ST.MARY'S UNIVERSITY

BUSINESS FACULITY

DEPARTMENT OF ACCOUNTING

CREDIT RISK APPRAISAL AND MANAGEMENT PRACTICE: THE CASE OF COMMERCIAL BANK OF ETHIOPIA

BY

GETANEH ZEMEDKUN

HALEFOM ABREHA

MERON KETEMA

JULY, 2014

SMU

ADDIS ABABA

CREDIT RISK APPRAISAL AND MANAGEMENT PRACTICE: THE CASE OF COMMERCIAL BANK OF ETHIOPIA

A SENIOR ESSAY SUBMITTED TO
THE DEPARTMENT OF ACCOUNTING
BUSINESS FACULTY
ST. MARY'S UNIVERSITY

IN PARCIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREE OF BACHELOR OF ARTS IN ACCOUNTING

BY
GETANEH ZEMEDKUN
HALEPHOM ABREHA
MERON KETEMA

JULY, 2014
SMU
ADDIS ABABA

TABLE OF CONTENT

ACKNOWLEDGEMENT

First and for most, my thanks goes to Almighty God without whom I could never have been what I am today.

Next, we would like to express our deepest gratitude to our advisor Ato Alula Hailu (MBA) who gave us a constructive advice throughout our work with full of patience.

Finally, CBE stuffs for their non stopping support to seeing successful paper preparation. To all my friends who helped us with everything they got to see finish what we have started.

To CBE bank employees who have been welcoming and so willing to answer my questions.

Abstract

Lending money is one of the most important functions of banks and the interest earned on advances makes up a large part of their income. Since most of the money which banks lend belongs to customer who have deposited in trust for them, utmost care should be taken to avoid risky lending. The key cause for bank failure is bad loans. Therefore, credit is both an attractive venture and a horrible nightmare for banks if they cannot minimize bad loans. Credit can take a bank up the ladder fast and can also throw it to the bottom of the ladder at an unbelievable speed if bad loans are not minimized.

The major intention of the study is to meet the objectives. The research will employ both primary and secondary data. Personal interview will be conducted with selected employees of the bank. As to the secondary data published and unpublished materials that include various books ,annual reports, credit policy manuals and publications will be consulted to bask up conceptual ground of the study.

The major elements of credit policy have eligibility criteria for every sector being financed by the bank and they contain the 5C's. The bank uses CRR (credit risk rating) as means of credit risk management practice, which is a system employed by the bank to differentiate the degree of credit risk in different credit exposure. Causes for the occurrence of credit risk are incomplete information, weakness in collateral arrangements, technical incompetence, the ability to analyze financial statements and to obtain and evaluate other credit information, lack of adequate supervision of old and familiar borrowers. The main reason for a loan to turnout bad is that borrowers do not use the fund for the purpose they had taken it for and reckless lending, collateral oriented loan assessment and poor credit follow up.

Statement of Declaration

This research is done on the topic the process of credit risk appraisal and management in case of Commercial Bank of Ethiopia. This research work is our own work. It is carried independently with the guidance and support of the research advisor.

Prepared By:	**Advisor**
Name: Getaneh Zemedkun	**Name:** Messele Getachew
Signature: _______________	**Signature:** _____________
Halephom Abreha	**Date:** June 7, 2012
Signature: _______________	
Meron Ketema	
Signature: _______________	
Date: June 7, 2012	

Acronym

NPL	Non Performing Loans
CAR	Capital Adequate Ratio
DTS	Domestic Trade Service
BOD	Board of Directors
CRR	Credit Risk Rating
CAFF	Credit Application Assessment Form
LAF	Loan Approval Form
5C’s	Character, Capacity, Capital, Collateral and Condition

CHAPTER ONE

1.1. BACKGROUND OF THE STUDY

Banks are one of the most important financial intermediaries whose primary function, as well as their reason of existence is to mobilize funds and pass them over or lend to those which need to finance businesses or projects. In other words, banks act as a bridge between those sections of society which save and those who seek to invest but do not have the financial means to do.

Because of their intermediary function, banks also serve as a vehicle for the economic and social development of a country. This is particularly true in the less developed countries like Ethiopia where capital markets are either under developed or virtually non-existent to meet the credit needs of society.

The term credit has been defined in many ways and by many writers. When analyses, however many of proposed definition are rather than definition of credit itself. To understand what credit is and what it does the following definition will be followed by Robert Cole, credit is a medium exchange of limited acceptance. Credit does have a particular characteristic that is created at the time of transaction and that arise for the purpose of facilitating that transaction. Banks have managed four types of risk to earn profits, for maximizing shareholders wealth, the risk are credit risk, interest rate risk, liquidity risk and operational risk credit. (Cole, 1992)

The assessment of the various risks that can impact on the repayment of loan is credit appraisal. Depending on the purpose of loan and the quantum, the appraisal process may be simple or elaborated. For small personal loans, credit scoring based on income, life style and existing liabilities may be enough. But for project financing the process comprises technical, commercial marketing appraised as also implementation schedule and ability. The credit appraisal management process of bank is believed to be a good indicator of the quality of the banks portfolio. (CBE Manual)

However, in this process of extending credit to customers, a bank should have a way of examining its borrowers so that it would minimize the risk of defaults. The effect of defaults is not limited to that of affecting the profits of one particular bank but it has a ripple effect that extends itself to the economy, at large. (Robert H. Cole, 2001)

As such, it is one of the greatest sources of the risk to bank's safety and soundness. The strength of the bank is also judged by the soundness of its advances. Commercial bank of Ethiopia as whole must have management practice to ensure its continued existence and well-being. These practices usually take the form of written and unwritten rules and regulations laid down by the society which provided. In order to make sure that, this short study tries to indicate credit risk appraisal and management practice is applied in Commercial bank of Ethiopia.

The important of credit in the banking industry can be seen position in the financial statements of banks. Loans are the most important asset in any commercial bank. Loans account for half to three quarter of the total value of all banks assets. In the competitive environment, more and more line of business, which a huge investments are being opened. Some of these huge investments are financed through commercial bank loans. With this respect, banks play a major role in the overall economic development of a country. (CBE 2011/12 Annual Report)

1.2. BACKGROUND OF THE ORGANIZATION

Commercial Bank of Ethiopia is the biggest bank in Ethiopia, established in 1942 pioneer to introduce modern bank to the country. The commercial Bank of Ethiopia has been playing a conspicuous role in economic development of the country for 70 years now. CBE was established to handle the national banking and commercial banking functions, respectively. In 1963 CBE was legally reestablished to take the commercial banking activities and to carry on all types of banking businesses.

In 1981-1993, in this period, CBE was in a monopoly era dominating the banking business all over the country. However, 1994-1998, this period was characterized by the country's shift from a command economy to market-oriented economy, due to a policy redirection. The new Banking proclamation, enacted in 1994, has created several new opportunities for the private sector to be involved in the banking sector.

The commercial Bank of Ethiopia has about birr 158.1 billion in assets, holding 120.1 billion in deposits and. As all June 30th 2012, total deposits stood at bill 158.1 billion asset and capital of the bank reached birr 150.4 billion and 7.6 billion respectively. The bank has 12,782 employees and 547 branches positioned in main cities and regional towns.

