47.1	47.1	47.1
	Conservative	14	20.0	20.0	67.1
	Moderate	23	32.9	32.9	100.0
	Total	70	100.0	100.0	

Source: Primary Data

Employees were also asked reveal their opinion on Credit providing procedures of the bank. Consequently, as presented in table 4.16, near to half of respondents (47.1%) agreed that the credit providing procedure of the bank is based on creativity, 20% stated that it is conservative and 32.9 %of employees responded that the credit provision practice of the bank is moderate. Although each procedures have their own advantages and shortcomings, high dependency on conservative provision might affect the bank's overall operating performance adversely.

Table 4.17 Bank loan approving/recommending procedure of credit proposal of client					
		Frequency	Percent	Valid Percent	Cumulative %
Valid	Loan committee	51	72.9	72.9	72.9
	Branch manager	9	12.9	12.9	85.7
	Loan department	6	8.6	8.6	94.3
	Board	2	2.9	2.9	97.1
	Except correct	2	2.9	2.9	100.0
	Total	70	100.0	100.0	

Source: Primary Data

As the above table 4.17 depicts, 72.9 percent of employees agreed that loans and advances of the bank is recommended or approved by the loan committee at all levels. That is, both at branch and at head office as per the discretions provided. Moreover, the study revealed that 12.9 percent agreed that loan approval is made by President and branch manager while very few number of respondents, 8.6%, and 2.9%, respectively agreed that loan approval were made by loan departments and boards. Thus, with respects to loan recommendation and approval, the bank did not follow uniform system in all branches although loan committee at level dominantly participated in the system.

Table 4.18: Functioning of CRM Department independent of loan origination					
		Frequency	Percent	Valid Percent	Cumulative %
Valid	Yes	54	77.1	77.1	77.1
	No	15	21.4	21.4	98.6
	Not know	1	1.4	1.4	100.0
	Total	70	100.0	100.0	

Source: Primary Data

Separation of duties and responsibilities with respects to credit risk management and loan origination function minimizes the information asymmetry and moral hazard problem before approving loan and collecting the loan provided to various classes of clients. To assess this, respondents were asked questions and their reposes presented in table 4.18. Accordingly, 77.1 percent replied that the function of your credit risk management department independent of loan origination function while 21.4 percent agreed that both functions are overlapping and hence no need to assign them to different concerned departments and this might accepting default loan clients or rejecting innocent and prudent clients which adversely affects the banks credit risk management practices.

Table 4.19: Tools used to measure Credit risk					
		Frequency	Percent	Valid %	Cumulative %
Valid	Internal rating	40	57.1	57.1	57.1
	Through the five c's of credit	22	31.4	31.4	88.6
	Through Financial Statement Ratios	8	11.4	11.4	100.0
	Total	70	100.0	100.0	

Source: Primary Data

It is advisable for all banks to measure the credit risk of each loan requests made by clients before approval at least to minimize the risk of adverse selection. Theoretically, there are different tools can be used for this purpose. In this regard, the findings showed in table 4.19, 57.1 percent of the respondents said that the bank's internal credit rating is used as a primary tool while 31.4 percent stated that the five C's of credit rating are used as a sound method. The remaining 11.4% agreed that various financial statement ratios of the loan applicants are used as a tool to measure their credit risk. This implies that each bank have using their own best method of credit risk measurement although it recommended in various literatures that combination of various methods can be used to minimize the credit risks.

Table 4.20: Probability of defaultness of customers					
		Frequency	Percent	Valid %	Cumulative %
Valid	Yes	57	81.4	81.4	81.4
	No	7	10.0	10.0	91.4
	3	5	7.1	7.1	98.6
	4	1	1.4	1.4	100.0
	Total	70	100.0	100.0	

Source: Primary Data

As far as the uncertainty of the future or loss contingency from default customers is concerned, estimation of probability of default of customers before approving loan to applicants can minimize the risk of adverse selection. The results of the survey findings in this respect are presented in table 4.20 and interpreted as 81.4 percent of respondents collectively agreed that their banks calculate probability of default of customers and only 10% replied that probability of default of customers are not calculated. Therefore, majority of the banks have used the probability theories and estimate the chance of existence of of default of customers before loan approval.

4.4 Credit Recovery of the Banks

After the credit assessment and disbursement is done, the credit customer is expected to payback the installment as per agreed schedule. Each bank has a different repayment mechanism. Based on the specifics of the bank, customers can pay weekly, bi-weekly, or monthly installments (Odongo, 2004). In order to ensure good repayment, Banks have to ensure proper monitoring and follow up actions. According to majority of the banks' credit policy manual, credit is transferred to the legal service when it fails to regularize or settle the loans in default and when all efforts used to kindly repay the loans fail and it is ascertained that legal action is to be the last alternative.

