ST. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES

ASSESSMENT OF CREDIT RISK MANAGEMENT POLICIES AND PRACTICES IN AWASH BANK S.CO

BY: MESERET ZELALEM

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ADDIS ABABA

ASSESSMENT OF CREDIT RISK MANAGEMENT POLICIES AND PRACTICES IN AWASH BANK S.CO

A THESIS SUBMITTED TO ST. MARY'S UNIVERSITY, SCHOOL OF GRADUATE STUDIES IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION

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APPROVAL BY BOARD OF EXAMINERS

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ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a university advisor.

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Advisor Signature

St, Mary's University, Addis Ababa May, 2018

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ACRONYMS

AB -- Awash Bank

CRM -- Credit Risk Management

NBE-- National Bank of Ethiopia

NPL--- Non Performing Loan

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Abstract

The purpose of this study was to assess the credit risk management policies and practice of Awash Bank. To undertake the study, a descriptive research design was used. The sample consisted of branch managers, credit analysts, supervisors and experts in Addis Ababa City branches. A structured questionnaire was used to collect data from respondents. Purposive sampling technique was employed to select 87 respondents who have direct experience with credit. However, 10 respondents did not return the questionnaires and 77 questionnaires were collected. The data obtained from the 77 respondents were analyzed using descriptive statistics. Findings revealed that Awash bank has a well-documented policy, strategies and guidelines to manage credit risk. The Bank makes use of credit risk management procedure that include; thorough loan appraisal, asking for collateral and checking the credit history of the borrowers. Additionally, the bank uses different risk management tools like covenants, credit rationing, loan securitization, and loan syndication. Most of the strategies employed by the Bank align with the principles of credit risk management. Different factors which are important to the effectiveness of credit risk management were also identified. In order to manage the dynamic nature of credit risk, Awash Bank's management need to periodically revise its credit policy and procedure incorporating the feedback of clients and employees.

Key words: Credit, credit policy, credit risk, credit risk management, credit risk practice, loan, risk management in ba

CHAPTER ONE: INTRODUCTION

1.1. Background of the Study

Among the core activities of Banks, credit provision is one of their central business. Although credit creation is the main income generating activity for the banks, 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 (Pasha & Bayush, 2017).

Risk is defined as the element of uncertainty or possibility of loss that prevail in any business transaction in any place, in any mode and at any time. In the financial area, risk can be broadly categorized as credit risk, operational risk, market risk etc. Among the various forms of risks, credit risk is the most important form of risks for the banking industry. Globally, it is reported that more than 50% of the total risk elements in Banks and financial institutions (FI) are credit risk alone (Lalon, 2015).

Credit risk is conceptualized as the possibility that a borrower or counter party fails to meet agreed obligations (Otieno, 2015; Kessey, 2015; Lalon, 2015). Alebachew (2015) similarly describes credit risk as the risk of a credit institution suffering losses due to default, late or incomplete execution of the debtors' financial obligations before the credit organization in accordance with the terms of the contract. Crouhy et al (2006) also explain that credit risk involves the risk of a particular bank and the borrower's portfolio risk.

Among the different risks that banks face, credit risk is of great concern to most bank authorities and banking regulators since it easily and most likely prompts bank failure (Otieno, 2015). Credit risk often arises whenever a lender is exposed to loss from a borrower, counterparty, or an obligor who fails to honor their debt obligation as they have agreed or contracted" (Colquitt, 2007:1). This loss may derive from deterioration in the counterparty's credit quality, which consequently leads to a loss to the value of the debt. In the worst case, the borrower defaults when he/she is unwilling or unable to fulfill the obligations.

According to Tsai and colleagues (2016) credit risk can be grouped into lending risk or issuer risk and counterparty risk. Lending risk refers to the violation of agreement when borrowers or bond issuers do not repay their debts or their credits get deteriorated. Lending risk or issuer risk is often correlated to borrowers and bond issuers' debt credit situations; counterparty risk on the other hand could be divided into two types: settlement risk and pre-settlement risk. Settlement risk is the risk that counterparties do not fulfill their contract duties in the due settlement time and cause the loss of the equality principal to the bank. Pre-settlement risk is the risk that counterparties violate the agreement before the final settlement day and cause the risk of contract violation to the bank.

Banks these days operate in a changing environment. These changes present them threats or opportunities thus exposing the banking sector to high risks. Managing credit risk for efficient management of financial institutions has thus become the most crucial task (Lalon, 2015). A number of banks in the world has collapsed or experienced financial problems due to inefficient credit management systems (Sabeza, Jaya & Gaurav , 2015). Risk control of the credit granting is thus viewed as the foremost task to each bank (Tsai et al, 2016).

In the Banking industry, risk management has emerged as a distinctive subject and as an arm of practical management of risk in Banks and other financial institutions. Risk management brings ideas and techniques drawn from many disciplines in order to provide a sound conceptual.

foundation and a set of tools for analysis and control of risks (Sabeza, Shukla & Bajpai, 2015). Credit risk management encompasses the total process of lending starting from inquiring potential borrowers up to recovering the amount granted. In the context of banking sector, credit management is concerned with activities such as accepting application, loan appraisal, loan approval, monitoring, and recovery of non-performing loans (Pasha & Bayush, 2015). Lalon, (2015) also explains credit risk management as the identification, measurement, matching mitigations, monitoring and control of the credit risk exposures.

The way credit risk is managed greatly determines the performance of a bank. Credit risk management policies are designed and applied both internally as an operational tool by bank management and externally by bank regulatory authorities to manage the financial health of the banking sector. The focus of such policies is asset diversification; maintenance of balance between returns and risk, bank asset quality and ensuring safety of depositors fund (Lalon , 2015).

Although all Banks have credit policy set to reduce credit risk and non-performing loans (NPL), the extent to which credit risk policy and management contributes to profitability of the Banks and to what extent the policies are effectively implemented is not investigated in many Banks. It is in line with this issue that the researcher wanted to carry out this study so as to examine the credit risk management policies and practices of Awash Bank.

1.2. Background of Awash Bank

Awash Bank is the pioneer private commercial bank in Ethiopia after the downfall of the military regime and introduction of market economic policy in 1991. It was established by 486 founder shareholders with a paid-up capital of Birr 24.2 million. Licensed on November 10, 1994, it started banking operations on February 13, 1995. Awash Bank was named after the popular river "Awash" which is the most utilized river in the country especially for irrigation and hydroelectric power. The bank at present operates a paid up capital of over 2.6 billion birr as of June 2017 (Awash Bank Annual Report, 2017).

Awash Bank at present (as of 30/06/2017 G.C.) has 316 branches and 6,772 employees and has registered with capital of 31.1 billion assets. Total deposits of the bank, including margins held on letters of credit, surged remarkably by 35% (Birr 8.5 billion) and reached Birr 32.8 billion at the end of June 2017 from Birr 24.2 billion during the same period of last year. In general, AB is the leading bank from private banks operating in Ethiopia and serve as the major source of finance to the national development effect. The bank provides different types of credit facilities such as overdraft, merchandise loan facility, pre-shipment export credit facility, post shipment credit facility, letter of credit facility, short term loan, medium and long term loans, agricultural input loan, agricultural investment loan, etc (Awash Bank Annual Report, 2017).

The loan portfolio of the bank was diversified across all sectors of the economy. Loan and advances availed to the domestic trade and services accounted for the lion's share of 30.4 percent, followed by foreign trade services (30.2%), building and construction (18.3 %), manufacturing (8%) and transport (6.7 %). The remaining 6.4% was accounted for by other sectors. The disbursed loan and advance have been increasing from year to year. During the 2016/17 fiscal year, the Bank disbursed a total loan of 22.6 billion Birr. This study assesses credit risk management policy and practice of the bank and the policy environment and ways of alleviating credit risk (Awash Bank Annual Report, 2016/17).

1.3. Statement of the Problem

Studies indicate that a Bank's continuing profitability and its financial stability majorly depends on sound credit management whereas deteriorating credit quality is the most frequent cause of

poor financial performance (Das & Das, 2007; Kessey, 2015; Lalon, 2015). Exposure to credit risk continues to be the leading source of problems in banks world-wide. As a result, Banks need to have useful evidence-based information from prior experience and empirical studies. They should have a keen awareness of the need to identify measure, monitor and control credit risk as well as to determine that they hold adequate capital against these risks and that they are adequately compensated for risks incurred (Kessey, 2015).