Credit risk appraisal and management is all about bringing together the effort, skill and success of individuals and organizations for collective efforts to facilitate the change and transformation within expected results.

In General, CBE, as a commercial bank plays financial intermediary roles by mobilizing funds from the surplus sector in the form of deposits and transferring them to the deficit sector by way of credit extension and investments.

1.3. STATEMENT OF THE PROBLEM

Today's companies are facing toughest competition to by doing a better job in order to satisfy the customer's expectations.

Providing credit is a major function of commercial banks. It is also one of the key mechanisms through which a lasting mutually beneficial relationship is established between banks and borrowers. According to the report of CBE Credit generates the lion's share of the "bread and butter" of commercial banks.

Therefore, it is a very attractive venture for banks viewed from the income side. However, it should also be noted that credit is also a risky venture for banks who essentially lend other people's money - depositors' money - to whom the banks have promised to pay their deposits on demand, a promise which must be fulfilled by banks without any ifs and buts. (National Bank, 2009)

Credit risk arises from the bank's dealing with or lending to corporate, individuals and other banks or financial institution. High credit risk will reduce earnings and capital, increase administration cost of the bank and induce liquidity problems affecting cash flow. That is why it is essential that managements focus much of its attention on managing the loans.

From day today observation & information gathered from staffs working in credit appraisal department it has different problems of processing loans of any size is considerable as assessment of potential borrowers, their repayment prospects and security; administration of outstanding loans, collecting from delinquent borrowers.

As a result this reduces their role in banks major activities and facing various challenges in banks credit risk management performance to be evaluated in context of applying credit policies and techniques achievement.

Commercial bank of Ethiopia conducts many researches and trainings based on the problem they face. Such incident makes the researchers to be interested to look the banks credit risk appraisal practice. Studying the credit risk appraisal and management practices of CBE's very helpful to find well organized effective practices.

This study also contributes data and fact generation on the subject of credit risk appraisal and management practice. Thus negative deviation can be enhanced through proper study of the banks practices.

In light to this, the study attempts to address the problem and find answers to the following research question:-

- What are the policies and control procedures for a credit risk?
- What problems are there in the credit follow –up of CBE?
- How effective is the preventive techniques?
- What possible approaches to minimize the non performing loan (NPL) in the loan portfolio of the bank?

1.4. OBJECTIVES OF THE STUDY

1.4.1 General objectives

The general objective of the study is to identify the process of credit risk appraisal and management practice of CBE.

1.4.2 Specific objectives

The Specific objectives of this study are:

- To identify the major problems on the credit appraisal and management practices of CBE.
- To assess the problems and challenges facing in policies of credit risk management practice.
- To assess the effectiveness to the techniques.
- To indicate different approaches that contributing minimizing of NPL.

1.5. SIGNIFICANCE OF THE STUDY

In light of the essence of the objectives it sets out to achieve, the study is a vital input for the improvement of the process of credit risk appraisal and management. It also enables the bank to review its credit management practices and comprehend the reasons behind it's ever NPL.

Furthermore the study can serve as:-

- A reference material for any interested reader on the subject
- To show the strong and the weak points in credit appraisal and management of CBE
- Provide a highlight to the needs to tackle credit risk appropriate credit appraisal techniques.

1.6. SCOPE OF THE STUDY

Poor loan quality is not the outcome of poor credit management alone. There are other factors that decline the quality of a loan, for example natural factors. However, the study does not focus on such issues and the study is only limited to asses' the credit risk appraisal and management practice aspects of the bank.

1.7. LIMITATION OF THE STUDY

The researchers know that bank's creditor's information is highly confidential and private lenders are reserved to reply for researchers need. The study might have some deviation from the existing situation because of some respondents' response reliability may have limited the comprehensiveness of the study.

1.8. RESEARCH DESIGN AND METHODOLOGY

1.8.1 Research Design

The strategy of this study examining on a particular study which credit risk appraisal and management practice in CBE. The study explores the problem in an interpretative view, using descriptive type of research. This method is appropriate to undertake this research because it allows collecting original data from the department and enable the researcher to observe processes and the actual practice.

This kind of research is utilized considering the desire of research to obtain first hand data from the respondents as to formulate rational and sound conclusion and recommendations for this study.

1.8.2 Population and sampling technique

In order to collect the relevant data required for the study, selected department heads, credit follow up and supervisors were considered as target population for this study. The purposive sampling method is used to select individuals from each category due to the accessibility of the pertinent and to have sufficient information's from designated staffs and relatives.

The sampling frame of the study is the list of all 52 workers in credit appraisal department, which was obtained from CBE human resource department. Since the study participants are 38 in number and selected participants are considered as an attempt to minimize the sampling error.

As the main focus for this paper explores credit risk appraisal management practice, it is rational to consider credit process clerical employees who are in head office as main focal area because more of the credit requests of CBE are now being processed in central Head Office. So in this Central office relevant employees are taken as samples for this study, selected techniques is purposive sampling techniques because the student researchers believe that is very important to distribute questioners and interviewed properly.

1.8.3 Type of data used & population sampling

The major intention of the study is to meet the objectives; the research involves both primary and secondary source of data. The primary data collected using questionnaires and interviews. To complement the questionnaires and interviews directors, supervisors, credit appraisal section staffs and other relatives are key focused informants.

As to the secondary data published and unpublished materials that include various Books, Annual reports, credit policy manuals and publication also consulted to back up the conceptual ground of the study.

1.8.4 Method of Data Collection

The researchers used an interview, questionnaires and examining of the company annual report and related information in order to complete the study.

Interview

Employees who are working in the organization interviewed by using structured interview especially the credit supervisors and managements of the credit appraisal department also interviewed.

Questionnaire

Relevant close-ended structured questionnaires are developed and administrated to 38 CBE credit appraisal department staffs, credit follow up supervisors and related stuffs working in the organization based on having data from human resource department.

1.8.5 Method of Data Analysis

As the research methodology is qualitative and quantitative in nature, i.e. descriptive elaborations discussions are employed to analyze the data. Simple data analysis techniques of the mean have been used to analyze the data. The information obtained from different source presented more in descriptive method.

Findings of the study are organized and analyzed in light of theoretical frameworks and best practices. Conclusion and recommendation based on data analysis techniques findings could enable management of the CBE to take the required action.

1.9. ORGANIZATION OF THE STUDY

The research comprises four chapters: the main in chapters one is to highlight what the research is all about and includes topics such as background of the study, statement of the problem, objectives of the study, and significances of the study, scope and limitation of the study, and Methodology of the study.

The second chapter, review of related literature, presents conceptual evidences on the study from the review of various literatures. Chapter three mainly deals with the analysis and explanation of relevant data. The findings of the study are supposed to be presented in this chapter. Chapter four focuses on the discussion of the conclusion and recommendation of the study.

CHAPTER TWO
RELATED LITERATURE REVIEW

In this chapter, previous works that are related and relevant to propose the study are reviewed. However, it seems appropriate to start with definition of credit risk.

2.1 Definition of credit risk

Banks make money by providing services that their customers want and by granting their credit. There are some risks with this services and the most significant risk is credit risk.