Table 4.21 Calculation of recovery rate of a loan known/unknown					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	47	67.1	67.1	67.1
	No	22	31.4	31.4	98.6
	Don't know	1	1.4	1.4	100.0
	Total	70	100.0	100.0	

Source: Primary Data

In table 4.21, responders were asked to state whether their banks calculate recovery rate of a loan or not. Accordingly, more than half (67.1%) said that their banks calculate recovery rate of a loan and this enable them to know performing and non-performing loan clients. However, still few banks were negligent to calculate this rate as supported by 31.4 % of the respondents and this implies that those banks faced difficulties of determining performing and non-performing loan clients for a specific period.

Table 4.22: Criteria used by Bank to mitigate Credit risk					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Credit limit	32	45.7	45.7	45.7
	Taking collaterals	18	25.7	25.7	71.4
	Diversification	13	18.6	18.6	90.0
	Loan selling	4	5.7	5.7	95.7
	Credit insurance	1	1.4	1.4	97.1
	All	2	2.9	2.9	100.0
	Total	70	100.0	100.0	

Source: Primary Data

There are different ways of mitigating credit risk used by banks and each of them have their own cons and pros. As indicated in table 4.22, credit limit, taking collaterals, diversification, loan selling, and credit insurance are used as a means of alleviating or at least minimizing the risks associated with providing loan to clients as agreed by 45.7%, 25.7%, 18.6%, 5.7%, and 1.4% of respondents respectively. Only 2.9 percent of the respondents confirmed that their used all the above-mentioned methods. Hence, the findings imply that credit limit, taking collaterals, and diversification are the three most popular methods used to mitigate credit risk albeit the banks' habit to use different methods in combination is still discouraging.

Table 4.23: Bank procedure /polices concerning Credit exposure limits					
		Frequency	Percent	Valid %	Cumulative Percent
	Groups of connected counter or economic parties	21	30.0	30.0	70.0
	For particular industries or economic sectors	9	12.9	12.9	82.9
	Geographic regions	6	8.6	8.6	91.4
	Specific loan type	4	5.7	5.7	97.1
	All	2	2.9	2.9	100.0
	Total	70	100.0	100.0	

Source: Primary Data

Setting different or diversified credit limits for different kinds of loan applicants is essential for each bank to include all categories of borrowers, diversify its credit risk and to increase the outstanding loan, which later on increase the expected interest income on the loan. Thus, as depicted in table 4.23, almost near to three quarters (70%) of the respondents, agreed that their banks have procedures /polices concerning credit exposure limits, which is set for single borrower and groups of connected counter or economic parties. The remaining 30% of the respondents replied that their banks have procedures /polices concerning credit exposure limits, which is set for particular industries or economic sectors, geographic regions, specific loan type, and all the above mentioned loan clusters.

Table 4.24: Maintenance of credit files by the bank of all borrowers

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	all are yes	70	100.0	100.0	100.0

Source: Primary Data

Maintaining credit files all borrowers vis-vis credit information, purpose of loan, loan approval document, insurance coverage, financial statement are necessary for banks to get access these information when needed and to make the agreement legally binding. In this regard, the findings presented in table 4.24 clearly shows that all respondents (100%) said that their banks adequately keep credit files of all borrowers of all information and hence no problem of information which can be used as supporting evidences of why, to whom, when and for what purposes the loan was provided.

V. CONCLUSION AND RECOMMENDATION

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

5.1 Conclusion

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

- Majority of employees of the bank working in credit department are by 2nd degree holders followed by 1st Degree holders and highly experienced which might this enables the bank to accelerate its service delivery and become effective in the growing stiff competitive banking industry in Ethiopia as qualified and experienced work force enhances competence and increase in operating results.
- The study concluded that banks used different credit risk management tools, techniques and assessment models to manage their credit risk, and that they all have one main objective, i.e. to reduce the amount of loan default which is the principal cause of bank failures.
- The weaknesses in credit creation and procedure which most of the employees have agreed might adversely affect loan growth and client reputation .
- The study also reveals that banks with good or sound credit risk management policies have lower loan default ratios (bad loans) and higher interest income (profitability)

5.2 Recommendations

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

- ✓ Believing on the importance, attractiveness, and convenience of flexible credit policies and procedures as it assists for loan creation and growth, the bank's top management need to revise its credit policy and procedure incorporating the sayings of the clients and employees;
- ✓ The bank's loan processing and approving procedure is conservative for few banks. This is highly retarding the loan growth of the branches in particular and the Bank in general. Hence, the bank should follow creative way of loan processing and approving direction that assists to meet the loan demand of potential loan applicants and the required level of loan growth.
- ✓ Establishing a good relationship with borrowers was found to be the most favorable strategy employed by banks in the effort of reducing non -performing loans. This will be done through assisting borrowers by advising them on how to solve their problems, attend some of borrowers' business meetings, deliver good services and provide reasonable charges and also go further and organize dinner party and other social events where banks invite their borrowers. These findings suggest that innovation on new ways of dealing with borrowers is necessary for banks to be able to recover their money; and
- ✓ Therefore, most of the banks studied need to strengthen their loan management process especially in monitoring their borrowers and probably come up with new ways of monitoring them. As to whether these strategies worked out positively are another issue to be studied further though results in this study suggest so. In addition, further research may be conducted to include borrowers in the sample thus enriches further the body of knowledge.

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