To date, a number of studies have been made on the issue of credit risk. These include studies on the practice of credit risk management (Afande, 2014); the importance of credit risk management (Das & Das, 2007); evaluation of credit risk management policies and practices(Luy, 2010) and challenges of operationalizing credit risk management policies (Kessey, 2015). Findings from the different studies reveal that though many Banks have risk management policies and strategies, their implementation is not always effective.

Local studies in relation to credit risk in the context of private and government Banks in Ethiopia have come up with different findings. A study by Alebachew (2015), for example, indicated that factors such as poor credit policy, weak credit analysis, poor credit monitoring, inadequate risk management and lack of management information system have impacted the attainment of successful credit risk management in Nib International Bank. Other local studies (Kassahun, 2017; Belsti, 2016; Solomon, 2013; Abdi, 2010; Feyisa, 2009) explored the issue of credit risk in the context of different Banks. Belsti (2016) examined the policies implemented in Birhan International Bank in order to manage credit risk. Solomon (2013) in his study on credit risk management practices of NIB International Bank evaluated the polices and frameworks of the Bank towards credit risk management, and also evaluated the techniques implemented in managing credit risk. Abdi (2010) assessed the financial performance of Awash Bank by relating

with credit risk. Feyisa (2009) investigated the trend of loan recovery and a recent study by Kassahun (2017) on the credit risk management practice of Awash Bank revealed that the bank has no regular assessment of collateral coverage and borrowers' financial health which consequently creates an increment of the NPL of the bank.

Findings from different studies abroad and in local context on credit risk management indicate that managing credit risk is a complicated task for any Bank. With the change of time, Banks may experience diverse challenges and empirical studies also come up with inconsistent findings. In the case Awash Bank, Abdi's (2010) analysis of the financial performance of the Bank shows that for the period 2000- 2009, the Bank's financial performance is not improving. Feyisa (2009) on the other hand noted that poor loan assessment procedure, lack of effective use of man power, lack of revision of credit management and unwillingness of borrowers to disclose their full information are impacting Awash Bank's loan recovery performance. In addition, examination of the non-performing loan (NPL) of the Bank indicates that as of June 2017, from the total loans and advance disbursed amount of Birr 22.6 billion, 354 million Birr or 1.6% is under the category of NPL. Though the NPL ratio of the Bank is below the required level of NBE (i.e. 5%), there is no improvement of NPL amount in the past three consecutive years (Awash Bank Annual reports, 2017).

Specific credit risk management policies and practices of Banks often differ depending upon the nature and complexity of their credit activities. In addition, the dynamic nature of credit risk with the change of time; the presence of unexplored issues regarding credit risk management in Awash Bank, such as the extent to which the credit risk management policy of the Bank is effectively implemented, and the absence of improvement in NPL of the Bank with time necessitate a study in relation to credit risk management. This study therefore investigates the credit risk management policy and practice of Awash Bank

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1.4. Objective of the Study

1.4.1. General objective

The general objective of this study is to investigate the credit risk management policies and practices of Awash Bank.

1.4.2. Specific objectives

Based on the general objective, the following specific objectives are formulated:

- To asses the procedures/ system employed by Awash Bank to manage credit risk.
- To assess the alignment of Awash Bank's procedures/ system of credit risk management practice with the principles of credit risk management
- To assess whether or not the credit risk management policy of the Bank's is effectively implemented
- To examine factors related with the effectiveness of credit risk management in Awash Bank

1.5. Research questions:

In pursuit of the specific objectives, this study seeks to answer the following questions:

- What procedures/ system are employed to manage credit risk in Awash Bank?
- Are the procedures/ system employed by Awash Bank to manage credit risk management aligned with the principles of credit risk management?
- Is the credit risk management policy of Awash Bank effectively implemented?
- What are the factors that relates to the effectiveness of credit risk management in Awash Bank?

1.6. Significance of the study

Since credit is the back bone of the banking industry in generating income, the outcome of the study is expected to be relevant to those parties who have similar objectives and seek information on issues related to credit risk management. Specifically, the investigation is expected to help policy maker, loan processing and credit appraisal department, credit administration department and credit risk management department of Awash Bank by forwarding relevant information that will help improve their credit risk management practice. Moreover, the study may also have relevance for other banks policy makers by providing empirical data that help in improving or formulating the policy environment for credit risk management practice of their banks. Furthermore, the research may serve as an input for future study in the area of credit risk management policy and practice. More specifically, the following are the possible significance of the research output.

- It will help Awash Bank to get insight on various component of credit risk management practice.
- It may be used as an input or documentation for credit risk management procedure for Awash Bank
- It can be used as source of information or secondary data for those who wish to undertake future study on similar issues.

1.7. Scope of the study

Since the issue of credit risk is a broad area of study, the present study focuses on only assessing credit risk management policies and practices in AB excluding other area of Bank risks such as operational, interest rate, liquidity risks etc. The focus of the research is assessment of credit risk policies and management of Awash Bank and the researcher mainly focuses on credit administration, credit appraisal and related area at head office and risk management department in order to gather relevant information about the area of study. Therefore, the study is limited to the credit activity and risk management practice of Awash Bank on the above mentioned departments. Other operations of the bank were not the subject matter of this research.

1.8. Limitation of the Study

The data used for the study was collected from 77 participants. This sample may not be adequate for a descriptive survey study. However, it is believed that the fact that participants being employees who have relevant information about the issue studied are assumed to give comprehensive data about the risk management policies and practices of the bank. The study's scope being limited to Addis Ababa branches can also limit the generalization of the study for other branches out of Addis Ababa City government. Nevertheless, since the practice and policy of the Bank are expected to majorly similar for the Bank much of the findings can be applied for other branches.

1.9. Organization of the Paper

This section of the paper guides readers on the organization of the proposal. The central theme of the thesis lies in credit risk management and assessment of credit risk management policy and practice. The second chapter briefly reviews relevant literature concerning the policy and practice of credit risk management. The third chapter focuses on the methodology of the research. It describes the research design, sampling technique, data Instruments to collect data, procedure of collecting the data, ethical issues and data analysis technique. Analysis of the collected data and interpretation of the analyzed data is presented in the fourth chapter. And finally, the fifth chapter presents summaries of major findings, the conclusions and the possible recommendations.

CHAPTER 2: LITERATURE REVIEW

This chapter reviews the existing literature on credit risk, credit risk management policy, and credit risk management. The chapter presents theoretical, conceptual and empirical literature and provides highlight on the history of Awash Bank along the key constructs in the study.

2.1. Risk and Banking Risks

Risk is defined in multiple ways. Risks in banking business, risks in trading activities, risks in our normal life or whatever kind of risks are what potentially happen sometime in the future and will have unexpected impacts on risk recipients. The banking business, compared to other types of business, is substantially exposed to risks, especially in this ever-changing competitive environment. Banks no longer simply receive deposits and make loans. Instead, they are operating in a rapidly innovative industry with a lot of profit pressure that urges them to create more and more value-added services to offer to and better satisfy the customers. Risks are much more complex now since one single activity can involve several risks (Lalon, 2015).

2.2. Bank credit risk and risk management

According to Tsai et al (2016), credit risk has been the most important management issue to banks. The quality of credit risk management, good or bad, matters a lot to banks which absorb the financial risks in exchange of benefits as their essence of business. In credit risk, the borrower or the business counterparties are unable to fulfill the duty of their contracts out of the deterioration and other factors from the entrepreneurs (such as entanglement between firms); therefore this causes the risk of agreement violation and the loss of money.

Generally, from different contexts and behaviors, the credit risk could be divided into two types: lending risk, also called, issuer risk and counterparty risk. Lending risk is due to the violation of agreement when borrowers or bond issuers do not repay their debts or their credits get deteriorated, causing the money loss. Lending risk or issuer risk are often correlated to borrowers and bond issuers' debt credit situations, and correlated to the risk sensitiveness degree of the financial products. The second credit risk is counterparty risk; it could be further divided into two risks: settlement risk and pre-settlement risk. Settlement risk is the risk that counterparties do not fulfill their contract duties in the due settlement time and cause the loss of the equality principal to the bank. Pre-settlement risk is the risk that counterparties violate the agreement before the final settlement day and cause the risk of contract violation to the bank (Tsai et al, 2016).