According to Paul (1999) credit risk is the risk of loss due to the financial weakness of the banks customer. Generally the customer will not be able to provide funds to settle its transaction, usually due to bankruptcy or some other liquidity crises. It also defines credit risk by another author as follows: it is the risk of loss arising from a borrower's or counterparty's inability to meet its obligations. (Paul, 1999)

2.2 The need of credit risk management

Banks play pivotal role in mobilizing saving. In doing so they face, risk arising from credit, interest rate, liquidity, exchange rate, transaction, compliance, strategic and reputation. Banks key challenge in managing risk in understanding the interrelation of this factors they may be positively or negatively corrected. To be consistent with the research, the focus here is on credit risk which is risk repayment, i.e. the possibility that an obligor will fail to perform as agreed. Banks lend to individuals, corporation and government who in turn contribute to growth, employment and better socio-economic condition. (LTTP:\\www.bis.org/publ/bcbs54.htm)

The goal of credit risk management is to maximize banks 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 transaction.

Banks should also consider the relationship between credit risk and other risks. The 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. For most banks, loans are the largest and most obvious sources of credit risk; however, other source of credit risk exist throughout the activities of a bank, including in the trading book, and both on and off the balance sheet. (LTTP:\\www.bis.org/publ/bcbs54.htm)

Banks are increasingly facing credit risk in various financial instruments other than loans, including acceptance, interbank transaction, trade financing, foreign exchange transaction, financial future, swap, bonds, equities, and options, and in the extension of commitments and guarantees, and settlement of transaction. The taking of credit risk is the principal function of banks. How a bank approaches credit risk represents one of its important polices. The willingness of banks to take credit risk has provided major services to a market economic throughout banking history.

A future particular instance of credit risk relates to the process of settling financial transactions. If one side transaction is settled but the other fails, a loss may be incurred that is equal to the principal amount of the transaction.

Even if one party is simply late in setting, then the other party may incur a loss relating to missed investment opportunities. Settlement risk (I.e. the risk that the completion of settlement of the financial transaction will fail to take place as expected) thus includes element of liquidity, market, operational and reputation risks as well as credit risk. The level of risk is determined by particular arrangements for settlement.

2.3 Importance of credit risk management

The importance of credit risk management for banking is tremendous. Bank and other finance institutions are often faced with risks that are mostly financial nature. These institutions must balance risk as well as returns. For a bank to have a large consumer base, it must offer loan products that are reasonable enough. However, if the interest rates in loan products are too low, the bank will suffer from losses. In terms of equity, a bank must have substantial amount of capital on its reserve, but not too much that it misses the investment revenue, and not too little that it leads itself to financial instability and to the risk of regulatory non-compliance. (http:\\EzineArticles.com\importance of credit risk management)

Credit risk management, in finance term, refers to the process of risk assessment that comes in an investment. Risk often comes in investing in the allocation of capital. The risk must be assessed so as to derive a sound investment decision. Likewise, the assessment of risk is also crucial incoming up with the position to balance risk and return.

Banks are constantly faced with risk. There are certain risks in the process of granting loans to certain client. There can be more risks involved if the loan is extended to unworthy debtors. Certain risk may also come when banks offer securities and other forms of investment.(http:\\EzineArticles.com\importance of credit risk management)

The risks of losses that result in default of payment of the debtors are a kind of risk that must be expected. Because of the exposure of banks to many risks, it is only reasonably for a bank to keep substantial amount of capital to protect its solvency and maintain its economic stability. The second Basel Accords provides statement of its rules regarding the regulations of the bank's capital allocation in the connection with the level of risks the bank is exposed to. The greater the bank is exposed to risks, the greater the amount of capital must be when it comes to its reserves, so as to maintain its solvency and stability. To determine the risks that come with lending and investment practices, banks must assess the risk. Credit risk management must play its role then to help banks in compliance with Basel II Accord and other regulatory bodies. (http:\\EzineArticles.com\importance of credit risk management)

To manage and assess the risk faced by banks, it is important to make certain estimates conduct monitoring and perform reviews of the performance of the bank. However, because banks are in to lending and investing practices, it is relevant to make reviews on loans and to scrutinize and analyze portfolios. Loan reviews and portfolios analysis are crucial then it determining the credit and investment risks. (http:\\EzineArticles.com\importance of credit risk management)

The complexity and emergence of various securities and derivatives is factor banks must be active in managing the risks. The credit risk management system used by many banks today has complexity; however, it can help in the assessment of risks by analyzing the credits and determining the probability of defaults and risks losses.

Credit risk management for banking is a very useful system, especially if their risks are in line with the survival of banks in the business world. (http:\\EzineArticles.com\importance of credit risk management)

2.4. Effect of Credit on Liquidation and Profit

The fundamental objective of bank management; as with other firms is to maximize share holders wealth or profit. This goal is typically interpreted to mean maximizing the market value of a firm's common stock. Wealth maximization in turn, require that managers evaluate the present value of cash managers evaluate the present value of cash flows under uncertainty with larger near term cash flows preferred when evaluated on term cash flows preferred when evaluated on a risk-adjusted basis (Koch, 1995).

Profit maximization differs from wealth maximization. To obtain higher yields, a bank must either take on increased risk or lower operating costs. Greater risk manifests itself in greater volatility of net income and market value of bank stock holders equity. Wealth maximization requires that the manager evaluate and balance the trade-off among the opportunities for higher returns, the probability that the bank might fail (Koch, 1995).

There are five fundamental risks that are faced by all banks according to timothy W. Koch

1. Credit Risk

Whenever a bank acquires an earning asset, it assumes the risk that the borrowers will default-that is not repaid the principal and interest on a timely basis. Credit risk is the potential variation in income and market value of equity resulting from this non-payment or delayed payment.

2. Liquidity Risk

Liquidity risk is the variation in net income and market value of equity caused by difficulty in obtaining cash at reasonable cost from either the sale of asset or new borrowings. Liquidity risk is greatest when bank cannot anticipate new loan demand or despite withdrawals and doesn't have access to new source of cash.

3. Interest Rate Risk

Interest rate risk refers to the potential variability in a bank's net interest income and market value of equity due to charged in level of market interest rate. It encompasses the total portfolio composition focusing on mismatched asset and liability maturities and durations as well as potential charges in interest rate.

4. Operational Risk

Operational risk refers to the possibilities that operating expenses might vary significantly from what is expected, producing a decline in net income and firm value. A bank operating risk is thus closely related to its burden number of division or subsidiaries and number of employees.

5. Capital or Solvency Risk

A bank that assumes too much risk can become insolvent and fail. Operationally, a failed Bank's cash inflows from debt service payments, new borrowing and asset sales are insufficient to meet mandatory cash out flows due to operating expense deposit withdraws, and maturing debt obligations capital risk closely associated with financial average which refers to use of debt and preferred stock that pay fixed rates as part of a firms capital structure. (Koch, 1995).

2.5. Approval and Review Process of Credit Administration

This committee reviews each steps of the credit analysis as presented by the loan officer and supporting analysis and makes collective decisions. Loan committees meet regularly to monitor the credit approval process and discussion asset quality problems in their arise. When required, the board of director or director's loan committee reviews this decision and grants final approval (Koch, 1995).