Managing credit risk is a fundamental component in the safe and sound management of all licensed financial institutions. Sound credit risk management involves prudently managing the risk/reward relationship and controlling and minimizing credit risks across a variety of dimensions, such as quality, concentration, currency, maturity, security and type of credit facility (Bank of Jamaica, 2005).

Although the particulars of credit risk management will differ among institutions depending upon the nature and complexity of their credit functions and portfolios, a comprehensive credit risk management program requires identifying existing or potential credit risks to which the institution is exposed in conducting its business activities and developing and implementing sound and prudent credit policies to effectively manage and control these risks; developing and implementing effective credit granting, documentation and collection processes; and developing and implementing comprehensive procedures to effectively monitor and control the nature, characteristics, and quality of the credit portfolio (Bank of Jamaica, 2005).

2.3. **Credit Risk Management Policies**

The foundation of an effective credit risk management program is the identification of the existing and potential risks inherent in an institution's credit products and credit activities, and

the development and implementation of clearly defined policies, formally established in writing, that set out the credit risk philosophy of the institution and the parameters under which credit risk is to be controlled. The credit risk philosophy is a statement of principles and objectives that outlines the institution's willingness to assume credit risk and will vary with the nature and complexity of its business, the extent of other risks assumed, its ability to absorb losses and the minimum expected return acceptable for a specific level of risk(The Bank of Jamaica, 2005).

Pressures for increased profitability, marketing considerations and a vastly more complex financial environment have resulted in innovative credit instruments and approaches to credit. Measuring the risks attached to each credit activity permits the determination of aggregate exposures to counterparties for control and reporting purposes, concentration limits and risk/reward returns. Credit policies establish the framework for lending and reflect an institution's credit culture and ethical standards. To be effective, policies must be communicated in a timely fashion, be implemented through all levels of the organization by appropriate procedures and revised periodically in light of changing circumstances (The Bank of Jamaica, 2005).

Credit policies need to contain, at a minimum: a credit risk philosophy governing the extent to which the institution is willing to assume credit risk; general areas of credit in which the institution is prepared to engage or is restricted from engaging; clearly defined and appropriate levels of delegation of approval, and provision or write-off authorities, and sound and prudent portfolio concentration limits.

Credit policies need to be developed and implemented within the context of a credit risk management environment that ensures that all credit dealings are conducted in the highest possible standard of ethical behavior (The Bank of Jamaica, 2005).

A similar explanation of credit policy is the one given by Kessey, (2015). Credit policy according to Kessey cover among others, the credit risk philosophy governing the extent to which the institution is willing to assume that risk. That is general areas of credit in which the institution is prepared to engage or is restricted from engaging. Again, credit policies establish the rules and framework for effective management operation of credit portfolio. Credit policies, if effectively implemented enable the financial institution to maintain sound credit underwriting standards. Also, it assists the institutions to assess, monitor and control credit risk. Again, it covers evaluation of new business opportunities, identify, administer and collect challenging credits. This implies that credit policy framework for addressing risk has to be comprehensive.

2.4. The Credit Process

The credit process begins with a thorough analysis of the borrower's creditworthiness, or capacity and willingness to repay the loan (Bearing Point, 2006). The examiner should find an assessment by the credit officer of the borrower's current and expected financial condition; the borrower's ability to withstand adverse conditions or "stress"; the borrower's credit history and a positive correlation between historical and projected repayment capacity; the optimal loan structure, including loan amortization, covenants, reporting requirements the underwriting elements; collateral pledged by the borrower – amount, quality and liquidity; bank ability to realize the collateral under the worst case scenario, and qualitative factors, such as management, the industry and the state of the economy.

This process begins with the collection, analysis and evaluation of information required to determine the creditworthiness of the borrower seeking credit from the bank. After the credit analysis is completed and borrower has been determined to be an acceptable risk, the credit officer proposes a loan structure for approval that preserves the strengths and protects against identified weaknesses of the borrower. The process ends with determination of a risk rating for the credit and loan approval (or rejection). The bank's credit policy, lending standards and procedures create the parameters for this process, thereby establishing the bank's appetite for risk, conservative or aggressive. The credit policy and standards should define acceptable loan purposes, types of loans and loan structures, and industries to which the bank is willing to lend, as well as the types of information the lender is required to obtain and analyze. The policy and standards help to create the framework, requirements and tolerance limits for lending in which all bank credit personnel will engage. The lender must understand the bank's credit risk management system and his/her role in it, as s/he engages in lending activities – analysis, underwriting and monitoring.

2.5. Principles for the Assessment of Banks' Management of Credit Risk

While financial institutions have faced difficulties over the years for a multitude of reasons, the major cause of serious banking problems continues to be directly related to lax credit standards for borrowers and counterparties, poor portfolio risk management, or a lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of a bank’s counterparties. Below are some of the principles for appropriate credit risk environment (Basel Committee on Banking Supervision, 2006).

2.5.1. Establishing an appropriate credit risk environment

Principle 1: The board of directors should have responsibility for approving and periodically (at least annually) reviewing the credit risk strategy and significant credit risk policies of the bank. The strategy should reflect the bank’s tolerance for risk and the level of profitability the bank expects to achieve for incurring various credit risks.

Principle 2: Senior management should have responsibility for implementing the credit risk strategy approved by the board of directors and for developing policies and procedures for identifying, measuring, monitoring and controlling credit risk. Such policies and procedures should address credit risk in all of the bank’s activities and at both the individual credit and portfolio levels.

Principle 3: Banks should identify and manage credit risk inherent in all products and activities. Banks should ensure that the risks of products and activities new to them are subject to adequate risk management procedures and controls before being introduced or undertaken, and approved in advance by the board of directors or its appropriate committee.

2.5.2. Operating under a sound credit granting process

Principle 4: Banks must operate within sound, well-defined credit-granting criteria. These criteria should include a clear indication of the bank’s target market and a thorough understanding of the borrower or counterparty, as well as the purpose and structure of the credit, and its source of repayment.

Establishing sound, well-defined credit-granting criteria is essential to approving credit in a safe and sound manner. The criteria should set out who is eligible for credit and for how much, what types of credit are available, and under what terms and conditions the credits should be granted.

Banks must receive sufficient information to enable a comprehensive assessment of the true risk profile of the borrower or counterparty. Depending on the type of credit exposure and the nature

of the credit relationship to date, the factors to be considered and documented in approving credits include the purpose of the credit and sources of repayment ; the current risk profile (including the nature and aggregate amounts of risks) of the borrower or counterparty and collateral and its sensitivity to economic and market developments; the borrower's repayment history and current capacity to repay, based on historical financial trends and future cash flow projections, under various scenarios; for commercial credits, the borrower's business expertise and the status of the borrower's economic sector and its position within that sector; the proposed terms and conditions of the credit, including covenants designed to limit changes in the future risk profile of the borrower; and where applicable, the adequacy and enforceability of collateral or guarantees, including under various scenarios.

In addition, in approving borrowers or counterparties for the first time, consideration should be given to the integrity and reputation of the borrower or counterparty as well as their legal capacity to assume the liability. Once credit-granting criteria have been established, it is essential for the bank to ensure that the information it receives is sufficient to make proper credit-granting decisions. This information will also serve as the basis for rating the credit under the bank's internal rating system.

Principle 5: Banks should establish overall credit limits at the level of individual borrowers and counterparties, and groups of connected counterparties that aggregate in a comparable and meaningful manner different types of exposures, both in the banking and trading book and on and off the balance sheet.

An important element of credit risk management is the establishment of exposure limits on single counterparties and groups of connected counterparties. Such limits are frequently based in part on the internal risk rating assigned to the borrower or counterparty, with counterparties assigned better risk ratings having potentially higher exposure limits. Limits should also be established for particular industries or economic sectors, geographic regions and specific products.

Exposure limits are needed in all areas of the bank's activities that involve credit risk. These limits help to ensure that the bank's credit-granting activities are adequately diversified. As mentioned earlier, much of the credit exposure faced by some banks comes from activities and instruments in the trading book and off the balance sheet. Limits on such transactions are particularly effective in managing the overall credit risk profile or counterparty risk of a bank. In order to be effective, limits should generally be binding and not driven by customer demand.

Effective measures of potential future exposure are essential for the establishment of meaningful limits, placing an upper bound on the overall scale of activity with, and exposure to, a given counterparty, based on a comparable measure of exposure across a bank's various activities (both on and off-balance-sheet).

Banks should consider the results of stress testing in the overall limit setting and monitoring process. Such stress testing should take into consideration economic cycles, interest rate and other market movements, and liquidity conditions. Bank's credit limits should recognise and reflect the risks associated with the near term liquidation of positions in the event of counterparty default.8 Where a bank has several transactions with a counterparty, its potential exposure to that counterparty is likely to vary significantly and discontinuously over the maturity over which it is calculated. Potential future exposures should therefore be calculated over multiple time horizons. Limits should also factor in any unsecured exposure in a liquidation scenario.

Principle 6: Banks should have a clearly-established process in place for approving new credits as well as the amendment, renewal and re-financing of existing credits.

Principle 7: All extensions of credit must be made on an arm's-length basis. In particular, credits to related companies and individuals must be authorized on an exception basis, monitored with particular care and other appropriate steps taken to control or mitigate the risks of non-arm's length lending.

2.5.3. Maintaining an appropriate credit administration, measurement and monitoring process

Principle 8: Banks should have in place a system for the ongoing administration of their various credit risk-bearing portfolios.

Credit administration is a critical element in maintaining the safety and soundness of a bank. Once a credit is granted, it is the responsibility of the business unit, often in conjunction with a credit administration support team, to ensure that the credit is properly maintained. This includes keeping the credit file up to date, obtaining current financial information, sending out renewal notices and preparing various documents such as loan agreements.

Given the wide range of responsibilities of the credit administration function, its organizational structure varies with the size and sophistication of the bank. In larger banks, responsibilities for the various components of credit administration are usually assigned to different departments. In smaller banks, a few individuals might handle several of the functional areas. Where individuals perform such sensitive functions as custody of key documents, wiring out funds, or entering limits into the computer database, they should report to managers who are independent of the business origination and credit approval processes. In developing their credit administration areas, banks should ensure the efficiency and effectiveness of credit administration operations, including monitoring documentation, contractual requirements, legal covenants, collateral, etc.; the accuracy and timeliness of information provided to management information systems; adequate segregation of duties; the adequacy of controls over all “back office” procedures; and

compliance with prescribed management policies and procedures as well as applicable laws and regulations.

For the various components of credit administration to function appropriately, senior management must understand and demonstrate that it recognizes the importance of this element of monitoring and controlling credit risk.

The credit files should include all of the information necessary to ascertain the current financial condition of the borrower or counterparty as well as sufficient information to track the decisions made and the history of the credit. For example, the credit files should include current financial statements, financial analyses and internal rating documentation, internal memoranda, reference letters, and appraisals. The loan review function should determine that the credit files are complete and that all loan approvals and other necessary documents have been obtained.

Principle 9: Banks must have in place a system for monitoring the condition of individual credits, including determining the adequacy of provisions and reserves.

Principle 10: Banks are encouraged to develop and utilize an internal risk rating system in managing credit risk. The rating system should be consistent with the nature, size and complexity of a bank’s activities.

Principle 11: Banks must have information systems and analytical techniques that enable management to measure the credit risk inherent in all on- and off-balance sheet activities. The management information system should provide adequate information on the composition of the credit portfolio, including identification of any concentrations of risk.

Principle 12: Banks must have in place a system for monitoring the overall composition and quality of the credit portfolio.

Principle 13: Banks should take into consideration potential future changes in economic conditions when assessing individual credits and their credit portfolios, and should assess their credit risk exposures under stressful conditions.

2.5.4. Ensuring adequate controls over credit risk

Principle 14: Banks must establish a system of independent, ongoing assessment of the bank's credit risk management processes and the results of such reviews should be communicated directly to the board of directors and senior management.

Principle 15: Banks must ensure that the credit-granting function is being properly managed and that credit exposures are within levels consistent with prudential standards and internal limits. Banks should establish and enforce internal controls and other practices to ensure that exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.

Principle 16: Banks must have a system in place for early remedial action on deteriorating credits, managing problem credits and similar workout situations.

2.5.5. The role of supervisors

Principle 17: Supervisors should require that banks have an effective system in place to identify, measure, monitor and control credit risk as part of an overall approach to risk management. Supervisors should conduct an independent evaluation of a bank's strategies, policies, procedures and practices related to the granting of credit and the ongoing management of the portfolio. Supervisors should consider setting prudential limits to restrict bank exposures to single borrowers or groups of connected counterparties.

2.6. Factors Influencing Effectiveness of Credit Risk Management practices

Loans that constitute a large proportion of the assets in most banks' portfolios are relatively illiquid and exhibit the highest credit risk (Koch and MacDonald, 2000). The theory of asymmetric information argues that it may be impossible to distinguish good borrowers from bad borrowers which may result in adverse selection and moral hazards problems. Adverse selection and moral hazards have led to substantial accumulation of non-performing accounts in banks (Bester, 2001).

2.6.1 Credit Risk Management Process

According to Basel (2004), the management of credit risk in banking industry follows the process of risk identification, measurement, assessment, monitoring and control. It involves identification of potential risk factors, estimate their consequences, monitor activities exposed to the identified risk factors and put in place control measures to prevent or reduce the undesirable effects. This process is applied within the strategic and operational framework of banks.

2.6.2 Risk – Adjusted Performance Measures

Several risk-adjusted performance measures have been proposed (Heffernan, 2002). The measures, however, focus on risk-return trade-off, which include measuring the risk inherent in each activity or product and charge it accordingly for the capital required to support it. This does not solve the issue of recovering loanable amount. Effective system that ensures repayment of loans by borrowers is critical in dealing with asymmetric information problems and in reducing the level of loan losses, thus the long-term success of any banking organization (Basel, 2004).

2.6.3 Credit Risk Management Practices

Effective credit management involves establishing an appropriate credit risk environment; operating under a sound credit granting process; maintaining an appropriate credit administration that involves monitoring process as well as adequate controls over credit risk (Basel, 2004). It requires top management to ensure that there are proper and clear guidelines in managing credit risk, that is, all guidelines are properly communicated throughout the organization; and that everybody involved in credit risk management understand them. Considerations that form the basis for sound credit risk management system include: policy and strategies (guidelines) that clearly outline the scope and allocation of a bank credit facilities and the manner in which a credit portfolio is managed, that is, how loans are originated, appraised, supervised and collected (Basel, 2004; PriceWaterhouse, 2001). Screening borrowers is an activity that has widely been recommended by, among others (Derban, Binner and Mullineux, 2005). The recommendation has been widely put to use in the banking sector in the form of credit assessment. According to the asymmetric information theory, a collection of reliable information from prospective borrowers becomes critical in accomplishing effective screening.

2.6.4 Assessment of Borrowers

The assessment of borrowers can be performed through the use of qualitative as well as quantitative techniques. One major challenge of using qualitative models is their subjective nature (Bryant, 2001). However, borrowers attributes assessed through qualitative models can be assigned numbers with the sum of the values compared to a threshold. This technique is termed as "credit scoring". The technique cannot only minimize processing costs but also reduce subjective judgments and possible biases (Bluhm, Overbeck and Wagner, 2003). The rating systems if meaningful should signal changes in expected level of loan loss. Chijoriga (2000) concluded that quantitative models make it possible to, among others, numerically establish which factors are important in explaining default risk, evaluate the relative degree of importance of the factors, improve the pricing of default risk, be more able to screen out bad loan applicants and be in a better position to calculate any reserve needed to meet expected future loan losses.

2.6.5 Clearly Established Credit Approval Process

Clearly established process for approving new credits and extending the existing credits has been observed to be very important while managing credit risk (Heffernan, 2002). Further, monitoring of borrowers is important as current and potential exposures change with both the passage of time and the movements in the underlying variables and are also very important in dealing with moral hazard problem (Derban *et al.*, 2005).