Once a loan has been approved, the officer notifies the borrower and prepares loan agreement. This agreement formality the purpose of the loan, the terms, repayment schedule collateral required and any loan covenants. It also estates what condition will constitute a default by the borrower. This condition may include later principal and interest payments, the sale of substantial assets a declaration of bankruptcy and breaking any restrictive loan covenant. The officer, checks that all loan documentation is present and in order. The borrower signs the agreement along with other guarantors, turns over collateral if necessary and receives the loan proceeds.

Customer's base credit administration consumer credit administration in today's credit based economy cannot be considered as specialized tool or as an isolated function. Instead customer based credit administration must continually and increasingly familiarized itself with the problems, procedures and possibilities of its credit function as an integral part of a company's total operations and as path to potential future profits. Experience, ability and education are essential in customer based administration. Opportunities in this field are increasing with the expanding economy and demands and standards of performance are raising simultaneous (Koch, 1995).

The administration of customer based credit activities involves the fundamental principles of administration found in all other types of operations (Iraein, 1997).

2.6 Principle of credit risk management

2.6.1 Establish an appropriate credit risk environment

Principle 1:

The board of directors should have responsibility for approving and periodically reviewing the credit risk strategy and significant credit risk policies of the banks. 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.

Principle 3:

Banks should identify and manage credit risk inherent in all product and activities. Bank should ensure that the risk of product and activities new to them are subject to adequate risk management procedures and controls before being introduced or under taken and approved in advance by the board of directors or its appropriate committee. (Frank, 2nd edition 1996, 121)

2.6.2 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 a though understanding of the borrower or counterparty, as well as the purpose and structure of the credit and its source of repayment.

Principle 5:

Banks should establish over all credit limits at the level of individuals borrowers and counter parties, and groups of connected counterparties that aggregate in a comparable and meaningful manner different type of exposure, both in the banking and trading book and on and off the balance sheet.

Principle 6:

Banks should have a clearly-established process in place for approving new amendments renewal and refinancing of existing credits.

Principle 7:

All extensions credit must be made on arm's-length basis. In particular, credits to related companies and individuals must be authorized on the exception basis, monitored with particular care and other appropriate steps taken to control the risks of connected lending. (Frank 1996:140)

2.6.3 Containing an appropriate credit administration

Measurement and monitoring principle

Principle 8:

Banks should have in a place the system for the ongoing administration of their various credit risks bearing portfolios.

Principle 9:

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

Principle 10:

Banks should develop and utilize internal risk rating systems in managing credit risk. The rating system should be consistent with the nature, size and complexity of bank's activities.

2.6.4 Ensuring adequate controls over credit risk

Principle 11:

Banks must establish a system of independent, ongoing assessment of the bank's credit risk management process and result of such review should be communicated directly to the board of directors and senior management.

Principle 12:

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

Principle 13:

Banks must have a system in which place for early remedial action on deteriorating credits, managing problem credit and similar workout procedures.

2.6.5 The rule of supervisor

Principle 14:

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 banks strategies, policies, procedures and practices related to the granting of credit and the ongoing management of portfolio. Supervisors should consider setting prudential limits to restrict bank exposure to single borrowers or group of connected counterparties.

2.7 Credit Risk Management Approach

Banks manage their credit risk. There are three approaches that are minimizing risk, price risk and the diversity of risk. The approaches require an ability to assess credit risk. The difference between the three approaches is the way assessments of risk are used by bank. (Herrick, 1990)

2.7.1 Minimal Risk Approach

The minimal risk approach to credit management attempts to separate loans, securities and other assets into two groups. The first group includes credit in which there is no reasonable doubt that the asset will redeemed at face value or in the case of equity investment no reasonable doubt that the investment will provide a significant return over a period of years.

A step outside this circle of knowledge and friends reduces the value of years of banking acquaintances in other established areas of business or government. Although the minimal risk approach has these important limitations, many banks have been very successful for many years following this policy of credit risk. (Herrick, 1990)

2.8.2 Price for risk approach

Risks pricing recently has developed as an alternative approach to credit risk. The risk approach looks at all degrees of risk as a normal part of the banking business. It views the assets of the bank loans, securities and investment in various shades of white and gray and accepts all of them as legitimate, worthwhile assets. Assets of greater credit risk involves greater risk of loss, but these assets are expected to priced to earn enough more interest income to offset their credit risk, a profit for a bank. Assets of little credit risk involve low risks of loss. These assets are expected to earn lower interest rates and also earn profit for a bank. If risk pricing is done properly, assets fall types of credit risk should show approximately the same profit to bank. (Herrick, 1990)

The risk pricing method reflects trends in banking during the banking during the past decade. First it has been a growing assurance among many banks that they possess the technical capabilities of assessing risk to a greater extent that did an earlier generation of bankers. New techniques have been applied to banking that do not an earlier generation ago. Computers have enabled banks to handle much greater quantities of information. Operations have opened new ways of analyzing information.

The second trend underlines the growth of risk pricing is the recent emphasis for banks to show strong earnings gains. Risk pricing opens the door to the major expansion in banking business. A large proportion of business that would be turned down on the basis of the minimum risk approach becomes choice bankable business. (Herrick, 1990)

2.8.3 Diversity of risk approach

Credit risk management often diversify a portfolio of loans, securities and investment simple, yet effective way of keeping problems of credit risk under control. However the approach is sometimes mistakenly used to justify taking greater individual credit risk or similar risk price. Premiums then otherwise would be justified, which is mistaken.

In fact, diversity can only partially control risk and it is not an approach to credit risk that can stand independently of other approaches to. For example if the credit department of a bank is covered by other departments, or is not well managed and low quality assets are acquired with no appreciable risk premium a program to diversity these assets would not eliminate their risk.

It would mean that the bank would hold a wide variety of low quality assets diversity permits the more fundamental approaches to credit risk minimal risk and risk pricing to be fulfilled in truer color. If reduced the likely hood that a random or accidental occurrence will have an appreciable effect on one of these fundamental polices.

A major practical problem in diversifying credit risk is determined what constitutes diversity. There are literally thousands of ways of classifying assets and a case could be made that many of the categories represent diversity on logical grounds. Yet to be effective, risk diversity requires relevant category and determination of relevant categories is not an easy matter. (Herrick, 1990:135)

2.8 Challenges of risk management

Risk management is relatively new field; many mangers may not be familiar with its principles and concepts lacking knowledge of the area, those managers are quite unlikely to include risk management considerations in their decision making.

Many important risk management concepts are not easily explained to mangers in other areas. Principles of profitability or the relationship between information and uncertainty may be challenging concept. Risk management also be frequently requires a different orientation towards time. (William Smith, 1998: 146)

Many important risk management issues require scientific knowledge on the part of the audience\and the communicator\ to fully appreciate the nature of the exposure to risk.