Monitoring involves, among others, frequent contact with borrowers, creating an environment that the bank can be seen as a solver of problems and trusted adviser; develop the culture of being supportive to borrowers whenever they are recognized to be in difficulties and are striving to deal with the situation; monitoring the flow of borrower's business through the bank's account; regular review of the borrower's reports as well as an on-site visit; updating borrowers credit files and periodically reviewing the borrowers rating assigned at the time the credit was granted (Donaldson, 2000).

2.6.6 Credit Management Tools

Tools like covenants, collateral, credit rationing, loan securitization and loan syndication have been used by banks in developing the world in controlling credit losses (Greenbaum and Thakor, 2000).

2.6.7 Credit Management Staff and Information Technology

It has also been observed that high-quality credit management staffs are critical to ensure that the depth of knowledge and judgment needed is always available, thus successfully managing the credit in the bank (Koford and Tschoegl, 2001).

2.7. Empirical evidence of the study

To date, a number of studies have been made on different aspects/issues of credit risk. Afande (2014), for instance, investigated the practice of credit risk management in commercial Banks of Kenya. The study disclosed that together with other strategies, commercial banks in Kenya make use of different credit risk management practices such as a thorough loan appraisal, asking for collateral and checking the credit history of the borrowers, credit rationing, loan securitization, and loan syndication.

A study by Kessey (2015) examined 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 also recommended that Bank's risk policies should be reviewed frequently.

Another study by Chen and Shuping (2012) on credit management of Commercial Banks of Lianyungang City for the small scale and medium enterprises (SMEs) also came up with its own finding.. 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, the study found out that commercial bank's liquidity performance was not as per 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 (2010) investigated Credit Management on Wogagen Banks. The main objective of the study was 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 (2009) investigated the newly emerging challenges in credit risk management process that commercial banks encounter in Ethiopia.

2.8. Summary of the Literature

The chapter reviewed literature on a wide range of issues concerning credit risk management. It begun by discussing the theoretical concept of credit and credit risk. Subsequently, literature on credit risk management was explored to bring the main issues to the fore. On top of this, both local and overseas empirical literature where also reviewed which are related with the concept of credit risk management.

CHAPTER 3: RESEARCH METHODOLOGY

This chapter deals with the research methodology of the study. Research design and approach, sources of data, sample size and sampling techniques, data collection instruments, ethical considerations, and data analysis techniques are discussed.

3.1 Research Design and Approach

The study used a quantitative approach employing descriptive and cross sectional research design in order to gather quantitative data. Descriptive study is undertaken in order to ascertain and be able to describe the characteristics of the variables of interest in a situation. Descriptive research is concerned with conditions or relationships that exist; practices that prevail; beliefs, points of views, or attitudes that are held; processes that are going on; effects that are being felt; or trends that are developing. The main objective of descriptive research is to analyze the state of affairs as it prevails at the time of the study (Bramble, 1997). In this view, taking the Ethiopian National Bank credit risk management guideline as a bench mark descriptive research will help to analyze the existing credit risk management policy and practice of Awash Bank.

3.2. Population, Sample Size and Sampling Technique

Population refers to the entire group of people, events, or things of interest that the researcher wishes to investigate. The population of the study was all credit analysts and supervisors who are working in Addis Ababa in four regional areas (i.e. south, north, west and east) and head office central processing center and all Grade 1-3 branch managers in Addis Ababa city which are undertaking loan were taken as samples. Specifically, managers, supervisors, and at head office those who are specifically concerned with credit risk were taken as samples. The reason for using purposive sample is that collecting data from relevant population, who are directly undertaking tasks related to the issue, help to get valid and relevant data in relation to the theme of the research. In empirical research, study of sample of a population rather than the entire population may produce reliable results in specific contexts (Bramble, 1997). Thus, the collection of the primary data was made from employees and managers specifically concerned with credit risk at branches, regional offices and head office (central processing center) of the Bank.

Awash bank has 316 branches as at June 30, 2017 across the country (Annual report,2016/17) out of which 142 branches were found in Addis Ababa . The branches have five grades based on the deposit mobilized, loan and advances granted and on their profitability. The grades of the branch are Special grade branch (highest grade), Class 1 branch (2nd highest), Class 2 branch (3rd highest), Class 3 branch (4th highest) branches and t Class 4th branch (last or new branch)

The targeted population for the study was 87 which include 42 branch managers of grade 1 up to 3 and 25 credit analysts and supervisors and the rest 20 were Head office staffs from different departments and relationship managers

3.3. Data collection method

As the study is quantitative, the researcher relied on quantitative data which were collected from employees of the bank who are directly concerned (involved) in credit management process. Secondary data were also collected from published annual reports of the Bank

Questionnaire

Questionnaire with structured items (questions) was designed to collect the quantitative data. Items for the questionnaire were identified from literature and prior studies on the similar theme. . The questionnaire has both dichotomous items (yes/no) and a five point Likert scale with some open-ended questions. The questionnaire was also made to have brief open questions which were used to obtain short and precise responses from the respondents.

Document Analysis

Secondary data were collected from published annual report of the Bank. Specifically, data regarding the non-performing loan (NPL) of the Bank is taken from annual report of the Bank, that of June 2017.

3.4. Validity and Reliability: To test the validity and reliability of the questionnaires, 25 questionnaires were distributed to pilot respondents and reliability was computed based on the data. The computed reliability of the questionnaire is 0.87. This reliability value indicates that the instrument is acceptable for final data collection. Comments from the advisor were also used to check the validity of the questionnaire.

3.5. Data Collection Procedure

After the questionnaire was pilot tested and reliability determined, it was duplicated and distributed to sampled participants. Respondents were oriented about the purpose of the study and were requested to return it back on the next day. Based on the agreement, respondents returned the questionnaire on date.

3.6. Ethical Issues

Informed consent of the respondents was obtained from research participants. The information collected from the respondents through questionnaires and was treated with strict confidentiality. To keep anonymity of the respondents, they were asked not to write their name. The secondary data used in the research was taken from official published and unpublished sources of the Bank.

3.7. Data Analysis

Based on the research questions of the study, a questionnaire and document analysis were employed to collect data. After the data were collected from the sample using the specified instrument, analysis was made to answer the research questions. Data analysis was done with SPSS software. Accordingly the primary data gathered through questionnaires was analyzed using descriptive statistics- frequency; percentage, mean and standard deviation were used for the data analysis.

CHAPTER FOUR: DATA PRESENTATION AND ANALYSIS

In this chapter, the data collected through questionnaire is presented and analyzed. The research questions were addressed by analyzing the data through descriptive statistics. Frequency, percentage, means and standard deviation were employed as data analysis technique.

The questionnaire was distributed to 87 employees of the Bank from credit office at different branches in Addis Ababa and from the Head Office. However, 10 respondents did not return the questionnaire and questionnaire. Thus, 77 questionnaires were finally used which is about 89.7% of the total distributed questionnaires. This response rate is fair enough to represent the sample.

4.1. Demographic characteristics of the respondents

The first section of the questionnaire comprised of questions about demographic information of the respondents. It covered sex, age, marital status, educational level and specialization, work experience and current position in the Bank. The subsequent tables show the demographic characteristics of the respondents.

Table 1: Summary of respondents' data by age and sex

Sex of respondents	Frequency	Percent
Male	61	79.2
Female	16	20.8
Total	77	100
Age of Respondents	**Frequency**	**Percent**
18-25 years	1	1.3
26-35 years	48	62.3
36-40 years	21	27.3
More than 40 years	7	9.1
Total	77	100.0

Source: Questionnaire Results, 2018

As shown in Table 1 above, majority of the respondents (79.2%) are males. Only 20.8 % of the participants are females. This may imply that few female applicants join the Bank or those qualified for the position in the job market are not adequately available. As to the age of participants, majority of the respondents (i.e. 62.3%) are in the age range 26- 35 years (see Table 1 above). This implies that the Bank's credit related staff is generally young. Young people are most often energetic at work place and it is easy to these staff to adapt themselves with technology and such behavior benefits the Bank. However, youth are also highly disposed to turnover as they are not easily settled in one organization which adversely affects the bank's performance as human power is the most valuable resource in any institution.

Another demographic variable about respondents is their educational qualification. Educational qualification is an important variable of interest about participants. It indicates to what extent credit unit of the Bank is staffed by qualified employees. The result is presented in Table 2 below.

Table 2: Educational level of respondents

Educational Status of Respondents	Frequency	Percent
Diploma	1	1.3
BSC/BA	61	79.2
MSc/MA	15	19.5
PhD	0	0.00
Other	0	0.00
Total	77	100.0

Source: Questionnaire Results,2018

As shown in Table 2 above, majority of the staff of Awash Bank who work on credit and credit related matter (i.e. 79.2%) holds their first degree and 19.5% of them have second degree. Only 1.3% of them hold diploma. Generally, the result regarding credit staff's qualification shows that the Bank is in a good position in terms of the educational qualification of the credit staff.

The policy of the Bank requires educational level of first degree and above for the position of credit risk management and managerial positions. The data shows that 94. 8% of them holds their first degree and above.

This implies that the qualification of the credit unit staff suffice the expected profile of the Bank. Qualified staff is expected to deal with credit risk and related cases more professionally than less qualified or unqualified staff. The present finding is consistent with other studies (Alebachew, 2015; Afande.2014).

The specialization and current position of the participants of the study were also explored. The result is presented in Table 3 below.

Table 3: Specialization and current position of respondents

Specialization and current position of respondents	Frequency	Percent
Accounting	41	53.2
Management	24	31.2
Economic	8	10.4
Public administration	4	5.2
Total	77	100.0
branch manager	40	51.9
credit analyst	23	29.9
Supervisor	5	6.5
relationship manager	7	9.1
senior portfolio analyst	1	1.3
senior credit analyst	1	1.3
Total	77	100.0

Source: Questionnaire Results, 2018

As indicated in Table 3 above, majority of Awash Bank credit staff are specialized in accounting (53.2%). This is followed by management (31.2%). The least number in terms of specialization among the respondents is public administration (5.2%). Respondent were also asked about their current position. The result indicates that 51.9 % of the respondents are branch managers. This is followed by credit analyst (29.9 %). The least numbers are relationship manager (9.1%), supervisor (6.5%) senior portfolio analyst (1.3 %) and senior credit analyst (1.3%). The specialization of participants indicates that majority have the training on accounting. This implies that respondents have relevant knowledge and skill in relation to credit risk management and this helps the workers to be effective in their assigned position. Other studies also indicate that credit risk management staff require qualification related to their job, where accounting is one of such fields (Alebachew, 2015; Das &Das, 2007; Hagos,2010)

Demographic information about respondents' marital status and work experience were also analysed. Participants' responses regarding these variables are presented in Table 4 below.

Table 4: Marital status and work experience of respondents

Marital Status	**Frequency**	**Percent**
Married	44	57.1
Single	32	41.6
Divorced	1	1.3
Total	77	100.0
Work experience of Respondents	**Frequency**	**Percent**
Less than 2 years	0	0.0
2-5 years	8	10.4
6-10 years	25	32.5
More than 10 years	44	57.1
Total	77	100.0

Source: Questionnaire Results, 2018

As presented in the above table, a greater proportion of the respondents are married (57.1%).The remaining 41.6% are single. Only a very small number (1.3%) of the respondents are divorced. Being married lessens employees' mobility and may imply greater probability of stability. In line with this a significant proportion of the respondents being single may affect stability of the staff. Single employees often aspire better payments and most often shift their jobs as compared the married ones.

The respondents' work experience shows that majority of them (i.e. 57.1%) have work experience of more than 10 years, whereas 32.5% of respondents have an experience between 6-10 years. Overall, above 89.6% of the respondents have work experience above 2 years. A reasonable experience is an opportunity to get adapted to the work and become more skilled in the job.

From the present finding, it can be inferred that respondents were good enough in revealing accurate information about the issues under investigation. Due to their experience, respondents came across many credit risk exposure. This might have helped them to clearly understand the current credit experience. Other studies similarly stress the importance of the experience of credit staff (Das &Das, 2007; Hagos, 2010).

4.2. Credit risk Management Policies and Practice of Awash Bank

Credit risk management and control is of crucial importance in ensuring that Awash Bank holds adequate capital against the risks involved in the business and the potential losses on incurred risks. Below are the findings related to the policy and practice of the Bank.

4.2.1. Existence of Policy, Manuals and Strategies

The first research question of the study attempted to assess the procedures/system employed by Awash Bank to manage credit risk. In line with this the study first assessed the existence of credit management policy, manuals and strategies that guide credit management of the Bank. Participants' responses in relation to this issue are presented in Table 5 below.

Table 5: Existence of Policy, Manuals and Strategies

Existence of policy, manuals and strategies	Yes		No	
	Frequency	Percent	Frequency	Percent
Awash Bank has a well-documented credit risk management policy	75	97.4	2	2.6
Awash bank has credit manual that documents and elaborates the strategies for managing credit	76	98.7	1	1.3
Awash Bank has strategies for granting credits at the branch and corporate division levels while assessing borrowers	62	80.5	15	19.5

Source: Questionnaire Results, 2018

As shown in Table 5 above, almost all the respondents replied that Awash Bank has a well-documented credit risk management policy that elaborates the products offered and all activities that have to be performed to manage credit risk. Only 2 respondents (2.6%) replied that the Bank has no policy. Similarly, except one respondent (1.3%), all other participants of the study indicated that Awash Bank has a credit manual that elaborates the strategies for managing credit risk. For the question "Does Awash Bank has strategies for granting credits?" a greater proportion (80.5%) indicated that the Bank has such strategy which focuses on who, how and what should be done at the branch and corporate division levels while assessing borrowers. The remaining 19.5%, however, replied that the Bank has no strategy for granting credits. The existence of credit policy and manual implies that all relevant personnel are accountable for complying with the established policies and procedures. This also assists the Bank to easily approve new credits as well as make amendment, renewal and re-financing of existing credits. Several studies unanimously indicate the importance of well documented policy and strategy for managing credit risk (Das &Das, 2007; Hagos, 2010 and Afande.2014).

4.2.2. Loan Appraisal and Approval Process

Among other factors, good principle of credit risk management requires thorough loan appraisal which includes asking borrowers' capacity, requesting for collateral and checking the credit history of the borrowers. In relation to such practice of credit risk management, the study examined factors that are considered important in loan appraisal and subsequent approval process. Respondents' answers are presented in Table 6 below.

Table 6: Loan Appraisal and Approval Process

Loan Appraisal and Approval Process in Awash Bank	N	Mean	Standard Deviation
Borrower's capacity	77	4.6316	.64997
Borrower's character	77	4.5584	.76937
Borrower's condition	77	4.5455	.80370
Borrower's credit history	77	4.2727	.82137
Borrower's collateral	77	4.2468	.96185

Source: Questionnaire Results, 2018

Table 6 above shows the responses of participants related to factors considered important in loan appraisal and subsequent approval process. Specifically, borrower's capacity, character, condition, credit history and asking for collateral are stressed. Mean results indicate that all the above factors are rated as important and are considered in the loan appraisal and approval process. Obtained mean results for all items are greater than the expected mean (3.00). This implies that Awash Bank considers all the above factors: borrower's capacity, character, condition, credit history and asking for collateral in order to appraise and approve loan. Knowing the purpose of the loan and the primary source of repayment, borrower's repayment history and current capacity to repay helps the Bank to have information how borrowers intend to repay the loan and the probability of successful repayment of the loan which further assist for proper loan sanction. This finding is consistent with other studies (Alebachew, 2015; Afande.2014)

With a structured open question participants were also asked to narrate the lending process of the Bank, steps involved, and undertaken by who and how? Almost all the respondents have a similar response. Customers initially communicate the branch manager and submit the required documents with their application letter. The application includes information on the amount, loan tenure, mode of payment, its purpose and sometimes the proposed collateral. Based on the requested loan, the applicant is requested to fulfill basic and supportive documents relevant for the requested loan.

In the meantime, the branch or at head office collect (by the branch manager or relation officer) required documents on the bank's side i.e. collateral estimation document if the offered collateral is building, credit information report from NBE and due diligence report. The analysis and appraisal will be done at regional offices if the requested loan is five million or less and the collateral is building. If the requested loan is other than building collateral and the amount is above five million the analysis will be made at central processing center. Following this step, the analysis and appraisal report is presented by the credit analyst for the respective credit committee as per their discretionary limit to get approval.