Attitudes towards risk are influenced by personal factors that may be unique to the individual; consequently the risk manger faces the challenge of communicating information that may be interpreted in different ways. (William Smith, 1998: 146)

2.10 Credit Follow-up

Credit follow-up is one of the main tasks of the branch managers, loan officers and the credit department of head office. It is imperative that the bank devises a system where by delinquent borrowers are convinced that they must repay their loans. To be constantly reminded of one's failure to liquidate an obligation and to settle debts requires an effort. This fact must be very carefully taken into consideration when dealing with borrowers. If one is careless in his attitude towards defaulters one can be assured that the customer will soon sense these weaknesses and take full advantage of it. So, in order to safeguard the bank's good relations with borrowers and, at the same time protect the bank's interest, one shall bear the following remarks in mind. (www.crfonline.org)

Effective Credit and Collection Policy

Effective credit management is about developing consistency in your credit and collection processes. This, in turn, will insure efficiency in your entire revenue cycle.

The secret to consistency is a thoughtfully designed and actively implemented credit and collection policy. Such a policy has power to breathe new life into your entire credit-to-cash process. Even if you already have a credit and collection policy, it's important to review it on a regular basis to assess its effectiveness. (www.crfonline.org)

Follow-up of Loans and Advances

One of the major tasks in credit handling is its follow-up part. Generally the bank in order to stand at "Healthy Credit Status" each credit request must be analyzed properly. Above all, right after each loan disbursement there should be no hesitation in the follow-up of delinquent loans and advances. Hence arrangements must be made by mangers and loan officers for allocating adequate time to make proper and sufficient follow-up.

Credit follow-up must be day to day activity of mangers and loan officers. Branches and credit department should adhere to the following approaches of credit follow-up.

At Branch Level

- If a borrower with a monthly or quarterly repayment schedule is in arrears for 30 days, he/she shall be reminded by telephone and a note must be kept in file for the action taken.
- If payment is not forthcoming in 60 days time, the branch must serve the first written reminder and pay a business visit. Report of the visit must be in file.
- The second reminder should be served on the 90th day if positive response is not received.
- The last reminder is to be served on the 120th day indicating that the case will be referred for foreclosure.
- Copy of all the reminders must be sent to the credit and risk management department.

At Head Office Level

Follow-up also will be carried out at Head Office Department and the tasks to be performed will include the following:

- The department will review all loans and advances of branches based on the monthly return of the branches and identify those loans and advances which have problems.
- The department should contact by telephone or in person directly or in consultation with the branches all borrowers which are in default for 90 days and above.
- The credit and risk management department is required to make site visit of the borrower and make final discussion before the case is transferred to foreclosure action.
- The credit and risk management department shall prepare every moth the statues of all non-performing loans and advances by branch and by age and present them to management credit committee every month.
- The report submitted to the credit and risk management department will be reviewed branch in the presence of the branch manager and loan officers. This will be communicated to the branch by credit department.
- Executive management credit committee will pass decision on each defaulting borrower or as a package. Such decision will be recorded and credit department is responsible for follow-up whether the decision has been complied with by the branch.

  Branches are strictly advised to follow the foregoing procedure effective from the date mentioned above. (National Bank of Ethiopia regulation, 2009)

2.10.1 Before Disbursement

After all the credit processing is completed and the loan is approved, a loan contract should be prepared and duly signed. The loan contract and the collateral offered should be registered before the loan is disbursed. The collateral held and registered should have a full insurance coverage.

Filling and documentation of relevant documents should be made in two parts depending on the importance of the document, which means customer lone file and safe custody documents.

2.10.2 After Disbursement of loans

- Follow-up whether the approved loan is used for the intended purpose or not.
- Review operation of customers account at least once a month.
- Identify early warning signals (on financial, management and banking relationship) and take remedial action.
- Notify applicants to submit renewal application ahead of the due date (a month before the due date)
- Frequent follow-up for renewal collateral insurance policy.
- Classifying loans and advances per the NBE (National Bank of Ethiopia) directive and give due attention based on their severity

2.10.3 Provisioning of Loans and Advances

As per NBE decision banks shall maintain provisions for non-performing loans and advances account which shall be created by charges to provision expense in the income statement and shall be maintained at a level adequate to absorb potential losses in the loans or advances portfolio.

In determining the adequacy of the provision for non-performing loans and advances account, provisions may be attributed to individual loans or advances or groups of loan and advance.

Banks shall maintain minimum provision percentage for each classification category in accordance with the relevant NBE directive.

Provisions on loans and advance are made every quarter of a fiscal year.

2.10.4 Classification of Loans and Advance

- In line with the characters issued by NBE, loans and advances should be regularly reviewed and classified in a manner consistent with regulatory standards.

- Loans or advances which are non-performing in accordance with contractual repayment terms are recognized and reported as past due in a manner consistent with regulatory standards.

Generally the directive classifies are made every quarter of fiscal year.

- **Pass:** loans or advances in this category are fully protected by the current financial paying capacity of the borrower and are not subject to criticism. In general, any loan or advance, or portion therefore, which is fully secured, both as to principal and interest, by cash or cash substitutes, shall be classified under this category regardless of past due status or other adverse credit factors.
  - Provision rate one percent of the approved limit.
- **Special Mention:** the following loans and advance at minimum shall be classified special mention.

A. loans or advance with pre-established repayment programs past due 30(thirty) days or more, but less than 90(ninety) days.

B. overdrafts loans or advances that do not have a pre-established repayment program past due 30(thirty) days or more, but less than 90(ninety) days, throughout reimbursement of past due interest.

- Provision rate three percent of the approved limit.

- **Substandard:** the following non-performing loans and advances at a minimum shall be classified substandard:

  A. loans or advance with pre-established repayment programs past due 90(ninety) days or more, but less than 180(one-hundred-eighty) days.

B. overdraft and loans or advances that do not have a pre-established repayment program past due 90(ninety) days or more, but less than 180(one-hundred-eighty) days, throughout reimbursement of past due interest.

- Provision rate twenty percent of the approved limit.

- **Doubtful:** the following non-performing loans are advances at a minimum shall be classified doubtful:

  A. loans or advances with pre-established repayment programs: past due 180 (one-hundred-eighty) days or more, but less than 360(three-hundred-sixty) days.

  B. Overdrafts and loans or advances that don't have a pre-established repayment programs past due 180 (one-hundred-eighty) days, or more, but less than 360(three-hundred-sixty) days, throughout reimbursement of past due interest.

- **Loss**

  The following non-performing loans and advances at a minimum shall be classified loss:

  A. Nonperforming loans or advances with pre-established repayment programs past due 360(three-hundred-sixty) days or more.

  B. overdraft loans or advances that don't have a pre-established repayment program past due 360(three-hundred-sixty) days throughout reimbursement of past due interest.

  - Provision rate fifty percent (50%) and above of the approved limit.

  (National Bank of Ethiopia regulation, 2009)

2.10.5 Rescheduling of loans and advances

Banks are engaged in lending business and inevitably encounter some customers who are unable to repay credits extend to them due to circumstances beyond their control, diversion of fund or because of incompetent management. In such case, banks design rescheduling program for the credit in order to facilitate the repayment of credit smoothly. (National Bank of Ethiopia regulation, 2009)

2.10.6 Write-off

Businesses today cannot afford excessive write-offs or large numbers of delinquent accounts. Few business owners will dispute the fact that cash is king. A lack of operating cash was the primary “cause of death” for many U.S. companies in the early 2000s (www.creditReport.com). Poor cash flow management continues to result in the collapse of business enterprise, large and small, worldwide. One of the most common cash traps is not providing the most essential product or services; the one your customer can stay in business without. Or, by regular follow-up that keeps you in front of your customer on a consistent basis.

2.10.6.1 Write-off conditions

When borrower and/or guarantor, if any, have no property and income to pay the loan, in the form of legal person with limited liability or in the form of a natural person is insolvent and the value of property, if any, of the borrower/guarantor is less that the cost of recovering the loan, when a borrower declared bankrupt and the value of assets disposed of by court is insufficient to settle the debt and when the highest appellate court rules against the bank and all legal means are exhausted and not worthy. (National Bank of Ethiopia regulation, 2009)

CHAPTER THREE
DATA PRESENTATION AND ANALYSIS

3.1. Overview

This chapter presents the data collected through interview questionnaire and observation of annual report of the company. During the data collection the researchers focused on the challenge of credit risk and prospect of management practice. The data obtained is analyzed through descriptive techniques in an attempt of filtering basic findings that answer the research questions. The data gathered and analyzing made is presented in this section below.

Regarding the qualitative information, which will be generated through interviews, analysis will be made by categorizing, summarizing and merging of the key issues. In the entire analysis process, all information generated from this study (both quantitative and qualitative data analysis) will be triangulated so that the convergence of evidence can show the whole picture of the study.

The researchers were designed and distributed 38 questioners for stuffs, and 2 interviews for department manager. Both employees and managers are works in head office. From the total distributed questionnaire for merchant, only 33 were returned.

3.2. Personal Characteristics of Respondents

Table 1

Number		Item	In Figure	In Percentage
1	Sex	Male	14	42
		Female	19	58
		Total	**33**	**100**
2	Age	18 – 25	3	9
		26 – 35	14	43
		36 – 45	10	30
		≥46	6	18
		Total	**33**	**100**
3	Educational Background	Grade 12 high school	-	-
		Certificate	-	-
		Diploma	4	12
		Degree	17	52
		More than first degree	12	36
		Total	**33**	**100**
4	What category best describe your job	Senior Director Group	6	18
		Middle management group	10	30
		Supervisor/follow up/group	12	37
		Support staff group	5	15
		Total	**33**	**100**

Source primary data (2014)

Item one. In table one indicates that 58% the respondent are female and 42% of the respondents are male. This indicated that numbers of female are greater than male. In item two most of the respondents are found on the age group of 26-35 i.e. 43% are indicated in this age group. The other 30% and 18% are found on the age group of 36-45 and ≥46 respectively and additionally few of 9% respondents are young between 18-25 age group.

Item three indicated that the educational statues of the respondent. 12% of the respondents are diploma holders and 52% are degree holder and others 36% of them have more than first degree holders. From this we understand that majority of the respondent are degree and more than first degree holder.

Item four tell as about the type or category describe respondents job are engaged in 18% are in Senior Director Group, 30% are in Middle management group, 37% are in Supervisor/follow up/group and other specific Support staff group.

3.3. Analysis of the Finding directly related to the study

Table 2
Company policy & procedures

Description	Response	Respondent	
		No	**Percentage**
Do you have operating policies and procedures applying on credit risk management?	Yes	31	93
	No	2	7
	Total	**33**	**100**
Description	**Response**	**Respondent**	
		No	**Percentage**
What are the measurement variable to given loans to the clients?	Asset collateral	26	80
	Personal guarantees	4	12
	Group guarantees	3	8
	Other (Specify)	-	-
	Total	**33**	**100**

Source primary data (2014)

Table 2 present that 93% of respondent take concentration more on the company policy and procedures system, 7% of the responds that still there gap on it. It implies that most of the operating policies and procedures are applying in organization and others more express is there is difficult in applying on credit risk management.

In table 2 Item two 80% of the respondents believe that asset collateral preferable and 12% and 8% of respondents are have said other options Personal guarantees and Group guarantees respectively. It indicates banks can use other company variables to give loan or credit to creditors.

Table 3

Credit risk preventing techniques or system

Description	**Response**	**Respondent**	
		No	**Percentage**
Does your organization effectively use preventive techniques to reduce credit risk?	YES	29	88
	NO	4	12
	Total	**33**	**100**
Do you think that the follow-up and supervisory system is effective in that of to control credit risk of the bank?	YES	28	85
	NO	7	15
	Total	**33**	**100**

Source primary data (2014)

As indicated in the above table 3 item numbers 1 add the respondents 29(88%) of the managers and leaders have believed by the same way of effectively use preventive techniques of the org.

In the same table item number 2, 28(85%) of the section leaders says we think that any follow-up & supervisory system have effect on controlling purpose and others 7(15%) managers and section leaders say need of improving org. follow-up and controlling system. This shows most section leaders stick with company organizational structure follow-up and supervisory system to control credit risk of the organization.

Table 4

Challenges of NPL

Description	Response	Respondent	
		No	Percentage
On average how many of your clients repay their loan?	50% of clients	4	13
	75% of Clients	12	36
	More than 75% clients	17	51
	Total	**33**	**100**
Description	**Response**	**Respondent**	
		No	**Percentage**
Have you face a problem on your creditors in repaying the loan?	YES	18	55
	NO	15	45
	Total	**33**	**100**

Source primary data (2014)

As indicated in table 4 item no 1, the requirements to choose the best average repay their loan is 17(51%) of the respondent replied More than 75% clients repay their loan, other respondents 12(36%) and 4(13%) replied 75% of customers and 50% of the customers repay their loan. this shows that there is big chance of repay of credit from the clients depend on the situation.

When we see table 4 item no 2, the questionnaire asks the manager and section leaders about the challenges in organizational 18(55%) of the response was most of the managers face the problem and others respondents 15(45%) of the leaders didn't face problem.. this shows manager and a much of the section leaders usually face difficulties most of the time.

Table 5

Training at the organization

Description	Response	Respondent	
		No	**Percentage**
Have your credit staffs, supervisors and directors takes short-term training related to credit risk management?	Yes	14	42
	No	19	58
	Total	**33**	**100**

Source primary data(2014)

As we can see in the above table 5 item number 1, all of the respondents 14(42%) of the managers and section leaders said to they take training related to credit risk management and 19(58%) of managers response shows that the company didn't gave them any training related to credit risk management. These data shows that this company is believe in training but have not fully given to them.

Banks Loan Portfolio

The total asset of the bank grew by 38.4%, and reached birr 158.1 billion during the fiscal year under review. The major account categories that pushed the asset balance up were loan and advance to customers, investments, other assets and property and equipment. (Annual Report, 2011/2012)

Moreover, the asset quality of the bank has shown successive improvement over recent years. The non-performing Loans (NPLs) ratio shrank to 0.16%, mainly as a result of the reduction of NPLs stock and to some extent due to the increase level of outstanding loans. The continued high domestic economic performance has notably has led to a general improvement in the loan repayment capacities of customers. (Annual Report, 2011/2012)

Outstanding Loans and advances by sector (Min.Birr)

	2011/2012	2010/2011	% Change
Loans to customers*	56,465.40	33,092.60	70.63
Agriculture	13,551.80	7,836.80	72.93
Manufacturing	18,673.70	8,587.80	117.44
Domestic Trade	5,310.30	3,393.60	56.48
Foreign Trade	14,949.20	10,345.80	44.50
Building & Construction	4,635.50	3,481.60	33.14
Personal Loan	719.10	328.90	118.64
Loan to Banks	487.70	243.30	100.64
Receivables-EGTE	3,987.10	1,763.00	126.15
Bonds(coupon & corporate)	62,052.40	40,397.70	53.60
Total Outstanding Loans	**122,992.60**	**75,496.60**	**62.91**

*Net of provision for impairment losses (Annual Report, 2011/2012)

Of late, the loans that the bank has been giving out have increased drastically and the outstanding loans and advances have reached Birr 58 billion, thereby increasing the risk of full repayment of loans and advances eventually. In order to mitigate future losses in this respect, the management of the bank decided to increase the provision for loans and advances by birr 500,976,908 and raised the provision to birr 1,374,111,936 in this year under review, which is actually in excess of minimum level of the provision that would be required as per directive of the national bank of Ethiopia by birr 822,290,000.

Movement in Provision of losses

	2012	2011
At 30 June 2011	881,932,711	444,163,929
Additional provision made during the year	500,976,908	458,073,934
Amount written off during the year	(8,797,683)	(20,305,152)
At 30 June 2012	**1,374,111,936**	**881,932,711**

(Annual Report, 2011/2012)

3.4. INTERVIEW ANALASIS

Besides the questionnaires, the student researcher interviewed two (2) additional staff namely, one from credit appraisal management, one from supervisory management and credit follow-up section employee based on the following on the following questions:

The credit risk management department is principally in charge of overseeing the overall credit risk management of the bank. This involves initiating new credit policies, enforcing the existing ones and periodically revising the credit policies and procedures and ensuring that loans are processed in accordance with the credit policies and procedures and forwarding credit proposals for credit decision.

The board of directors, credit department, the president, and bodies on the top of the organization structure are involved in the credit risk management issues. The BOD attends to the overall strategic credit and risk management department loan status and on the overall credit management performance and taking remedial actions.

Credit risk management is the process of maximization of bank's return on its assets while maintaining its credit risk exposure within acceptable limits because effective risk management is the foundation of any business. The bank with whom the interview is conducted, credit management is a necessity and not an option to insure stability of the bank which is to a large extent governed by the quality of its assets. In general the objective of credit risk management is to reduce the risks as much as possible with the help of analysis and review to assure a healthy loan portfolio, which is pivotal for the growth and expansion of the bank.

Additionally, the objective credit risk appraisal and management is explain the overall activities of from starting the loan process until pay back period consultation and close follow up of CBE department.

CBE bank face problems due to the fact some of the loans and credits granted to various users turned to be bad loans.

Different factors can be considered for some loans and advances to turn out to be bad loans. One of the main reasons is that borrowers don't use the fund for the purpose they had taken it for. Some loans become sick due to weak follow-up business by debtor. However, the loan process is not considered complete simply because it is processed; approved and disbursed.

Early detection of warning signals is crucial to maximize corrective action and minimize potential losses. Supervision is particularly important when loan mature or becomes past due or terms of agreements are violated. Assessments of these reviews lead to the expansion, modification, renewal or cancellation of existing facilities.

Finally, the preventive techniques used to reduce risk are, occurrence of risk sick loans could be minimized through prudent analysis made before the release of the loan. Moreover, if things are not as expected and the loan is trouble, work out loan procedure is implemented, strong and regular follow-up practice is exercised. Besides, controlling methods approaches are revised periodically to fit the dynamic business environment.

Before disbursement mechanisms include proper credit analysis, proper design and implementation of loan eligibility criteria and proper loan disbursement procedure. Credit analysis should include a clear induction of the bank's target. This analysis should set out whom eligible for credit and how much, what type of credit is available and what term and condition the credit should be granted.

Eligibility Criteria: - in evaluation of credits subjective judgment are to some extent unavailable. But CBE set loan eligibility criteria to minimize the effect of individual perceptions in loan evaluation. But in general, the basic criteria are: proof of engagement in a licensed business, presentation of financial statements or filling of financial credit report, presentation of collateral to secure the loan and feasibility study in the case of project finance.

One of the major tasks of credit handling is its follow-up part. Generally the bank in order to stand at "healthy credit status" each credit request must be analyzed properly. Above all, right after each loan disbursement there should be no relation in the follow-up of delinquent loans & advance. The loan officer will prepare schedule which contain the repayment data and telephone address of the borrower in order to make the follow up task easy. After this the officer is expected to call when payment is not made on the payment date.

Even if the payment is regularly, follow up by visiting customers business is necessary to create long lasting friendly relationship. This may elicit future payments and development partnership relation. Sometimes borrowers seem to ignore repayments for one reason or another. In such case, CBE under takes the following follow-up activities:-

- Giving verbal reminder after calling the customer and discussing the matter
- As a second reminder the loan officer will give personal visit to the customer and talk about the matter.
- The last warning is that the bank sends a written reminder that shows the bank is legally and morally bound to collect the debt would follow.
- If after all this notification the customer won't pay the loan the matter will go to head office and they will give the borrower days for payment based on the type of loan, otherwise there collateral will be sold on auction.

CHAPTER FOUR

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

4.1 SUMMARY

This chapter summarizes, concludes and recommends the finding of the research and forward possible solution for the problem. It was also intended to suggest possible solution to the problem identified organizational values that impede company performance and those that promote good result.

The major intention of the study is to assess the process the credit risk appraisal and management of CBE. To achieve this selected employee of the bank were consulted through distributed questioners and interview. After analysis of various views of respondents and a good review of the credit procedures and credit policy of the bank, the study has come up with the following major findings, conclusion and recommendations.

In this chapter a summary of the major findings of the study are presented below:

- The major elements of credit policy have eligibility criteria for every sector being financed by the bank and they contain the 5 C's.
- The bank uses CRR (credit risk rating) as means of credit risk management practice, which is a system employed by the bank to differentiate the degree of credit risk in different credit exposure.
- The overall objective of credit risk management is to reduce the risk as much as possible with the help of analysis and review to assure a health loan portfolio.

- Causes for the occurrence of credit risk are in complete information, weakness in collateral arrangements, technical incompetence the ability to analyze financial statements and to obtain and evaluate other credit information, lack of adequate supervision of old and familiar borrowers.
- The main reason for a loan to turnout to bad is that borrowers do not use the fund for the purpose they had taken it for and reckless lending, collateral – oriented loan assessment and poor credit follow –up system.
- CBE implements different mechanisms to reduce credit risk. Among this mechanisms proper credit analysis, loan eligibility criteria, credit disbursement procedure and follow up system are the major applicable.

4.2 Conclusions

The important of credit in the banking industry can be seen position in the financial statements of banks. Loans are the most important asset in any commercial bank. Loans account for half to three quarter of the total value of all banks assets. A bank should have a way of examining its borrowers so that it would minimize the risk of defaults. The effect of defaults is not limited to that of affecting the profits of one particular bank but it has a ripple effect that extends itself to the economy, at large.

Commercial Bank of Ethiopia uses CRR (credit risk rating) as a means of credit risk management practice. It is used by the bank to differentiate the degree of credit risk in different exposures. As the main objective of credit risk management is to reduce the risk as much as possible, CBE implements proper analysis, loan eligibility criteria, credit disbursement procedure and follow up mechanisms to reduce credit risk.

4.3 Recommendations

The more the bank lends the more profitable it becomes and in turn increase capital of the bank in the form of reserve along with its deposit mobilizations. Growth in capital leads to proportional growth of loan able funds. And this is the reason that credit risk appraisal and management is needed.

Thus from finding of the paper the following recommendations can be made for further growth and development of the bank.

On the side of the borrowers

- Conducting study regarding important and viability of the business undertaken before approaching to the bank of credit.
- Forecast the capital required to perform the task.
- Using the loan for the intended purpose.
- Compile at the information and document requested by banks to process the loan.

On the Bank Side

- To overcome banks credit risk the credit investigator and branch manager go and visit the working place of the applicants before granting a loan.
- Bank should proof of engagement in a licensed business, presentation of financial statements or filling of financial credit report, presentation of collateral to secure the loan and feasibility study in the case of project finance.

- The bank should be supported by adequate close loan follow up system to insure the best performance of the bank in collections repayments as scheduled.
- The bank should clearly overview the above three type approaches depending on their customers loan or credit type to minimize non performing loan.
- The bank should provide counseling service and giving training for all customers as the saying “customer is king”. No matter what the bank should provide the service in order to make the task easy to customers and protect them from unnecessary ups and downs. And attention should be given in handling customers.
- Regarding the measures to be taken to retain or overcome the problem of trainings on credit risk appraisal management, all the interviewee stated that the appraisal department should give relevant trainings to respective employees, supervisors and follow-up sections as well as to borrowers in building of effective credit risk management of the Bank.
- The bank should refrain from relying too much on non-financial assessments. Instead, it should give equal emphasis to both financial and non-financial assessments. This makes the credit decision more accurate and effective.

ST.MARY'S UNIVERSITY

CREDIT RISK APPRAISAL AND MANAGEMENT PRACTICE: THE CASE OF COMMERCIAL BANK OF ETHIOPIA

BY

GETANEH ZEMEDKUN

HALEPHOM ABRHAM

MERON KETEMA

BUSINESS FACULITY

DEPARTMENT OF ACCOUNTING

APPROVED BY THE COMMITTEE OF EXAMINERS

______________________	______________________
Department Head	**Signature**
______________________	______________________
Advisor	**Signature**
______________________	______________________
Internal Examiner	**Signature**
______________________	______________________
External Examiner	**Signature**

CREDIT RISK APPRAISAL AND MANAGEMENT PRACTICE: THE CASE OF COMMERCIAL BANK OF ETHIOPIA

BY

GETANEH ZEMEDKUN

HALEPHOM ABRHAM

MERON KETEMA

A SENIOR ESSAY SUBITED TO

DEPARTMENT OF ACCOUNTING

FACULTY OF BUSINESS

ST. MARY'S UNIVERSITY

IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE DEGREE OF BACHELOR OF ARTS OF MANAGEMENT

JULY 2014

SMU

ADDIS ABABA

St. Mary`s University

Faculty of Business

Department of Accounting

Questionnaire to be filled by Stuffs

Dear respondents

The purpose of this questionnaire is gathering data to prepare senior paper entitled "Credit risk appraisal and management practice of commercial bank of Ethiopia". The output of this questionnaire will have greater contribution for the company to improve its distribution performance your thoughtful response to the questions are sought to be a greater help to the success of this study. This study is anonymous and your responses will be kept highly confidential and used only for the intended purpose. Your feedback is very important for the retention of staff in the similar organizations in Ethiopia.

Therefore, please kindly extend your cooperation by frankly and honestly responding to the items contained in this questionnaire.

Remarks

- Writing your name on the questionnaire is not necessary.
- If the question has an alternative answer. Put (✓) or (X) on the space provided beside your answer.
- If the question is related to your personal opinion write it shortly and neatly on the space provided.

Thank you in advance for your cooperation!

I. Personal information

1. Sex

   A. Male ☐ B. Female ☐

2. Age

   A. 16 - 25 ☐ B. 26 - 35 ☐ C. 36 - 45 ☐

   D. 46 - 55 ☐ E. Above 55 ☐

3. Educational Background

A. Primary school ☐ B. Certificate ☐

C. Diploma ☐ D. Degree ☐

E. more than first degree ☐

4. What category best describe your job?

☐ Senior Director Group ☐ Middle management group

☐ Supervisor/follow up/group ☐ Support staff group

II. Questions directly related to the study

5. Do you have operating policies and procedures applying on credit risk management?

Yes ☐ No ☐

6. What are the measurement variable to given loans to the clients?

Asset collateral ☐ Personal guarantees ☐

Group guarantees ☐ other (specify) ______________________

7. Does your organization effectively use preventive techniques to reduce credit risk?

Yes ☐ No ☐

8. Do you think that the follow-up and supervisors system is effective in that of to control credit risk of the bank?

Yes ☐ No ☐

9. On average how many of your clients repay their loan?

☐ 50% of creditors ☐ 75% of clients

☐ More than 75 % of clients

10. Have you face a problem on your creditors in repaying the loan?

Yes ☐ No ☐

11. Have your credit staffs, supervisors and directors taken short-term training related to credit risk management?

Yes ☐ No ☐

St. Mary's University

Faculty of Business

Department of Accounting

Interview Questions to be answered by managers and supervisors

1. Which organizations are involved in credit risk management issues?
2. For which sectors do you give loan?
3. Which sectors contribute the highest loan and advance?
4. Which sectors are more risky? Why are they risk?
5. What is the objective of credit risk management?
6. What does the credit follow up of CBE look like?
7. What is the credit risk management practice of CBE look like?
8. What are the preventive techniques and approach mechanisms used to reduce credit risk?
9. What are the attitudes of management, supervisors and employees towards managing credit risk in commercial bank?
10. What are the impacts trainings on credit risk appraisal and management practice on your organization?

Thank you

For your cooperation!!

REFFERENCE

William Smith (1998), **Risk Management and Insurance**, 8th edition Page 146-150, London

Robert Bruce (1997) **Corporate Finance**, 5th edition, Page 320,340 United Kingdom, Birmingham Printing press

James S. Duisenberg (1996) **Money and Credit Impact and Control,** 6th Edition, Page 87, 160, USA

Eugene F. Brigham (1997) **Financial Management Theory and Practice,** 9th Edition, Page 186,192, United Kingdom (UK)

Robert H. Cole (1992) **Consumer and Commercial Credit Management**, 9th Page 210, Edition, USA

Frank, (1996) **Principle of credit risk management,** 2nd edition, Page 121-140

Churchill and Dancoster (2001) **Credit Management**, 3rd edition

Annual Report of CBE (2011/2012), Goal Printing and Advertizing P.L.C, Addis Ababa, Ethiopia

National Bank of Ethiopia regulation updated (2009)

http:\\EzineArticles.com\importance of credit risk management