Up on approval of the loan, the approved loan file will be returned to the branch for disbursement. Before disbursement, the collateral is registered, loan contract and mortgage contracts are signed and the collateral will also be covered by relevant insurance policy and other preconditions set by the credit committee will be fulfilled before the disbursement. Finally, collection and follow up activity is done at the branch by the branch manager or relation officer, at regional office and at head office by follow-up and relationship officer.

4.2.3. Credit risk controlling tools

In the Banking industry, different tools like covenants, collateral, credit rationing, loan securitization and loan syndication are often used in controlling credit losses. In the present study, participants were asked the extent to which these tools were utilized by Awash Bank.

Responses of respondents are presented in Table 7 below

Table 7: Credit Risks Controlling Tools

Credit Risks Controlling Tools	N	Mean	Standard Deviation
Collateral	77	4.5714	.81803
Loan securitization	77	3.6883	1.16144
Covenants	77	3.5974	1.16144
Credit rationing	77	3.5325	1.11903
Loan syndication	77	3.1447	1.32367

Source: *Questionnaire Results, 2018*

As presented in Table 7 above, the findings show that except one item, loan syndication(mean = 3.1447) all the other tools were rated as high with means 3.5 and above and all the other tools were rated as important in controlling credit losses. Mean values indicate that collateral is rated the highest (4.57). The least rated tool is loan syndication (3.14). This implies that except one tool, loan syndication, all the above tools are utilized by Awash Bank as they are important in controlling credit risk. Regarding the activities that the Bank undertakes to monitor credit, respondents were asked to rate tools which are important in monitoring credit on a five point scale ranging from not at all to very much. Participants' responses to these items are presented in Table 8 below.

Table 8: Credit Risks Monitoring Tools

Credit Risks Monitoring Tools	N	Mean	Standard Deviation
Frequent contact with borrowers	77	3.8312	.93756
Serving as solver of problems and trusted advisor	77	3.8312	1.03113
Development of a culture of being supportive to borrowers	77	3.6753	.96575
Monitoring the flow of borrower's business	77	3.5325	1.08318
Regular review of borrowers reports as well as an onsite visit	77	3.4805	1.10751
Updating borrowers credit files and periodically reviewing the borrowers rating	77	3.3117	1.11520

Source: Questionnaire Results, 2018

As presented in Table 8 above, the mean results for each of the items exceed the expected mean (3.00). Frequent contact with borrowers is rated highest with mean score of 3.83. This is followed by creating an environment that the bank can be seen as a solver of problems and trusted advisor. Updating borrower's credit files and periodically reviewing the borrowers rating; development of the culture of being supportive to borrowers, and striving to deal with the situation, monitoring the flow of borrower's business through the bank's account, and regular review of borrowers reports as well as an onsite visit. The findings indicate that all the above tools are used by the Bank in order to control credit risk. Another important issue of interest in the present research was to identify factors that influence the effectiveness of credit risk management. The finding is presented in Table 9 below.

Table 9: Attributes of Credit Risk Management Effectiveness

Attributes of Credit Risk Management Effectiveness	N	Mean	Standard Deviation
Policy and strategies (guidelines) outline the scope and allocation of bank credit facilities	77	4.2468	.67191
Policy incorporates credit risks inherent in all products and activities on which the Bank is engaged in	77	4.1818	.91374
Credit administration involves monitoring process as well as adequate control over credit	77	4.1688	.73274
Management supports to ensure that there are proper and clear guidelines in managing credit	77	4.1558	.67013
Credit approval is made in accordance with the Bank's written guideline and granted by the appropriate level of management	77	3.9740	.76044
Credit risk management guidelines are communicated throughout the organization and everybody involved in credit risk management	77	3.5974	.84697
Reliable information is collected from prospective borrowers in accomplishing effective screening	77	3.5325	.91168
The Bank has high quality staff with required depth of knowledge	77	3.5065	1.09573
Monitoring of borrowers change with the passage of time and the movements in the underlying variables	77	3.4805	.82095
Supportive technologies and equipment are utilized in credit analysis, monitoring and control	77	2.9740	1.11183

Source: Questionnaire Results, 2018

As presented in Table 9 above except one item: Supportive technologies and equipment are utilized in credit analysis, monitoring and control, with mean value of 2.9740, all other factors are considered as important and they are considered important in the credit risk management of the Bank.

Studies indicate that top management support is required to ensure that there are proper and clear guidelines in managing credit; all credit risk management guidelines should also be properly communicated throughout the Bank and everybody involved in credit risk management should understand them; collection of reliable information collected from prospective borrowers is critical in accomplishing effective screening; highly quality staff are critical to ensure that the depth of knowledge and judgment needed is always available; monitoring of borrowers is very important as current and potential exposures change with both the passage of time and the movements in the underlying variables and also very important in dealing with moral hazard problem; and supportive technologies and equipment such as computers are useful in credit analysis, monitoring and control, as they make it easy to keep track on trend of credits within the portfolio.

Considerations that form the basis for sound credit risk management system include: policy and strategies (guidelines) that clearly outline the scope and allocation of a bank credit facilities and the manner in which a credit portfolio is managed, i.e. how loans are originated, appraised, supervised and collected Regarding the quality and comprehensiveness of credit policy of the Bank, participants were asked 6 questions. Their responses are presented in Table 10 below.

Table 10: Comprehensiveness of Credit Policy of the Bank

Credit policy of the Bank	N	Mean	Standard Deviation
Awash Bank credit policy incorporates credit risk philosophy governing the extent to which the bank is willing to assume credit risk	77	4.3816	.67265
Awash Bank credit policy explicitly indicates general areas of credit in which the bank is prepared to engage or is restricted from engaging	77	4.0390	.75117
The credit policy of the Bank clearly defines appropriate levels of delegation of approval, and provision or write-off authorities	77	4.0260	.79429
The Bank's credit policy incorporate sound and practical credit portfolio concentration limits	77	3.8442	.85939
The credit policy place exposure limits on single counter parties and groups of associated counter parties	77	3.8182	.85420
The credit policy states diversification of key industries or economic sectors, geographical regions and new or existing products	77	3.6494	.99692

Source: Questionnaire Results, 2018

As shown in Table 10 above all the items about credit policy of the Bank have mean value greater than the expected mean (3.00). This implies that the Bank has a credit policy that incorporates credit risk philosophy which governs the extent to which the bank is willing to assume credit risk. The existing credit policy of the Bank also explicitly indicates the general areas of credit in which the bank is prepared to engage or is restricted from engaging. The Bank policy defines appropriate levels of delegation of approval, and provision or write- off authorities. Similarly the Bank policy incorporate sound and practical credit portfolio concentration limits and the policy places exposure limits on single counter parties and groups of associated counter parties. The credit policy also states diversification of key industries or economic sectors, geographical regions and new or existing products.

The findings indicate that starting from borrowers' appraisal to approval of loan; Awash Bank employs the guidelines developed by the Bank. The Bank also uses different tools to control credit losses. The Bank undertakes different monitoring mechanisms to monitor borrowers. However, examination of the non-performing loan (NPL) of the Bank indicates that as of June 2017, from the total loans and advance disbursed amount of Birr 22.6 billion, 354 million Birr or 1.6% is under the category of NPL. Though the NPL ratio of the Bank is below the required level of NBE (i.e. 5%), as presented in the table below there is no improvement of NPL amount in the past three consecutive years (Awash Bank Annual reports, 2017). This may imply that though the Bank has policy and guidelines, these policy and guidelines may not implemented as expected because of the dynamic nature of credit and credit risk.

Table 11: NPL in the past three consecutive years of Awash Bank

Description	**Fiscal Year**			
	2016/17	**2015/16**	**2014/15**	**2013/14**
Outstanding loan and advances	22,576,339,241	15,450,777,367	12,482,040,953	9,176,359,926
NPL amount	354,420,133	245,456,000	184,650,000	260,157,285
Percentage	**1.6%**	**1.6%**	**1.5%**	**2.8%**

Source: Awash Bank Annual Report, 2017

CHAPTER 5: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1. Summary

The result obtained from questionnaire indicated that in terms of human resource, Awash Bank is in good stand. The Bank has young and qualified credit staff. Majority of the respondents (i.e. 62.3%) are in the age range 26- 35 years. A large number of the staff of Awash Bank who works on credit and credit related matter (i.e. 79.2%) holds their first degree and 19.5% of them have second degree. Generally, the result regarding credit staff's qualification shows that the Bank is in a good position in terms of the educational qualification of the credit staff. Other key findings of the study are:

- The bank has credit management policies, strategies and guidelines that guide the credit risk management process.
- The banks uses different credit risk management tools, techniques and assessment models to manage its credit risk, and that this has one main objective, i.e. to reduce the amount of loan default which is the principal cause of bank failures.
- Though the Bank has policy and guidelines, the policy and guidelines may not be implemented as expected. This is because there is no significant improvement of NPL amount in the past three consecutive years of the Bank.

5.2. Conclusion

As the results indicate, Awash Bank has young and qualified staff. Majority of the staff are also experienced. Young people are energetic at work place and it is easy to these staff to adapt themselves with technology and such behavior benefits the Bank. With the existing profile of the credit staff, together with other factors, there is a greater chance for the Bank to be profitable and will have low rate of non-performing loan.

However, this is not the case with the Bank. Thus, other factors such as salary, incentives, absence of conductive working environment and other external factors may explain why Awash Bank is not successful to the expected level. Better credit risk management results in better bank performance. Thus, it is very important that Awash bank should practice farsighted credit risk management and safeguard the assets of the banks and protect the investors' interests.

As mentioned above, majority of employees of the bank working in credit department are 1st and 2nd degree holders and are also experienced. With appropriate incentive and conducive working environment, the presence of young, qualified and experienced staff might enable 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.

5.3. Recommendations

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

- ✓ Noting the importance, attractive, convenient and flexible credit policy and procedure, in assisting loan creation and growth, the Bank"s top management need to periodically revise its credit policy and procedure incorporating the feedback of clients and employees;
- ✓ In some cases, the Bank's loan processing and approving procedure is conservative. This may retard the loan growth of the branches in particular and the Central Bank in general. As a result, 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 an important 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. This idea suggest that innovation on new ways of dealing with borrowers is necessary for banks to be able to recover their money; and
- ✓ Awash Bank need to strengthen its loan management process especially in monitoring its borrowers and probably come up with new ways of monitoring them.

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Appendix

ST. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES
MBA PROGRAM

Questionnaire

Dear respondent, the purpose of this questionnaire is to collect data for a study aimed at assessing the credit risk management policies and practices of Awash Bank. The outcome of the study is expected to be useful to suggest possible solutions for problems identified related to the theme of the study. Your genuine answer is very important to the outcome of the research. The information collected through this questionnaire will only be used for academic purpose. Confidentiality of the responses of the participants' will be maintained and the participants' privacy would never be disclosed by any means at any stage of the study.

Thus, you are kindly requested to genuinely reply to all the questions below. Please use an (X) mark to respond to the questions and write the answer for blank item questions on the space provided.

Thank you in advance for your cooperation!

This Questionnaire has two parts. Part I contains Personal profile (Demographic characteristics of respondents) and Part II comprises of questions/items related to Banks' credit risk policies and credit risk management practices.

Part I: Personal Profile

1.1. Sex: Male_____ Female_______

1.2. Age: 18-25 yrs____ 26-35yrs____ 36-40 yrs___ more than 40yrs_____

1.3. Marital Status: Married ___________ Single __________Divorced__________

1.4. Educational Specialization ____________________

1.5. Educational Level: Diploma____ BS/BA _______MSc/MA_____ PhD____ Other_

1.6. Work experience in the Bank: Less than 2 year ___ 2 – 5 year____ 6- 10 year___ above 10 year____

1.7. What is your current position in Awash Bank __________________

2. Part II: Questions Related to Credit Policy and Credit Risk Management Practice:

Direction: The following items are designed to assess/ investigate the credit risk management policies and practices of Awash Bank. Please read each items/questions carefully and decide which answer/option is appropriate for you.

2.1. Does Awash Bank has a well-documented credit risk management policy that elaborates the products offered and all activities that have to be performed to manage the credit?

(a) Yes (b) No

2.2. Does Awash Bank has a credit manual that documents and elaborates the strategies for managing credit and they are formulated in compliance with the bank credit policy?

(a) Yes (b) No

2.3. Does Awash Bank have strategies for granting credits focus on who, how and what should be done at the branch and corporate division levels while assessing borrowers?

(a) Yes (b) No

2.4. Briefly explain the lending process of Awash Bank (Steps involved, undertaken by who and how)

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____

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2.5. **With respect to Awash Bank, please indicate the extent to which each of the following factors are considered important in loan appraisal and subsequent approval.**

S.N	**Factors considered important in loan appraisal and subsequent approval (the five Cs)**	**Not at all (1)**	**Somehow (2)**	**Neutral (3)**	**Much (4)**	**Very Much (5)**
1	Borrower's capacity					
2	Borrower's character					
3	Borrower's condition					
4	Borrower's credit history					
5	Borrower's collateral					
6	Other (Specify)	________________________________				

2.6. Please indicate the extent to which Awash Bank uses each of the tools Please indicate the extent to which Awash Bank uses each of the listed tools in controlling credit losses.

S.N	Tools for controlling credit losses	Not at all (1)	Neutral (2)	Somehow (3)	Much (4)	Very Much (5)
1	Covenants					
2	Collateral					
3	Credit rationing					
4	Loan securitization					
5	Loan syndication					
6	Others (specify)	______________________________				

2.7. **Please Indicate the Extent to which Awash Bank Undertakes Each of The Listed Activities with Regards to Monitoring of Borrowers.**

	Activities involved in monitoring of borrowers	Not at all (1)	Somehow (2)	Neutral(3)	Much (4)	Very Much (5)
1	Frequent contact with borrowers					
2	Creating an environment that the bank can be seen as a solver of problems and trusted advisor					
3	Development of the culture of being supportive to borrowers wherever they are recognized to be in difficulties and are striving to deal with the situation					
4	Monitoring the flow of borrower's business through the bank's account					
5	Regular review of borrowers reports as well as an onsite visit					
6	Updating borrowers credit files and periodically reviewing the borrowers rating assigned at the time the credit was granted					

2.8. Factors that influence effectiveness of a credit risk management system. With respect to Awash Bank please indicate the extent to which you agree/disagree that the following factors are considered important in influencing the effectiveness of a credit risk management system.

	Factors influencing the effectiveness of a credit risk management system	**Strongly disagree (1)**	**Disagree (2)**	**Somehow agree (3)**	**Agree (4)**	**Strongly agree (5)**
1	Appropriate credit environment is established through policy and strategies (guidelines) that clearly outline the scope and allocation of bank credit facilities					
2	Existing credit policy is made to incorporate credit risks inherent in all products and activities on which the Bank is engaged in					
3	An appropriate credit administration that involves monitoring process as well as adequate control over credit is maintained					
4	Top management supports to ensure that there are proper and clear guidelines in managing credit					
5	Credit approval made in accordance with the Bank’s written guideline and granted by the appropriate level of management					
6	All credit risk management guidelines are properly communicated throughout the organization and everybody involved in credit risk management understands them					
7	Reliable information is collected from prospective borrowers in accomplishing effective screening					
8	The Bank has high quality staff with required depth of knowledge					
9	Monitoring of borrowers change with the passage of time and the movements in the underlying variables					
10	Supportive technologies and equipment are utilized in credit analysis, monitoring and control to make the task easy and to keep track on trend of credits within the portfolio					

2.9. **Questions related to credit policy of the Bank**

S.N	**Specific Questions related to credit policy of the Bank**	**Strongly disagree (1)**	**Disagree (2)**	**Somehow agree (3)**	**Agree (4)**	**Strongly agree (5)**
1	The Bank's existing credit policy incorporate credit risk philosophy governing the extent to which the bank is willing to assume credit risk					
2	The existing credit policy of the Bank explicitly indicate general areas of credit in which the bank is prepared to engage or is restricted from engaging					
3	The credit policy of the Bank clearly defined appropriate levels of delegation of approval, and provision or write- off authorities					
4	The Bank's credit policy incorporate sound and prudent credit portfolio concentration limits					
5	The credit policy place exposure limits on single counter parties and groups of associated counter parties					
6	The credit policy states diversification of key industries or economic sectors, geographical regions and new or existing products					

Please write below if you have any additional comment in relation to the bank's credit risk management system: