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SCHOOL OF GRADUATE STUDIES

DEPARTMENT OF ACCOUNTING AND FINANCE

ASSESSMENT OF CREDIT RISK MANAGEMENT PRACTICE: THE CASE OF OROMIA INTERNATIONAL BANK

FOR PARTIAL FULFILLMENT OF THE REQUIREMENT FOR DEGREE OF MASTER OF BUSINESS ADMINISTRATION IN ACCOUNTING AND FINANCE

BY

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UNDER GUIDANCE OF ZENEGNAW ABIY HAILU (PhD)

June, 2021

ADDIS ABABA, ETHIOPIA

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DECLARATION

I, the undersigned, declare that the thesis entitled "ASSESSMENT OF CREDIT MANAGEMENT PRACTICE AT OROMIA INTERNATIONAL BANK S.CO." is my original work, prepared under the guidance of Dr. Zenegnaw Abiy. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning.

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APPROVAL

This is to certify that this thesis has been submitted in fulfillment of the requirements for the degree of Masters of Business Administration in Accounting and Finance with my approval as a university advisor.

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Abstract

Credit risk management is one of the most important tasks for the financial liquidity and stability of banking sector in connection with increased sensitivity of banks to the credit risks. This research asses the practice of credit risk management in Oromia International Bank. Therefore, the main objective of undertaking this study is to assess the credit risk management practice of Oromia International Bank and to see the possible problems that influence the credit risk management activity of the bank and to suggest possible solution for those problems exhibited on credit risk management practice of the bank. For the study primary data is used. Primary data is collected using questionnaire and interviews. Regarding to the nature of the study, the research design is descriptive and quantitative study approach is adopted to assess credit risk management practice of bank. Even if the NPL position of the bank is below the thresh hold set by NBE which is 5% considering the period from 2017/18 to 2019/2; the research found that, credit risk monitoring procedure is not reviewed and updated regularly, the bank's credit professionals do not conduct a formal meeting to discuss the customer's history and future plans and there is lack of adequate training to credit management staffs and there is lack of adequate staff in credit management department of the bank. Finally based on the findings of the study, the following recommendations are given. Credit monitoring procedure should be reviewed and updated on regular basis; the bank should be adequately staffed the credit management department and the bank should arrange short term or/and long-term training to update and enhance the employees understanding about credit risk management.

Key word: credit risk management, credit portfolio, NPL and OIB

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List of Acronyms

CB	Commercial Bank
CRA	Credit Risk Analysis
CRM	Credit Risk Management
FDRE	Federal Democratic Republic of Ethiopia
ISO	International organization for Standard
OIB	Oromia International Bank
RM	Risk Management
NBE	National Bank of Ethiopia
NPL	Non- Performing Loan

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CHAPTER - ONE

Introduction

1.1. Background of the study

Commercial banks render a number of services such as provisions of different credit facilities, mobilizing savings, fixed time, demand deposits, local and foreign money transfers, transaction of currency, credit and debit cards and other related activities. Among this, extending of credit service to their customers is the principal business line of any commercial banks and financial institution.

On other side, this credit business operation of the bank is also the main cause for credit risk which is the probability that some of bank's assets, especially its loans, will decline in value and possibly become worthless. Among the risk that face banks' credit risk is one of the main concerns to most bank's stake holders and banking regulators. This is because credit risk is the risk that can easily and most likely prompts bank failure (Suresh & Paul, 2010). Since exposure to credit risk remains to be the main cause of problems in banks and can greatly put at risk the smooth operation of a bank's business, banks and their managements should be able to take useful lessons and give more attention to manage this risk properly.

Thus, management of credit risk is very important and central to the health of a bank and indeed the entire financial system. So that banks or financial institutions shall assess the investments and loans that the company is committing to it. Based on this the credit manager must think long-term and look critically at the soundness of each investment and loan as the company's financial health depends on safe, profitable investments. Moreover, these credit managers not only look at the business's loans, they must also review and determine the soundness of the credit the company is extending to customers. (Upadhaya, 2009)

Therefore, appropriate credit management practices help the banks to ensure selection of right type of loan or proposals and right type of borrower. For selecting the borrower security should not the only thing to be relied upon. So, responsibilities of the bankers to investigate the client from different point of view. For instance, the strength and weakness of the clients that the client will be able to repay the bank loan as repayment schedule, loan approval, monitoring, and recovery of non-performing loans. To prevent future financial crises, it is absolutely necessary to manage credit so as improve the borrowers‟ financial literacy, the lenders‟ process of

transparency and to better assess loan product affordability and suitability. Thus, the axle of this study is to make in-depth assessment on the relationship between the theories, concepts and models of credit management and what goes on practically in one of the reputed private banks in Ethiopia which is Oromia International Bank.

1.2. Statement of the problem

The banking business is more sensitive due to more of their income (revenue) will be generated from credit (loan) given to their customers (Colquitt. 2007). This credit business operation exposes the banks to high credit risk which leads to loss. Hence, without effective credit risk management good bank performance or profit will be unthinkable.

Accordingly, the development and establishment of a system for credit risk management is extremely important from the viewpoint of ensuring the soundness and appropriateness of a financial institution's business. Based on this, the institution's management is charged with and responsible for taking the initiative in developing and establishing such a system (Solomon, 2013).

The negative impact of credit risk to business profitability may be evident that the more commercial banks expose themselves to credit risk, the more accumulation of Non-Performed Loans (NPL), implying that these loan losses have produced lower returns to the bank. The accumulation of NPL caused by lack of proper credit risk management would have substantial adverse impact on the performance of the banks in particular and the overall economy in general (Sallemicahel, 2009).

Regarding to Oromia International Bank (OIB), Non-performed Loan (NPL) position of the bank was 3.4% in the year 2019/20 (Annual Report of OIB 2019/20) and even if that is not exceeding the standard limit of National Bank of Ethiopia (which is 5%), it is higher than NPL position of other competitive private banks of Ethiopia such as Bank of Abyssinia and United Bank which is less than 2% (Annual report of Abyssinia and United bank, 2019/20).

Additionally, some researches were conducted in Ethiopia mainly focused on credit risk management practice of different commercial banks. Saheb and Krishna (2018) assessed on credit risk management technique and practice of Commercial Bank of Ethiopia and Awash Bank; Gedefaw (2019) has assessed credit risk management system and practice of four

Ethiopian private commercial banks (Berhan International Bank S.C, Bunna International Bank S.C, Debub Global Bank S.C and Enat Bank S.C). Hable (2018) has assessed credit management practice of United Bank S.C. Sahlemichael (2009) has investigated credit management on Ethiopian Commercial Banks; Solomon (2013) in his paper assessed credit risk management techniques and practice of NIB International Bank. Tibebu (2011) in his paper has also examined credit risk management and profitability of commercial banks in Ethiopia.

Accordingly, due to the NPL position of the bank and lack of studies conducted mainly to identify the problems related to credit risk management practice of Oromia International Bank, the researcher felt it appropriately to take up the present research entitled "Assessment of credit risk management practice at Oromia International Bank" to examine the credit management problems and thereby to recommend the necessary course of action to improve the credit risk management practice of the bank. Therefore, the main concern of this study is to learn to what extent Oromia International Bank can manage its credit risks, and to what extent its existing performance is supported by proper credit risk management techniques.

1.3. Objective of the study

General objective of the study

The main objective of the study is that to examine how Oromia International Bank is efficient in practicing credit risk management throughout its operations.

Specific Objective of the study

This study has the following specific objectives: -

1. To assess credit risk identification practice of the bank.
2. To assess loan granting process of the bank.
3. To assess the credit risk evaluation and monitoring process of the bank.
4. To assess the credit risk controlling practice of the bank.

1.4. Basic research questions

1. How the bank identifies credit risks?
2. What kind of process are applied by the bank to grant the loan?
3. What kind of practices are used by the bank for credit risk evaluation and monitoring?

4. Has the bank ensured adequate control over credit risk?

1.5. Significance of the study

This study will provide information to Oromia International Bank to understand its credit risk exposure and it assists the bank in setting better credit risk management system and implementation strategy. This will in turn to put in place the necessary policies & procedure to manage the risks. Moreover, this research will also provide good insight to those who require to conduct further study on the area of credit risk management practices and will use the research as a source of secondary data. It is also providing information to the regulatory body (NBE) and stakeholders about the soundness of the bank's credit risk management practice.

1.6. Scope of the study

The scope of the research covers on the credit risk management practice of Oromia International Bank at head office level. This is because, most of the bank's loan processing and lending function is done at head office level centrally and what happens at the head office is a good measure of what happens at the bank wide level. Based on this, it has dealt only with the credit risk identification, measurement, loan granting process, credit risk evaluation, monitoring practice that are being employed by the bank to manage such risk.

1.7. Limitation of the study

In conducting this research, obtaining data through interview was a great challenge due to the existing spread of COVID 19. Based on this most of an interview appointment with the division manager of credit department of the bank was unsuccessful. Moreover, Current studies focus on assessment of credit risk management practice of Oromia International Bank at head office level and lack detailed information on the overall credit management practice of the bank because of the scope of the study.

1.8. Organization of the paper

This thesis consists of five chapters. Chapter one covered introduction which contains background of the study, statement of the problem, basic research questions, objective of the study, significance of the study, scope of the study and organization of the study. Chapter two deal with review of related literatures on the topic. The third chapter deal with the methodology

that was applicable for the research. Chapter four contains the finding of the research. Finally, chapter five deal with summary of key findings, conclusion and recommendation of the study.

CHAPTER TWO

Literature Review

This chapter focuses on the review of literature related to credit risks and the operation that banks engage to handle such risks. It also deals with a review of the theories guiding the research, as well as the meaning and significance of credit risk management to Oromia International Bank. The review also based on theoretical literature that was articles, annual report, books, research papers, financial statements and information from the internet.

2.1 Theoretical Literature

2.1.1 The Concept of Credit Management

Credit can be defined as it is derived from a Latin word "credere" meaning trust. When a seller transfers his wealth to a buyer who has agreed to pay later, there is a clear implication of trust that payment will be made at agreed date. The main reasons for banking problem are directly associated with lack of credit standards for borrowers. Poor portfolio management or lacks of attention to changes in economic conditions are common in emerging economies. Banks as financial institutions, they provide credit to their clients in the form of loans, overdrafts and off-balance sheet activities. Banks mobilize deposits to increase their income streams, hold aggressive edge, to act as its bargaining energy in the industry, as the enterprise exercise as well as to improve the relationship with their customers. (Hirtel and Lopez, 1999).

Credit management is applying a set of policies and strategies to reduce the level of capital tied up in debtors and to reduce the exposure of the enterprise to doubtful loan. Credit management from a debtor's factor of view is managing price range in particular debts so as no longer to have a tail of creditors lurking behind your returned. (Koch & MacDonald, 2006). Credit management is a concern that both the debtor and the creditor should seriously handle. When it functions, efficiently credit management helps as an excellent means for the business to stay financially comfortable and to reduce credit risk.

The function of credit management starts with properly assessing the credit-worthiness of the borrowers and his/her company feasibility. It is done by focusing in to loan applications carefully which is part of the function of loan process. It is mainly significant if the business selects to provide such kind of credit service or revolving credit to the clients. Therefore, proper credit management is maintaining standard criteria that a customer shall meet before obtaining the proposed credit service. Basu and Rolfes (1995) proposed that the success of a financial institutions or banks is based on the implementation of a proper and quality credit management function. As phase of the evaluation function, credit management also focus on determining the overall credit service that will be provided to a certain client. Different determinants are used as part of the credit management process to estimate and qualify a client for the receipt of a given form of credit to perform a business. This comprises collecting data on the potential client's existing financial condition, including the existing credit file that discloses the performance of a client in meeting obligations and the collateral value that is held for the guarantee for the loan. As a result, it discusses the proper procedures that can be implemented in each of these areas with the main aim of examining the current loan management procedure of financial of institution mainly bank. A poor credit risk management system is the cause for many none performing loans. Generally, credit management contain three major steps those are credit analysis, credit approval and follow-up. The first two are pre-disbursement process while the last one is a post disbarment process. (Nishiru and al, 2001).

2.1.2 Risk and Risk Management

Risk can be defined as the circumstance in which there is a likelihood of adverse deviant from expected outcome or result. On the other hand, risks assumed have the potential to divert expected returns and may result into losses to the business. It could be either expected or unexpected. Expected losses are those that an institution knows with reasonable certainty will occur (For instance: - the expected default rate of loan portfolio) and are typically reserved for in some manner. Unexpected losses are those associated with unforeseen events e.g. losses due to a sudden downturn in market conditions, falling interest rates, natural disasters resulting in major business failures, or human action that affects business (Peter & Keith 2008).

Management is simply defined as the act of planning, directing, controlling, monitoring and testing for desired outcomes to be obtained. Or it is simply the act, manner, or practice of

managing; handling, supervision, or control. Furthermore according to the International Organization for Standardization (ISO) "risk management" is an essential part of any companies' strategic management it is the functions whereby companies systematically address the risks associating with their operations with the objective of attaining a stable benefit within every operation and across the portfolio of the entire operation (IRM, 2002). The key point in the sentences stated here is in bold. That is risk management is also a process and its main function is to provide benefits to the business and it would help them to be stable. And it is also at the heart of any firm's strategy. When firms are suffering in their business, it is clearly indicated that they will be exposed to a certain type of risk or another which in most case is an uncertainty although at times it can be certain that it will occur. Bank is a financial institutions those operational risks should be very certain since they don't operate in isolation with the changing environment, the growing regulations requirement they operate, diversification and the competitive environment in which they find themselves and they have to try to manage the risk so as to reduce the possibility of incidence or to minimize the outcome. These possibilities can range from "do nothing at all" to attempting to nullify the effect of every identified risk (William 2006). But, because of the type of the banking operation, a bank can't obtain itself in a condition to do nothing at all or to nullify the risk. Regarding to the riskiness of its operation, banks should actively involve to implement risk management in a wide range of its operation but does so right from the start. This is therefore, its operations are so related in such a way that if not well managed, the possible outcome can be directly associated with the performance of the companies and can even lead to bankruptcy. To attain this objective, management of the companies need to identify the entire risk properly, quantifies its intensity, analyze and monitor it. Then look for measures to control properly. This act of handling the risk is known as risk management (RM). RM is "a course of action planned, organized, implemented and controlled to minimize the risk of an event happening and to reduce the consequential outcomes should that event occur" (Keith, 1998).

2.1.3 Credit risk

Credit risk is defined as the probability that some of bank's assets, especially its loans, will decline in value and possibly become worthless. Because banks hold little owner' capital relative to the aggregate value of their assets, only a small percentage of total loans need to go bad to

push a bank to the brink of failure. Thus, management of credit risk is very important and central to the health of a bank and indeed the entire financial system. As banks make loans, they need to make provisions for loan losses in their books. The higher this provision becomes, relative to the size of total loans, the riskier a bank becomes. An increase in the value of the provision for loan losses relative to total loans is an indication that the bank‘s assets are becoming more difficult to collect (Tshore, Aboagy and Coleman 2011).

Credit risk is the possibility or likelihood of loss to the financial institution or bank through default of a borrower. Based on this, default is any type of breach or break of the contractual obligation to repay the loan by the borrowers. Default may be a result of many factors like failure of management, the industry, product market, economy and technology. Hence, failure to fulfilling the contractual obligation from the borrower side is the main cause of repayment or credit risk. Usually there is a confusion between risk and exposure. Therefore, risk is the deviation of future or actual outcome from the average (expected) outcome. On the other side, exposure is limited to the possible loss of principal less the probability of recovering a percentage of the bank's capital through asset liquidation (disposal) and enforcement of guarantees and it is calculated on the basis of possible losses from the credit portfolio. The probable losses in the credit business operation will be classified into expected losses and unexpected losses. Expected lose is originated from the borrower's expected possibility of default and the predicated exposure at default less the recovery rate, for instance, expected cash flow of the business, mainly from the acquisition of collateral. The expected losses could be valued for income projecting and considered as standard risk costs in the credit business operation. Unexpected losses originated from variation in losses from predicted exposures. Unexpected losses are taken into account only indirectly via equity cost on the course of income planning and setting of credit conditions. It can be handled or secured by the risk coverage capital (Saunders and Cornett, 2013).

As indicated by Dima and Orze (2010), there are two primary sorts of credit risk that a portfolio or position is presented to be specific, credit default risk and credit spread risk. Credit default risk is the risk happening when an issuer of debt, obligor, is not able to meet its financial commitments. Where an obligor defaults, an investor for the most part acquires a loss equivalent to the sum owed by the obligor less any recuperation sum, which the investor recoups as a consequence of abandonment, liquidation or rebuilding of the defaulted obligor. All portfolios

with credit business operation show credit default risk. The amount of credit default risk is portrayed by an organization's credit rating system. The credit rating is maintained after conducting a proper assessment of the borrower performance. This investigation is done by professional rating organization. Among them, the most recognized rating companies are Fitch Ratings, Moody's and Standard & Poor's. When they perform the investigation, some points are examined. Among these points, balance sheet ad income statement of the companies, expected cash flows and revenues, quality of management, company's ability to meet scheduled interest and principal and an outlook of the industry as a whole. The spread of credit business operation risk is the overabundance premium over the management or risk-free rate required by the business sector for tackling a certain accepted credit disclosure. This means the higher level of credit rating, the smaller the credit spread. In line with this, the credit spread risk is the risk of money related misfortune coming about because of changes in the level of credit spreads utilized as a part of the marking to-market of a fixed income product. Changes in observed credit spreads influence the portfolio's estimation and can prompt misfortunes for brokers or underperformance for portfolio managers (Ketan, 2009).

2.1.3.1 Sources of credit risk

The main sources of credit risk include, limited institutional capacity, inappropriate credit policies, volatile interest rates, poor management, inappropriate laws, low capital and liquidity levels, directed lending, massive licensing of banks, Poor loan underwriting, lack of credit assessment, poor lending practices, government intervention, and insufficient control by central bank (Coyle, 2000). To minimize these risks, it is necessary for the financial system to have well-capitalized banks, service to a wide range of customers, sharing of information about borrowers, stabilization of interest rates, reduction in non-performing loans, increased bank deposits and increased credit extended to borrowers. Loan defaults and nonperforming loans need to be reduced (Laker, 2007).

Credit risk is mostly inherent in assets on the balance sheet, but it can also be found in a number of off-balance-sheet liabilities.

Poor project supervision, evaluation, and management, as well as late loan disbursement, diversion of money, and loan beneficiary dishonesty, are all reasons of loan default, according to Okorie (1998). Another cause of credit risk is a lack of competent supervision, which occurs

when financial institutions' boards or management are unable to control multiple divisions to check that they are appropriately adhering with policy. In today's unpredictable economy, all banks face a wide range of risks that could affect their survival and profitability. To put it another way, banking is a risky business. As a result, effective risk management is vitally necessary. In the financial sector, risk management is more crucial than in other areas of the economy. The goal of a financial institution is to generate income and provide the maximum value to shareholders by providing a wide range of financial services, particularly risk management. The primary goal of a financial middleman is to generate commissions or interest (Carey, 2001).

2.1.4 Credit Risk Management

Credit Risk Management defined as the process of controlling the impact of credit risk-related events on the financial institution and involves the identification, understanding, and quantification of the degree of potential loss and the consequential implementation of appropriate measures to minimize the risk of loss to the financial institutions (Saheb & Krishna, 2018)

The management of credit risk of credit portfolios is therefore one the most important tasks for the financial liquidity and stability of banking sector in connection with increased sensitivity of banks to the credit risks and changes in the development of prices of financial instruments (Kiseľáková and Kiseľák, 2013). The most significant impact on performance of the enterprise has just financial risk. The unsystematic risks have a higher impact on performance of the enterprise as systematic risks (Kiseľákováet, 2015). The determination of each individual loan, or borrower, risk assessment techniques plays a primary role in the management and minimization of the credit risk. It is only after determining the risk represented by each individual borrower and by each individual credit service that one can begin to manage the loan portfolio as a whole. The credit risk assessment of the borrower consists in the study and evaluation of the qualitative and quantitative indicators of the economic situation of the borrower (Korobova, 2010). The assessment of the risk factors attending the granting of a particular loan and their comprehensive and systematic analysis enable the bank to take these factors into account in credit risk management and to prevent their recurrent and adverse impact on the results of the bank’s future activities (Rodina, 2013).

The methods used to quantify credit risk are accompanied by a special transparency requirement, including a quantitative assessment of the methods' accuracy and a statistical method property known as robustness. The transparency of the credit risk methodology presents an opportunity to view a given phenomenon not only as a whole but also in detail (Dmitriadi, 2010). Transparency has become the most important characteristic of credit risk assessment methods thanks to the need for the most thorough identification of both credit risk and the credit risk model itself. Methodological transparency refers to the precision of the employed mathematical methods, the reduction of the element of subjectivity in expert assessments, the clarity of the results of risk assessment and analysis, the bank employees' thorough understanding of these results, and the accessibility of the given methods to regulatory authorities and borrowers. In order to analyze, forecast, and manage credit risk, each bank must be able to quantify relevant credit risk factors, to analyze the risk involved, and to permanently monitor credit risk factors (Andrianova and Barannikov, 2013).

The bank's decisions about granting, or refusing to grant, a loan, about the interest rate, and about the level of loan default provisioning will depend on the accuracy of risk recognition and assessment. The accuracy of risk factor assessments is evaluated relative to the number of errors in the recognition of "bad" and "good" loans (i.e. borrowers) and their average number. The accuracy of risk factor assessments is determined in a similar manner when loans are classified into more than two classes. Furthermore, the stability of risk assessment methodologies is characterized by the property of statistical methods known as robustness. Different methodologies of risk assessment, or one and the same methodology used with different algorithms, yield dissimilar classifications of loans into "good" and "bad". The application of different methodologies may result in the categorization of one and the same loan as either "good" or "bad". Such instability in loan classification may affect the assessment of 20% of total number of loans (Solojentsev, 2004). Banks need to adapt their crediting-related activities to the changing conditions of the nation's developing economy and to the changes in the standard of living. The methods used to quantify and analyze credit risk are of great importance for the smooth functioning of a bank (Seitz and Stickel, 2002).

2.1.5 Credit Risk Management philosophy

Banks like any other firm or corporation have formal laid down policies and principles that have been put in places by the board of directors on how to manage credits and this have to be carefully implemented by management. This restricts supervisors or managers on how to take action. They must do so by looking at the policies laid down to known if they are doing the right thing at the right time. As it is specified that a credit policy has four major components which include credit standards, credit terms, credit limits and collection procedures (Maness & Zietlow 2005).

2.1.6 Credit Risk management practice

Banks have diverse credit risk management regulations, methodologies those are differ from one financial institution to the next, even if they are exposed to the same risk. The practices differ based on the principles and beliefs that have been established earlier. Some or all banks may choose to use hedging methods or insurance to impact their profits and/or reduce the costs of changes, but the way they do so will differ. Another gap can be found in the area of risk tolerance. Each bank has its own level of risk that it can then choose to accept or reject based on the terms of its risk management plan. Depending on the nature or complexities of their credit, banks may have different risk management practices. To summarize this, it is clear that the same industry, but the implementation in practice differs. Practices are not consistent with theory. In most cases because of data limitation for most industries, it is difficult to describe which firms' mange more risk than others or whether firms engage in dynamic risk management strategies and more importantly it cannot be reliably tested whether a firm's risk management practices conform to existing theories (Tufano 2006).

2.1.7 Credit risk management strategies

A strategy means a way to go about an activity. Thus, banks have their own strategies to attain their desired goals in the same or different way. The idea to go about a particular activity can exist to the knowledge of the bankers but the strategy of how to implement so that desired goals can be attained and/ or to make difference will be different for each bank or company. Given the competitive environment in which banks operate, it is always good to have strategy position of how to manage its credit risk that will make or show its difference from its competitors. A strategy positioning means performing different activities from rivals or performing similar activities in different ways –a company can outperform its rivals only if it can establish a

difference that it can preserve choosing to perform activates differently than rivals do. When a bank carries out its operational activities which are same activities carried out by other banks, they should try to a make difference from their rivals by not only trying to be more efficient but by trying to make difference in effective way. this can be done by performing different activities from the rivals or performing the same activities in a different way for example: although specific risk management practices may differ among banks depending on the nature or complexities of their credit risk activities, a bank which will want to show a difference will use a comprehensive credit risk management strategy like the others by addressing and keeping a proper credit risk environment, operating under a good credit giving process, and keeping a proper credit risk environment in connection with improved techniques in asset quality assessment, allocation and reserving adequacy, and credit risk disclosure (Porter 2016).

2.1.8 Credit Risk Management Culture

Under the umbrella guideline of credit culture, a lending organization's credit risk management design is established. It encompasses the perspectives, beliefs, actions, techniques, and values that are carried out and implemented across the credit organization as a result of managerial attitudes toward credit risk. It is frequently provided in the “mission, objectives, and lending strategies” to justify the importance given to credit quality and safe loan procedures. Credit culture provides a general framework for making credit decisions on a day-to-day basis. Moreover, a bank may be compared to a community, and as such, it has its own culture that reflects how it conducts its business. This culture's actions and behaviors will be at odds with the bank's duties and norms. The credit culture of a bank refers to the rules, procedures, attitude, and style of leadership in place to guide the lending manager or people in conducting out their credit management job. This describes the loan atmosphere and identifies the types of loan conduct that the bank accepts. Credit culture is defined as a set of characteristics that come together to create a lending environment that supports specific lending practices. Leadership's articulation of goals and priorities, lender indoctrination during training, and the bank's lending ideology and policy should all be included. Credit culture is beneficial since it serves as a guide for effective bank credit management, performance, and, in certain cases, failure. Even if a miscalculation with management of credit risk results in loss, the manager cannot be held personally liable if the decisions were made depend on the company's credit culture (Colquitt 2007).

2.1.9 Process of credit risk management

Risk management contains; identification, measurement, aggregation, planning & controlling and monitoring of the risk arising in a bank's overall business. Risk management is thus a continuous process to increase transparency and to manage risks. Each bank has to establish a long-term vision and strategy in respect of integrated risk management based on its scale, focus, positioning, and resources targeted with senior management's full commitment. Risk management is a complicated process that necessitates specialized knowledge and abilities (Saheb & Krishan, 2018).

2.1.9.1 Identification of credit risk

Identification of credit risk is the first step in the function of credit risk management. It can be divided in to three categories default, exposure and recovery risk. Default risk is the probability of an event of default, which is driven by the potential failure of a borrower to make promised payments. The second one is exposure risks arise out of uncertainty attached to future amounts at risk. Exposure risk does not exist with all lines of credit. It may be considered negligible for all lines of credit for which there is a repayment schedule. Project financing implies uncertainty in the scheduling of outflows and repayments. All off-balance sheet items can generate future exposures. The third one is recovery risk arise the event of default not being predictable. The last one takes the form of collateral risk, third party guarantee risk and legal risk. Collateral risk: refers to an uncertainty with respect to the ability to access the collateral, to dispose it off and to the costs required to sell it. The use of collateral to control credit risk transforms the credit risk into recovery risk plus an asset value risk. Third party guarantee risk: arises when a third party fails to commit to pay on behalf of the borrower. Also, there arises a joint default risk when the guarantees as well as the borrower default at the same time. Legal risk: arises when the legal procedure takes over in case of default. The chosen method of identifying credit risk may depend on culture, industry practice and compliance. The credit risk of a bank portfolios a rise from internal as well as external factors. The internal factors have been identified as deficiencies in loan policies or administration, lack of prudential credit concentration limits, inadequate setting of lending limits, deficiencies in appraisal of borrowers' financial position, inadequate risk pricing, lack of loan review mechanism etc. the external factors include state of economy, fluctuations in interest and foreign exchange rates, economic sanctions, government policies, and trade restrictions (Ketan, 2009).

According to Gardner, Mills and Cooperman (2005), the bank's overall lending policy follows and implements loan request procedures. The protocols ensure that loan presentations are consistent and that loan committee members may easily access them. The procedures include determining the source of the business, the primary contacts for the loan, the participation structure (if other banks are involved in the loan), the amount and rationale for the loan request, and financial statement analysis, including historical and ratios focusing on the company's ability to repay its debt, brief history and operations of the firm, optional industry analysis if needed, profile of managers and their experience and expertise, financial statement analysis, including historical and ratios focusing on the company's ability to repay its debt, collateral/risk analysis, which summarizes the available collateral as well as the loan's dangers such as entry obstacles into a particular industry, loan review and rating suggestion by the loan officer, including how the loan would be categorized as A, B, or C from excellent to average or below ratings, depending on the bank's classification of loan ratings, and finally conclusion as well as thoughts on the loan's beneficial and unfavorable aspects. Essentially, loan procedures focus on the risks inherent in the loan applicant's business, how those risks have been managed, the loan's usage and amount, the borrower's ability to repay the loan in terms of profits, and other sources of repayment and collateral which is held as a guarantee for the loan.

2.1.9.2 Measurement of credit risk

It is necessary to measure the credit risk. The purpose of the credit risk measurement is the quantification of potential losses from credit operation. The amount of losses is never known with certainty therefore it is necessary to estimate it.

According to "Measuring Credit Risk," credit risk measurement entails calculating Expected Loss (EL) and Unexpected Loss (UL). For the measurement of credit risk, quantification of the following components is necessary probability of default, expected exposure at default, loss given default, maturity or tenor of the exposure and degree of diversification in a bank credit portfolio.

The basic goal of credit rating a loan account is to determine if the account will remain a performing asset and will not default after a certain length of time has passed. The NBE study also provided banks with the essential standards for applying credit ratings to their borrower accounts and categorizing them according to their rating category. It has also advised banks to

develop and maintain necessary data on borrowers' loan defaults based on their credit rating category, as this will aid in the effective management of credit portfolios, as well as having a prior estimate of expected defaults, expected contribution, and capital requirements to keep the portfolio (Padmalatha & Justin 2010).

2.1.9.3 Credit Granting

Assessment of the overall risk Credit Risk Analysis (CRA) is the study from the perspective of a supplier of credit of a present/prospective claim on other economic agents in the form of debt. Credit risk analysis is important to borrower as well. It enables them to understand what the usual considerations of banks and financial institutions are while extending credit facilities. This not only facilitates proper presentation of facts but also enables the borrower to decide about the most feasible sort of financing (Assafa, 2009).

According to Padmalatha and Justin (2010), character, capacity, capital, condition, and collateral are all represented by the 5Cs model. These are used to assess a loan applicant's credit risk; as a result, the loan officer must have a thorough understanding of the customer's character, capability, collateral, terms, and capital. Character is the borrower’s willingness and determination to meet the obligations of the loan. Interviews and background checks, both personal (based on references provided by the borrower) and business, must be undertaken as part of the review. Capacity refers to the borrower's ability to create cash from its entire operations or from a single project (standalone credit), as well as the borrower's capacity to manage cash in past projects. The borrower's equity position is defined as capital, and the borrowers must contribute equity to the project for which the loan is required. By contributing an acceptable quantity of equity capital, the borrower must be willing and able to share project risk with the lending bank. The borrower must demonstrate his or her willingness to repay the loan. The current state and prognosis of the local, regional, and national economies, as well as the borrower's industry, are referred to as condition. Various economic conditions and expectations for various businesses typically necessitate different loan requirements at different points in the business cycle. Collateral, which can take the form of actual collateral or a guarantee, can help to compensate for weaknesses in one or more of the areas mentioned above.

2.1.9.4 Monitoring & Controlling of Credit Risk

Monitoring of the credit risk ongoing active monitoring and management of credit risk positions is an integral part of credit risk management activities. Monitoring tasks are primarily performed by the divisional credit risk units in close cooperation with the business which acts as first line of defense, dedicated rating analysis teams and portfolio management function. Credit risk monitoring can be divided into two level, (i) monitoring of credit risk at the level of the client and (ii) monitoring of credit risk at the level of the credit and bank portfolio.

Monitoring of credit risk at the level of the client: - at the level of individual trade operations, there is a regular monitoring, when the bank monitors the fulfilment of the contract conditions, financial situation of the client, and also the macroeconomic conditions. To identify changes in the ability to repay the loans, the bank may set many identifiers, such as turnover, repayment discipline, profitability, liquidity. Regular monitoring and identification of the changes in the ability to pay is an important tool for risk management. In the moment of the deterioration of debtor, the bank may initiate steps to maximize the return of their claim, or to minimize the losses, for example the negotiation of the additional conditions, the use of hedging instrument, the restructuring of the debt, and others. The frequency of credit risk monitoring depends on the creditworthiness of the client. Clients with good rating has been monitoring one a year, clients with a worse rating has been monitoring quarterly or monthly. In this regular monitoring, there is all the information about the client again evaluated, for example his financial situation and also the ability to meet his commitments. The output of the regular annual renewal is either the confirmation or modification of the rating and the revision of rating is updated by new calculation of limits. The information system monitors the exceeded the gross credit exposures compared to the currently valid limits. Bank follows up the changes of the client and if fund some of the following facts, the extraordinary monitoring is used. The impetus for extraordinary monitoring is exceeding of the credit exposure with comparison to applicable limits, new records in the bank or non-bank registers, changes in financial indicators outside the limits of tolerance, information about the execution or insolvency, changes in the number of turnovers on account, payment after the due date. The progress and content of the extraordinary monitoring is almost the same as the proper monitoring, but is caused by external factors, and given the nature of these factors can be expected deterioration in the situation of the client.

Monitoring of credit risk at the level of the credit and bank portfolio: - the credit portfolio is divided into four main segments: non-financial corporations, mortgages, consumer credits and the other credits. Structure of the credit portfolio is dependent on the type of the bank, i.e. whether the bank is universal or specialized. One of the basic rules of the credit risk management is the principle of diversification. The degree of diversification of the credit portfolio significantly related to the clients to who the bank is concentrated. If the bank provides a large amount of the credits to retail clients, mainly to households, the degree of diversification is higher than at the bank that provides credits to the large corporations. The quality of the credit portfolio of the bank depends on the economic position of individual credit borrowers. Status and basic trends of credit portfolio are expressed in terms of return of the credits, the cause of the subprime loans involve not only the ability but also the willingness of the borrower to repay the loan including interest. One of the methods of credit risk measurement is based on this principle, i.e. the willingness and ability to repay the credit and also on the behavior of individual components of the credit portfolio and uses the expected default rates. The expected default rates tell us what percentage of the credit will not be repaid whether due to inability or unwillingness of the client. At the level of the portfolio, the bank assesses the degree of diversification, the pumping limits and accumulation of debtor in the individual rating levels. Next, the bank assesses the developments in individual sectors and adjusts the funding levels for subjects of particular sectors of economy. The aims of the entire portfolio monitoring are to ensure, that the cumulative amount of credit does not exceed the established credit limits, to monitor the trends in individual credit portfolios managed by bank, and to ensure, that the limits set by the bank will minimize the risk and maximize the returns. Monitoring and evaluation of the credit portfolio as a whole often lead to identify trends that are not evident in individual credit monitoring. The most important trends of development that should be monitored are the share of abandoned assets in comparison with the total volume of assets, the classification of the risk, according to the number of clients in each class and according to the value of the credits in each class (weighted average risk rating),the trend to the concentration by the sector and geographical distribution, credit ratio, credits which were re-negotiated the conditions, to the total volume of loans, the technical exceptions, the profitability, and the marketing information such as number of credits, number of clients. The trends and limits are assessing at the level of credit portfolio. All the exceeded limits and warming trends must to by subjected to analysis and if it is necessary

take steps to remedy, such as block the credit limits, the rejection of applications for prolongation credits, considering of credit limit revision, reconsider the cost of credit. Credit risk management at the level of bank credit portfolio is based on the fact that the risk is present on the active side of the bank and it is included in the following items: receivables from clients and purchased credit securities (Erica, Kataria & Peter 2015).

Failure to monitor credit risk is the cause of many credit losses. Monitoring is typically conducted by gathering some information from the consumer and processing it though some minimal ratio analysis. Credit risk monitoring is defined as the proactive control of credit risk before major problems emerge. It necessitates a strong understanding of the operational and financial risks in order to detect bad changes in any of the underlying elements. The credit risk monitoring hypothesis should be that deterioration in economic and other business situations is unavoidably reflected in obligors' performance. The frontline credit risk management officer should be on the lookout for negative developments, such as early warning indications (Joseph, 2005). Because lending is a bank's primary and most important operation, the risk connected with it accounts for a significant portion of the bank's total risk exposure. As a result, lending activity must be backed up by a robust management and monitoring system. . At the branch level (transaction level), the bank engages in loan activity, which is pooled at the bank level to build a portfolio. A clear, well-documented, and well-communicated credit policy at the transaction level has become vital for controlling and monitoring credit risk. At this point, it's important to remember that a well-designed credit information system is the foundation of the industry (Sahlemicahel, 2009).

2.1.10 Mitigation of Credit Risk

Parties to a loan can arrange for mitigates such as collateral, guarantees, letters of credit, credit derivatives, and insurance during and after the loan is underwritten. Credit derivatives are also been used to efficiently transfer risk while preserving customer relationships. Although these mitigate have similar effect, there are important distinctions, including the amount of loss protection that must be considered when assigning risk ratings. For example, a letter of credit may affect a loan’s risk rating differently than a credit derivative. Credit mitigates primarily affect loss when a loan default and, except for certain guarantees, generally do not lessen the risk of default. Therefore, their impact on a rating should be negligible until the loan is classified.

Examiners should be alert for ratings that that overstate how much of a loan's credit risk is mitigated. Account officers at time assign less severe ratings based on the existence of collateral or other mitigates rather than undertaking a realistic assessment of the value the bank can recover. (Padmalatha & Justin, 2010).

2.1.11 Non-Performing Loan

Non- performing Loans calculates the portion of gross loans which are doubtful in banks" portfolio. The principal source of income for banks is loans and advances. A bank, like any other business, wants to maximize its profits. A bank is likely to offer as much of its capital as possible since loans and advances are more rewarding than any other asset. However, banks must exercise caution when it comes to the security of such advances (Radha .M, et al, 1980). Bankers naturally aim to strike a balance between maximizing profit through lending while also managing the risk of loan default, which would decrease earnings and thus equity. As a result, a bank must exercise extreme caution when making loans because there is a significant risk of default.

According to the Ethiopian banking business proclamation, non-performing loan (NPL) is defined as "loans or advances whose credit quality has deteriorated such that full collection of principal and/or interest in accordance with the contractual repayment terms of the loan or advances in question and it must be under 5% (NBE, 2008)."

2.2 Empirical literature

A number of empirical studies were conducted in the area of credit risk management both at global and Ethiopian banking system context.

2.2.1 Studies in Global Context

Al-Tamimi& Al-Mazrooei, (2007) carried out comparative study of bank's risk management between national and foreign banks in the United Arab of Emirates through survey. The survey questionnaire mainly composed seven items clustered under risk management practice (independent variable) and thirty-three items under understanding risk and risk management, risk identification, risk assessment and analysis, risk monitoring, and credit risk analysis (independent variables). The regression results revealed that risk identification and risk assessment and analysis had significant positive impact on risk management practice while other

variables had insignificant positive Impact. The researcher also found that risk identification and risk assessment and analysis were the most influential variables for risk management practice of nationally owned bank. It also further concluded that there was a significant difference between nationally owned and foreign banks in the aspect of understanding risk and risk management URM), risk assessment and analysis (RAA) and Monitoring and controlling aspects while did not with practice of risk identification (RI), risk management practice and credit risk analysis. Generally reported as foreign bank were more effective in risk management practice then nationally incorporated bank due to quality of staffs and regulatory requirement.

Benjamin (2015) conducted study on "An examination of agricultural development bank Ltd's credit risk management practice" and concluded that ADP's management needs adopt a credit risk management policy. It is focused toward awarding current loans while dramatically reducing the approval of loans that have the potential to become suspect or lose money in the long term, and the necessity to appropriately equip credit experts in order to minimize the risk of loan defaults.

Frederick (2012) conducted a study entitled "Evaluation of Credit Risk Management Practices in Ghana Commercial Bank Ltd." Focused that credit risk monitoring and supervision efforts should be implemented and exercised by the bank properly. The bank should maintain that credit business operation experts conduct consistent follow-ups on borrowers to ensure that the loans taken by the clients are used for the intended purpose and the bank must rigorously adhere to lending procedure and standards, avoiding any human intervention if conditions are not met.

Kosmas (2009) in his published journal entitled "The impact of effective credit risk management on bank survival" He discovered a finding that strongly supports the assumption that weak credit risk management led to the bank collapses to a greater extent. As a result, sound and quality credit risk management function is significant in banks operation and helps them to enhance their performance and avoid the stress of the bank. Better performance of the business is directly related with a sound risk management culture. Banks should have a complete credit risk management mechanism in place to detect, assess, monitor, and control credit risk and any material risk, as well as maintain capital against these risks where relevant. In banks, creating a complete credit risk management system should be a requirement because it contributes to the bank's overall risk management system. Banks must also follow solid corporate governance

standards, manage their risks holistically, concentrate on core banking activities, and follow prudential banking procedures.

Onyango (2010), conducted a research on “Assessment of the credit risk management practice of commercial banks in Kenya” he said, adding that banks should be aware of the need to identify, measure, monitor, and control credit risk, as well as ensure that they have sufficient capital to cover these risks and that they are properly compensated for risks incurred. Defining the risk, determining the risk, classifying it, evaluating it, and then monitoring the effectiveness of the loan and managing it effectively and successfully are all part of the credit risk management process. These procedures have proven to be effective in addressing a variety of risk areas.

2.2.2 Studies in Ethiopian Context

Saheb and Krishna (2018) in their paper entitled “Credit risk management practice in the banking sector in Ethiopia” the principal goal of the research was to examine and compare credit risk management practice between Commercial bank of Ethiopia (CBE) and Awash international bank (AIB), they concluded banks' credit risk management and policies are driven by internal as well as environmental influences. Their suggestions include revising the bank's current credit policies and implementing information systems and analytical methodologies that allow management to assess the credit risk inherent in all on- and off-balance sheet activities, as well as counter-party risk exposure.

Gedefaw (2019) in his paper entitled “Assessment of credit risk management system and practice of Ethiopian Commercial Banks (Case of some private Banks).The main objective of the study was to assess or examine credit risk management system and practice in Ethiopian banking industry in some of private sector banks (i.e, Berhan International Bank S.C, Bunna International Bank S.C, Debub Global Bank S.C and Enat Bank S.C). The study found that banks employed a variety of credit risk management methods, methodologies, and assessment models to manage their credit risk, with one common goal in mind: to minimize nonperforming loans, which were the leading cause of bank failures. He also concluded that banks with excellent credit risk management strategies have smaller bad loan amount.

Hable (2018) has assessed credit management practice of United Bank S.C. The study's major goal was to look into credit risk management practices in united bank s.co. Based on this the

research found some problems associated with the bank's credit management practice. Lack of credit follow-up by branches was one of them, absence of information systems to support the bank's credit risk grading system, branches' disregard for the bank's credit policy and procedure while exercising their discretionary lending limit, borrower's full default, and borrower’s lack of understanding about loan usage. The ability to achieve good credit management is influenced by factors such as fund diversion for unanticipated purposes, centralized decision-making by the bank, and centralized decision-making by the bank. On other side the bank’s credit management manuals and procedure is in accordance with the rules and regulation of NBE. The research also suggested that maintaining up with the existing portfolio management quality, to constantly address & implement the banks credit management manuals and procedure, to take up pre-audit as a part of the credit analysis process, handling the time duration it takes to complete a single loan request.

Sahlemichael (2009) in his study, examined the credit management practice of Ethiopian Commercial Banks. The principal goal of the research is to determine how banks handle their credit risk. Some of the proposals include establishing a separate department unit outside of the loan origination function in order to preserve credit discipline and clarify credit risk management and control processes. Credit policies must be communicated throughout the organization, implemented through appropriate procedures, monitored, and revised on a regular basis to account for changing internal and external circumstances, and banks should diversify their credit portfolios by avoiding large credit commitments on one or two industries, as well as on individuals or businesses.

Solomon (2013) concluded in his study "credit risk management methodologies and practice of NIB International Bank" that commercial banks' credit risk management systems are ineffective. Separation of credit risk management from credit sanction, credit processing/approval from credit administration, and lastly the formation of an independent credit audit and risk assessment function should be included as a check and balance for credit extension.

Tibebu (2011) in his study entitled “Credit risk management and profitability of commercial banks in Ethiopia” focused that the bank's board of directors is responsible for all of the bank's actions. As a result, they must provide additional training to their personnel. Especially for the manager and workers of the credit risk management department. Bank policymakers (NBE) must

establish policies and guidelines that force banks to reconsider their credit policies, risk management policies, and other important topics.

Girma Mekasha (2011) in his paper entitled "Credit Risk Management and Its Impact on Performance on Ethiopian commercial Banks" the main objective of his study was to have bigger picture on credit risk management and its impact on their performance. His research revealed that credit risk management and bank performance (in terms of return on asset) have a significant link (in terms of loan performance). Bank performance improves with greater credit risk management. As a result, it is critical that banks undertake appropriate credit risk management and safeguard their assets in order to protect their investors. The study also reveals banks with better profit capacity can absorb credit losses adequately whatever they crop up and therefore achieve good performances. Furthermore, the study shows that there is a direct but inverse relationship between return on asset (ROA) and the ratio of non-performing loans to total loan (NPL\TL) and loan provision to total loan.

Tesfaye Tadesse (2019) in his research entitled "Credit risk management and profitability -the case of united bank S.C" has investigated the effect of credit risk management on profitability of private commercial banks in Ethiopia-the case of United Bank S.C. His study concluded that credit risk management and profitability at United Bank S.C were found to be significantly positively related.

Tesfaye Mulugeta (2018) in his research entitled "The effect of credit risk on financial performance of commercial banks in Ethiopia." The main objective of his study was to investigate the effect of credit risk on the financial performance of Ethiopian commercial banks. Credit risk has a considerable impact on commercial banks' financial performance in Ethiopia, as per the study. As a result, the study recommends that Ethiopian commercial banks improve their competence in credit analysis and loan administration in order to support each component.

2.3 Summary and Literature Gap

The literature has tried basically to review the concepts of risk, risk management, credit risks and the activities undertaken by commercial banks to handle these risks. It also included a discussion of the theories that guided the research, as well as the meaning and significance of credit risk management to any commercial banks. Credit risk management is the process of controlling the impact of credit risk-related events on the financial institution and involves the identification, understanding, and quantification of the degree of potential loss and the consequential

implementation of appropriate measures to minimize the risk of loss to the financial institutions (Saheb & Krishna, 2018). This is therefore, it is one the most important tasks for the financial liquidity and stability of banking sector in connection with increased sensitivity of banks to the credit risks and changes in the development of prices of financial instruments (Kiseľáková and Kiseľák, 2013).

Regarding to this, researches were conducted worldwide and in Ethiopia mainly focused on credit risk management practice of different commercial banks. (Al-Tamimi& Al-Mazrooei,2007) in their journal entitled "Banks' risk management, a comparison study of UAE national and foreign banks" they carried out a comparative study between national and foreign banks and they concluded that there was a significant difference between nationally owned and foreign banks in the aspect of understanding risk and risk management, since foreign bank were more effective in risk management practice than nationally incorporated bank due to quality of staffs and regulatory requirement. Benjamin (2015) on his study "An assessment of credit risk management practice of agricultural development bank Ltd" and Frederick (2012) in his study entitled "Evaluation of Credit Risk Management Practices in Ghana Commercial Bank Lt." emphasized that proper credit risk monitoring and controlling practice should be applicable and intensified by any commercial banks for better . Kosmas (2009) in his published journal entitled "The impact of effective credit risk management on bank survival" he discovered a finding that clearly supports the assumption that poor credit risk management contributed to the bank collapses to a higher extent. This should be a requirement because it benefits to the bank's overall risk management system. Oniyango, (2010), did a study on assessment of commercial banks' credit risk management system in Kenya.

In Ethiopia, Saheb and Krishna (2018) assessed credit risk management technique and practice of Commercial Bank of Ethiopia and Awash Bank. Gedefaw (2019) has assessed credit risk management system and practice of four Ethiopian private commercial banks (Buna International Bank, Birhan International Bank, Debub Global Bank and Enat Bank Share Company). Hable (2018) has also assessed credit management practice of United Bank S.C. Sahlemichael (2009) has investigated credit management on Ethiopian Commercial Banks; Solomon (2013) in his study examined credit risk management methodologies and practice of NIB International Bank. Tibebu (2011) in his paper has also investigated credit risk management

and profitability of commercial banks in Ethiopia. Both Girma (2011) and Tesfaye (2018) on their research mainly focused to investigate the effect of credit risk management on commercial banks' financial results in Ethiopia. Tesfaye (2019) also looked into the impact of credit risk management on the profitability of Ethiopian private commercial banks the case of United Bank S.C.

Based on this, despite the numerous studies made but this study particularly focused on credit risk management practice of Oromia International Bank. Therefore, the purpose of this study is to evaluate the credit risk management practice of Oromia International Bank.

CHAPTER THREE

Research Design and Methodology

Business research is the application of the scientific method in searching for the truth about business phenomena. Business research is more than conducting surveys. This process includes idea and theory development, problem definition, searching and collecting information, analyzing, and interpreting collected data, and communicating the findings and their implications to end user. Hence, this chapter discussed the research methodology of the study. It deals with the research design, research approach, research population and sampling determination, data collection and analysis methods employed to answer the research questions.

3.1 Research Design

Descriptive research design adopted to examine the credit risk management practice of Oromia International Bank, since the study is required to describe and explain the bank's credit risk management practice.

3.2 Research Approach

A quantitative study approach is applied to assess credit risk management practice of Oromia International Bank. In order to fulfill the objectives of the study the research utilized quantitative data. By doing this, the study aimed to describe, and interpret the current credit risk management practice of the bank. The techniques used to collect data is by distributing a questionnaire to respondents those worked on credit business department especially directors, managers and senior officers and conducting an interview with division manager of the departments at head office level.

3.3 Data Source

Primary data was gathered by questionnaires issued to bank employees such as directors, managers, and officers who work on credit business operation and conducting an interview with division manager of credit management department. This is to gather a broad range of credit risk management baseline data. The reason for collecting data through questionnaires is that it is a simple and cost-effective method of collecting data, especially when significant amounts of data must be obtained from a big population.

3.4 Population

The target population for this study is 48 employees of the bank found in credit operation department at head office level, those employees are particularly credit analysts, Experts, Managers, Directors, on the same process at head office. Employees who are involved in the credit business operation are used as a selection factor for the target population. As a result, the study provided questionnaire to all employees who are engaged in credit and credit related operation at head office level. Because, it is the focal area and many of the credit request of OIB are now being processed in central head office. Based on this, in central (head) office's credit business department there are 48 employees, who are engaged on credit business operations. Therefore, the participants in this study comprised 48 employees who are engaged on credit operation as a whole.

3.5 Method of Data Collection

Primary data is first-hand information, data collected directly from an original source. Primary data can be collected through observation, interviews, or the use of questionnaires (Saunders. 2009). The study used questionnaires and interview to collect primary data for quantitative analysis. The data is gathered through questionnaire from the target population of 48 respondents of OIB's staff who have direct relation with credit operation and an interview with division managers of the department at head office level.

3.6 Method of Data Analysis

Descriptive statistical tools like percentages, frequencies, and tables were utilized for analysis of the data and interpretations to make it presentable for the readers. After the respondent's answer is analyzed on the respective table, explanation on the credit risk management practice of the bank is given based on answer given by the respondents.

3.7 Validity

Validity refers to the credibility of the research. It is concerned with the findings use really about what appears to be about. Validity defines as the extent of which data collection methods are accurately measured and what they were intended to measure (sounders, 2003). To accomplish the goals, the researcher developed survey questions based on a literature and empirical study. Accordingly, to ensure the contents validity, seven selected officers who know better about the

issue being investigated as a pilot test. As a result, the researcher proven that and reached at the confidence level same answer would be availed to another independent research.

CHAPTER FOUR

Data Analysis and Interpretation

This part of the study is concerned on the findings and interpretations of the data acquired from respondent questionnaires. Based on this, the finding of the study is shown as follow:

4.1 Demographic Characteristics of Respondents

The demographic aspect of the respondent has a significant contribution in the credit risk management systems of the bank to understand and implement the credit procedure, policy, manuals and improve when it is necessary. As a result, demographic features of respondents such as educational level, field of specialization and credit related experience are taken into account and assessed in this process.

Table 4.1: Educational Level of Respondents

Educational level	Frequency	Percent (%)
First Degree	41	85
Second Degree) Masters	7	15
Total	48	100

Source: Results of a survey conducted by a researcher using primary data sources

Educational background of employee is a significant element to be considered with regard to making credit business decision. As it is indicated on the above table (table 4.1), 85% of the respondents have a bachelor degree and the remaining 15 percent of respondents have master degree. This implies that the majority of the respondents working in credit area are bachelor and master degree holder and this enables them to perform the credit management operation systematically and scientifically in terms of the best interest of the bank. It also helps the researcher to obtain better quality of data regarding to credit management practice of the bank.

Table 4.2: Field of specialization of Respondents

Field of Specialization	Frequency	Percent (%)
Accounting	25	52
Management	10	21
Economics	2	4
Business Administration	11	23
Total	48	100

Source: Results of a survey conducted by a researcher using primary data sources

Field of specialization of the employee is an important factor to be considered with regard to conduct the credit business operation at professional way. As it is indicated on the above table (table 4.2), 52% of the respondents are accounting graduates, 21% the respondents are management graduates, 23% the respondents are business administration graduates, and the remaining 4 percent of respondents are economics graduates. This means that the majority of the respondents working in credit management department are graduates of business and business-related fields and they have appropriate profession for the area and this enables them to undertake the credit management operation professionally because credit management is one element of business administration.

Table 4.3: Position of Respondents

Position	Frequency	Percent (%)
Managerial	5	10
Expert and officers	43	90
Total	48	100

Source: Results of a survey conducted by a researcher using primary data sources

As it is stated on the above table (table 4.3), 10% of the respondents are at managerial position which includes managers of credit business operation where as 90% are professionals at officer level. The experts and officers are assigned on the activities of credit business operation such as on corporate credit, commercial credit, credit underwriting, workout loan and credit portfolio management and the managers have supervised, and approved the operation done by experts and officers.

Table 4.4: Credit Related Experience of Respondents

Year of Experience	Frequency	Percent (%)
< 1 year	2	4
1-5 years	12	25
6-10 years	27	56
More than 10 years	7	15
Total	48	100

Source: Results of a survey conducted by a researcher using primary data sources

Field of specialization of the employee is an important factor to be considered with regard to conduct the credit business operation at professional way. As it is indicated on the above table (table 4.4), about 56 percent of the participants have 6-10 years of experience on credit management, in addition to this 15 percent of the respondents have more than 10 years' experience. This would help the researcher to gather better quality of data on credit granting, monitoring and controlling process of the bank. Additionally, their experience enables them to perform the credit management operation of the bank accurately and with better quality.

4.2 Research related questionnaires

Table 4.5: Identification practice of credit risk

Item		Strongly Disagree		Disagree		Neutral		Agree		Strongly Agree		Total	
		Fr.	%	Fr.	%	Fr.	%	Fr.	%	Fr.	%	Fr.	%
A	The bank identifies all of the risks inherent with the credit products and activities.			4	8	4	8	32	67	8	17	48	100
B	The bank quantifies all of the risks inherent with the credit business at individual level					2	4	10	21	36	75	48	100
C	The bank quantifies all of the risks inherent with the credit business at portfolio level					5	10	6	13	37	77	48	100
D	The bank measures the entire unexpected loss of credit risk.	14	30	25	52	4	8	5	10			48	100
E	The bank measures the maturity of all exposure risks associated with the credit business.			7	15			11	23	30	62	48	100

As it can be seen from table 4.5, Item (A), respondents were asked whether the bank identifies all of the risks inherent with the credit products and activities. Based on this, 17% of the respondents strongly agreed, 67% agreed, 8% are neutral and 8% disagreed. As it is indicated that most of the respondents replied as the bank identifies all of the risks inherent with the credit products and activities. Due to this the bank enables to know the nature and types of credit related risks to manage properly.

On table 4.5 item (B), respondents were asked whether the bank quantifies all of the risks inherent with the credit business at individual level. Based on this 75% of the respondents' strongly agreed and 21% of the respondents' also agreed and 4% are neutral. It implied that almost all respondents witnessed that the bank measures all credit related risk at individual level.

In this regard the bank enables to know the amount of expected losses at individual level to manage properly.

On table 4.5 item (C) of table 4.5, 77% respondents strongly agreed that the bank carried out measurement of credit risks at portfolio level where as 13% agreed and the remaining 10% were neutral. As it is revealed that most of the respondents replied as the bank measure credit related risks at portfolio level and this would help the bank to develop and maintain data regarding to expected losses of credit risk at portfolio level to manage properly.

On table 4.5 item (D), respondents were asked whether the bank measures the entire unexpected loss of credit risk. 30% of the participants strongly dis-agreed, in addition to this 52% of the respondents dis-agreed while 8% of the respondents are neutral and 10% are agreed. As it is revealed that most of the respondents replied as the bank does not measure unexpected loss of credit risk. This implied that the bank does not know the amount of unexpected loss of credit risk which might be faced during its credit operation.

Regarding the question presented whether the bank measures the maturity of all exposure of credit risks are quantified by the bank on table 4.5 item (E), 62% of the participants strongly agreed, in addition to this 23% of the respondents agreed, where as 15% of them disagree and none of them strongly disagree. As it is indicated that most of the respondents replied as the bank measures the maturity of all exposure of credit risks. Based on this, the bank knows when exposure of credit risk is ended and this enables the bank to develop adjusted repayment collection schedule.

Table 4.6: Credit Granting Process

No		Strongly Disagree		Disagree		Neutral		Agree		Strongly Agree		Total	
		Fr.	%	Fr.	%	Fr.	%	Fr.	%	Fr.	%	Fr.	%
A	Bank's credit professionals always conduct a face to face meeting to discuss the customer's history and future plans.	14	30	25	52	1	2	8	16			48	100

B	Your bank always provides expertise advise in the event of loan work out situation with a customer			3	6			10	21	35	73	48	100
C	The bank perfectly analyzes the reputation of the customer before granting the loan.			2	4			34	71	12	25	48	100
D	The bank conducts comprehensive financial analysis of the customers before granting the loan.					2	4	29	60	17	36	48	100
E	Adequacy of collateral requirement is properly evaluated and measured.	6	13	5	10			25	52	12	25	48	100
F	Marketability of collateral requirement is properly evaluated and measured.			3	7	6	12	23	48	16	33	48	100
G	Enforceability of collateral requirement is properly evaluated and measured.			2	4			27	56	19	40	48	100
H	The bank has established credit limit for all types of credit services.							5	10	43	90	48	100
I	The entire economic factors will be analyzed before the loan is granted			3	6			9	19	36	75	48	100
J	Nature of the business is properly analyzed before the loan is granted			5	10			19	40	24	50	48	100
K	Nature of the industry is properly analyzed before the loan is granted			9	18			24	50	15	32	48	100
L	The bank diversifies its credit exposure to different industry sectors.			5	10	3	6	10	21	30	63	48	100
M	The bank diversifies its credit exposure to different geographical area.	4	8	4	8	1	2	25	52	14	30	48	100

As indicated on table 4.6 item (A) respondents were asked whether the Bank's credit professionals always conduct a face to face meeting to discuss the customer's history and future plans; 14% of the participants strongly disagreed with the questions presented to them while 52% of the respondents disagreed, while 16% of them agreed and the remaining 2% of the respondents are neutral. This implied that the bank's credit professionals do not conduct a face to face meeting to discuss the customer's history and future plans. Due to this the bank might be loose some relevant information that raised on the meeting to know about the customers future plans and history.

On item (B) of table 4.6, respondents were asked whether the bank always provides expertise advice in the event of loan work out situation with a customer. Based on this 73% of the participants strongly agreed and 21% of the respondents also agreed and the remaining 6% of them are disagree. As it is indicated that most of the respondents replied as the bank provides expertise advice in the event of loan work out situation with a customer. This enables the bank to work closely with its customers.

On table 4.6 item (C), 25% of the participants strongly agreed that the bank perfectly analyzes the reputation of the customer before granting the loan and 71% of them also agree and the remaining 4% of them are disagree. As it is indicated that most of the respondents replied as the bank analyzes the reputation of the customer before granting the loan. This enables the bank to know or understand the background of its customer.

On item (D) of table 4.6, respondents were asked whether the bank conducts comprehensive financial analysis of the customers before granting the loan. 36% of the participants strongly agreed, in addition to this 60% of the respondents agreed while 4% of them were uncertain. As it is indicated that almost all of the respondents replied as the bank conducts comprehensive financial analysis of the customers before granting the loan. This enables the bank to know or understand the financial capacity of its customer and the ability to repay the loans. Such as turnover, repayment discipline, profitability, liquidity of the clients.

On item (E) respondents were asked whether adequacy of collateral requirement is properly evaluated and measured. 25% of the participants strongly agreed with the question presented to them where as 52% agreed while 10% of the respondents disagreed and the remaining 13% of

the respondents are strongly disagree. As it is revealed that most of the respondents replied as the bank evaluate and measure the adequacy of collateral requirement before granting the loan. This enables the bank to hold adequate collateral for the compensation for uncollectable account.

For the question issued for the respondents whether marketability of collateral requirement is properly evaluated and measured; on item (F) table 4.6, 33% of the participants strongly agreed, at the meantime 48% of the respondents agreed and 12% of them were neutral and 7% were disagreed. As it is showed that most of the respondents replied as the bank evaluate and measure the marketability of collateral requirement before granting the loan. This enables the bank easily to convert non-financial asset (collateral) to cash

On item (G) of table 4.6, whether enforceability of collateral requirement is properly evaluated and measured; 40 % of the participants strongly agreed while 56% of the respondents agreed and the remaining 4% of them disagree. As it is indicated that majority of the respondents replied as the bank evaluate and measure the enforceability of collateral requirement before granting the loan. This enables the bank easily to take over the collateral.

On Item (H) of table 4.6 presented that 90% of the participants strongly agreed and the remaining 10% of them agreed that the bank has established credit limit for all types of credit services. As it is indicated that all of the respondents replied as the bank establish credit limit for all types of credit services. This enables the bank to control the credit level based on its risk level.

On table 4.6 item (I) being 75% of them strongly agreed while 19% agreed and the remaining 6% of disagreed on the question presented as the bank analysis the entire economic factors before the loan is granted. As it is indicated that most of the respondents replied as the bank conducts economic factor analysis before granting the loan. Due to this the bank knows or understand economic condition of the environment to reduce the risk level which associated with the economy.

On item (J) respondents were asked whether nature of the business is properly analyzed before the loan is granted. Based on this 50% of the participants strongly agreed and 40% of the respondents also agreed and the remaining 10% of them are disagree. As it is indicated that majority of the respondents replied as the bank conducts business analysis before granting the loan. This enables the bank to reduce credit risk that associated with the nature of the business.

On item (K) of table 4.6, 32% of respondents strongly agreed on the question presented as the bank properly analyze nature of the industry before the loan is granted and 50% of them also agree and the remaining 18% of them are disagree. As it is revealed that most of the respondents replied as the bank conducts industry analysis before granting the loan. It implied that the bank can reduce the risk level that associated with the nature of the industry.

As it is indicated on item (L) of table 4.6, participants were asked whether the bank diversifies its credit exposure to different industry sectors. 63% of the participants strongly agreed in addition to this 21% of the respondents agreed, 10% of them are disagreed and the remaining 6% of the respondents were uncertain. As it is indicated that majority of the respondents replied as the bank diversifies its credit exposure to different industry sectors. This enables the bank to minimize the risk level that related with the specific type of industry.

On item (M) respondents were asked whether the bank diversifies its credit exposure to different geographical area. 30% of the participants strongly agreed with the question presented to them additionally 52%of the respondents agreed while 8% of them disagree, 8% of the respondents are strongly disagree and the remaining 2% of the respondents are neutral. As it is indicated that most of the respondents replied as the bank diversifies its credit exposure to different geographical area. This enables the bank to minimize the risk level that associated with the specific geographical area.

Table 4.7: Credit risk evaluation and monitoring process

No		Strongly Disagree		Disagree		Neutral		Agree		Strongly Agree		Total	
		Fr.	%	Fr.	%	Fr.	%	Fr.	%	Fr.	%	Fr.	%
A	The bank strictly monitors loan terms and conditions that have been stipulated at the time of loan approval.			3	6			7	15	38	79	48	100
B	The bank uses a loan covenant checklist that routinely tracks its customer's adherence to covenants.			6	12	4	8	30	63	8	17	48	100

C	The bank regularly reviews and monitors the performance of Credit quality at individual level							24	50	24	50	48	100
D	The bank regularly reviews and monitors the performance of credit quality at portfolio level			6	13			26	54	16	33	48	100
E	Credit file is regularly updated in our bank.					3	6	13	27	32	67	48	100
F	The bank has properly applied its own internal risk rating system.					5	10	5	10	38	80	48	100
G	Credit monitoring procedure is regularly reviewed in our bank.	30	63	11	23	4	8	3	6			48	100
H	Credit monitoring procedure is regularly updated in our bank.	25	52	14	29			9	19			48	100

As indicated on table 4.7 item (A) respondents were requested about the bank strictly monitors loan terms and conditions that have been stipulated at the time of loan approval; 79% of the respondents strongly agreed with this point, 15% agreed and the remaining 6% of the respondents are disagreed. As it is showed that most of the respondents replied as the bank strictly monitors loan terms and conditions that have been stipulated at the time of loan approval. This implied that the bank ensures the fulfilment of the contract terms and conditions of the client to identify and take corrective action if there are any changes in the ability to repay the loan.

On item (B) of table 4.7, participants were requested whether the bank uses a loan covenant checklist that routinely tracks its customer's adherence to covenants. Based on this 17% of the participants strongly agreed, 63% of the respondents also agreed, 12% of them are disagreed and the remaining 8% of the respondents are neutral. As it is indicated that most of the respondents replied as the bank uses a loan covenant checklist that routinely tracks its customer's adherence to covenants. This implied that the bank ensures the fulfilment of client's obligation and this enables the bank to take the required corrective action before the loan is none performed.

On item (C) of table 4.7, respondents are requested whether the bank regularly reviews and monitors the performance of credit quality at individual level. 50% of the participants strongly

agreed, in addition to this 50% of the respondents agreed. All respondents replied as the bank regularly reviews and monitors the performance of credit quality at individual level. This enables that the bank to know the client's status on the ability to meet their commitments at individual level.

On item (D) of table 4.7, respondents are requested whether the bank regularly reviews and monitors the performance of credit quality at portfolio level. 33% of the participants strongly agreed, additionally 54% of the respondents agreed and the remaining13% of the respondents are dis agreed. Even if 13% of the respondents are disagreed on the issue, the majority of respondents replied as the bank regularly reviews and monitors the performance of credit quality at portfolio level. This enables that the bank to know the client's status on the ability to meet their commitments at portfolio level.

On item (E) of table 4.7, respondents were requested as credit file is regularly updated in the bank. 67% of the participants strongly agreed with the questions presented for them additionally 27% agreed and the remaining 6% of the respondents are neutral. As it is indicated on the above figure, even if 6% of the respondents standing as neutral, we can confidently say that the bank updated the credit file. This enables that the bank to have current information on the overall loan status.

Regarding the question presented whether the bank has properly applied its own internal risk rating system on item (F) of table 4.7, 80% of the participants strongly agreed, additionally 10% of the respondents agreed and the remainig10% of them were neutral. AS it is indicated here above most of the respondents replied as the bank properly applied its own internal risk rating system. This enables that the bank to acquire and maintain a relevant data and information regarding to loan defaults of clients based on their rating classification as it helps to handle credit portfolio management properly and to maintain a prior measure of expected defaults and amount of capital that needed to manage the portfolio.

On item (G) of table 4.7 about credit monitoring procedure is regularly reviewed in the bank; 63 % of the respondents strongly disagree, 23% of them also disagreed, 8% were neutral and the remaining 6% of them agreed. AS it is indicated that most of the respondents replied as the bank does not regularly reviewed the monitoring procedure. Due to this the bank cannot detect the

problem that is associated with credit monitoring procedure to take an immediate course of action.

On item (H) of table 4.6 describes that 52% of the respondents strongly disagree 29% of them also disagreed and the remaining 19% of them agreed that credit monitoring procedure is regularly updated in the bank. AS it is indicated that most of the respondents replied as the bank does not regularly updated the monitoring procedure. This leads the bank to follow and implement outdated credit monitoring procedure.

Table 4.8: Credit risk controlling practice

No		Strongly Disagree		Disagree		Neutral		Agree		Strongly Agree		Total	
		Fr.	%	Fr.	%	Fr.	%	Fr.	%	Fr.	%	Fr.	%
A	The bank constantly takes immediate corrective action for credit default sign.			7	15			12	25	29	60	48	100
B	Credit policy is regularly updated in our bank.					3	6	15	31	30	63	48	100
C	Policy measures have been taken regularly to solve loan recovery problem.							31	65	17	35	48	100
D	The bank maintains the actual risk profile at or under its risk tolerance.			2	4			27	56	19	40	48	100
E	Credit policy is consistently applied in all credit activities of the bank.			6	13			24	50	18	37	48	100
F	The bank constantly monitors the financial condition of counterparties and action taken as required.					2	4	34	71	12	25	48	100
G	The bank actively responds to new information in all aspect of credit products and activities.							10	21	38	79	48	100

H	The bank gives adequate risk management training for concerned staffs.	18	38	26	54			4	8			48	100

According to table 4.8 item (B), 60% of the respondents strongly agreed there is a constant and immediate corrective action has been taken by the bank for credit default. 25% of respondents agree with the above statement and the remaining 15% disagree with it. Even if the remaining respondents being stand on neutral and disagree on the above statement, it is confident to say banks has constantly takes immediate corrective action for credit default sign that has been occurred in due course of time as required. This would help the bank to solve credit related problems on time.

According to table 4.8 item (B), 63% of the respondents strongly agreed there is a regularly updated on Credit policy in the bank. 31% of respondents agree with the above statement and the remaining 6 % neutral with it. Even if the remaining respondents being stand on disagree and strongly disagree on the above statement, it is confident to there is a regularly updated on the credit policy of the bank. This implied that it would help the bank to work with latest credit policy and this also contribute a significant role to manage the credit business operation of the bank.

According to table 4.8 item (C), 65% of the respondents strongly agree there is a policy measures that have been taken regularly to solve loan recovery problem of the bank. 31% of respondents agree with the above statement and the remaining respondents being stand on strongly disagree, disagree and neutral on the above statement, therefore it is confident to say regular policy measures have been taken to solve loan recovery problem of the bank as required. This would help the bank to develop common awareness and consistency of credit activities among the employees of the department.

According to table 4.8 item (D), 40% of the respondents strongly agree the bank has maintained the actual risk profile at or below its risk tolerance, 56% of respondents strongly agree with the above statement and the remaining 4% disagree with it. The remaining respondents being stand on strongly disagree, and neutral on the above statement, therefore it is confident to say that the bank has keep its actual risk profile at or below its risk tolerance as required. This implied that

the bank has performed in accordance with the standard which is established to tolerate the credit risk.

According to table 4.8 item (E), 37% of the respondents strongly agree the credit policy is consistently applied in all credit activities of the bank. 50% of respondents strongly agree and the remaining 13% disagree with the above statement. The remaining respondents being stand on strongly disagree, and neutral on the above statement, therefore it is confident to say that the credit policy is consistently applied in all credit activities of the bank as required. It implied that the bank enables to assure the credit business operation of the bank is carried out in accordance with the standard of the bank.

According to table 4.8 item (F), 25% of the respondents strongly agree the bank constantly monitors the financial condition of the counterparties and action was taken as required.71% of respondents strongly agree and the remaining 4% neutral with the above statement. The remaining respondents being stand on strongly disagree, and disagree on the above statement, therefore it is confident to say that the bank is constantly monitors the financial condition of counterparties and action taken as required and this enables would help the bank to understand the client's and counterparties status on the ability to meet their commitments.

According to table 4.8 item (G), 79% of the respondents agree the bank actively responds to new information in all aspect of credit products and activities. 21% of respondents strongly agree with the above statement. The remaining respondents being stand on strongly disagree, disagree and neutral on the above statement, therefore it is confident to say that the bank actively responds to new information in all aspect of credit products and activities as required. This would help the management of the bank to make updated and latest decision on credit business operation. According to table 4.8 item (H), 38% of the respondents strongly disagree the bank is not giving adequate risk management training for concerned staffs as required. 54% of respondents disagree and the remaining 8% of the respondent is also neutral with the above statement. The remaining respondents being stand on strongly agree, and disagree on the above statement, therefore it is possibly confident to say that the bank is not constantly giving adequate risk management training for concerned staffs as required consequently it is possible to conclude that lack of adequate risk management training for concerned staffs negatively affects credit risk

management practice of the bank. Hence the banks must give attention to arrange short term or/and long-term training to update the employees understanding about risk Management.

Table 4.9: Summary of responses

Responses of the above research related questions are summarized as follow

No		Strongly Disagree		Disagree		Neutral		Agree		Strongly Agree		Total	
		Fr.	%	Fr.	%	Fr.	%	Fr.	%	Fr.	%	Fr.	%
A	Regarding to credit risk Identification practice of the bank	3	6	7	15	3	6	13	27	22	46	48	100
B	Regarding to Credit granting process of the bank	2	4	5	10	1	2	19	40	21	44	48	100
C	Regarding to Credit risk monitoring and evaluation practice of the bank	7	15	5	10	2	4	15	31	19	40	48	100
D	Regarding to Credit risk controlling practice of the bank	2	4	5	10	1	2	20	42	20	42	48	100

As it is depicted on the summary table Item (A) showed that 46% of the respondents strongly agreed, 27% agreed, 6% are neutral, 15% disagreed and 6% strongly disagreed. This implied that the bank identifies all risks inherent with the credit products and activities and measure expected loss of credit risks both at individual and portfolio level. This would help the bank to develop and maintain the required data regarding to the nature, types and amount of expected loss of credit risk to manage properly. However, the bank does not measure unexpected loss of credit

risk. Therefore, bank does not know the amount of unexpected loss of credit risk which might be faced during its credit operation.

As it is depicted on the summary table Item (B), 44% of the respondents strongly agreed, 40% agreed, 2% are neutral, 10% disagreed and 4% strongly disagreed. This implied that the credit granting process of the bank is done in a proper way except that the bank's credit professionals do not conduct a face to face meeting to discuss the customer's history and future plans. Due to this the bank fails to know or understand the background of the customers.

As it is indicated on table 4.9, Item (C), 40% of the respondents strongly agreed, 31% agreed, 4% are neutral, 10% disagreed and 15% strongly disagreed. This implied that most practice of credit minoring and evaluation is in good condition except that the credit monitoring procedure of the bank is not regularly reviewed and updated. This leads the bank to follow and implement outdated credit monitoring procedure.

Finally, on table 4.9, Item (D), 42% of the respondents strongly agreed, 42% agreed, 2% are neutral, 10% disagreed and 4% strongly disagreed. It is possibly confident to say that most practice of credit controlling is in a good condition except that the bank does not give adequate risk management training for concerned staffs to improve the credit risk management practice of the bank and this may affect the credit risk management practice of the bank.

4.3 Interviews

In order to get better understanding on the credit risk management practice of Oromia International Bank, I conducted the interview with division managers of credit management department. All of the interviewees have had more than five years' experience on credit business operation in the bank. Accordingly, most of the responses obtained from the interview are presented and analyzed in the questionnaire analysis and it was used as a supportive response. Based on this, my interview guide line was; first I select the working unit (department) which has a direct relation to the topic of my study. Since my research is about credit risk management practice of the bank, credit management is an appropriate working department to conduct the interview. Next, I choose the manager of the division who has more than five years' work experience in credit business operation. Regarding to this, my interview was conducted on the existing credit risk management practice of the bank. Therefore, the summary of the interview with the corresponding response is shown as follow: -

A- Summary of responses on the overall perception of credit management practice of the bank

According to the interviewee's response regarding to their perception about credit management practice of the bank, all of the respondents supposed that credit service is the main line for its business. This is therefore, all risks associated with the credit business operation is also properly managed to reduce loan default or the probability of denying the repayment. However, they also believed that there is shortage of man power (experts) and lack of required training to credit management's staff to undertake effective credit business operation at the bank. Therefore, in order to promote the credit business function to the required level and to minimize credit related risk, the bank should recruit the new staff and provide the required training to the concerned staff.

B-Summary of responses regarding to the credit worthiness of applicants

According to the interviewee's response regarding to the assessment practice of the bank on credit worthiness of applicants, after a client has requested a loan, the bank has analyzed all relevant information to determine whether the client's requests meets the bank's credit standards or not. Based on this, the bank has assessed the creditworthiness of a loan applicant mostly by gathering detail information on future plan of the client, type & nature of the business, financial requirement of the business, client's other liability if there is any, source of income for future repayment, past performance of the business, financial statement information to undertake financial information and projection, management competencies, nature of industry and economic condition. Based on this, I have learnt that the bank has collected adequate and detail information and data to undertake analysis on credit worthiness of the clients. This would help the bank to minimize the risk of uncollectable account.

C-Summary of the responses towards the bank's credit monitoring practice: -

According to the interviewee's response, the bank's risk-rating system with different grades, which includes subjective factors, such as management quality allows the bank to assign credit costs more precisely and the management information system of the bank helps them to track credit exposure. Risk pricing based on required rates of return that are then used in customer sourcing. In addition to this, the respondents indicated that a proactive role in guiding relationship managers on credit exposures in the portfolio. Generally, it showed as the bank regularly reviewed and monitored the performance of credit quality both at individual and

portfolio level. However, they stated as the bank does not update the credit monitoring procedure regularly. Therefore, in order to promote the lending function to the required level, the bank should produce and follow up to date credit monitoring procedure that is convenient to the credit business operation.

D. Summary of the response towards portfolio management

According to the interviewee's response, the loan portfolio is containing significant amount of asset and the main source of income for the bank. At the meantime, it is also the main causes of risk for the bank's credit business operation. Based on this, the respondents also indicated as different risk handling mechanisms has to be implemented to minimize or to reduce its credit risk exposure.

CHAPTER FIVE

Summary of Key Findings, Conclusion and Recommendation

In this chapter, the research has provided summary of key findings, conclusion and recommendation drawn based on the result of the research that has been discussed and analyzed in the previous chapter.

5.1 Summary of Key Findings

Among the findings of the research that has been discussed on chapter four, the key findings are summarized as follow: -

The bank identifies all risks inherent with the credit products and activities and measure expected loss of credit risks both at individual and portfolio level. This would help the bank to develop and maintain the required data regarding to the nature, types and amount of expected loss of credit risk to manage properly. The credit granting process of the bank is in a good condition that the bank analyzed the credit worthiness of the clients, the industry and economic condition thoroughly and properly before the loan is granted. The bank also monitors and evaluates the credit quality both before and after disbursement by making a regular review and monitor of the credit quality both at individual and portfolio level.

Unlike to the major findings stated here above, the bank's credit professionals do not conduct a face to face meeting to discuss the customer's history and future plans. Due to this the bank fails to know or understand the background of the customers. The bank does not adequately measure unexpected loss of credit risk. Therefore, the bank does not know the amount of unexpected loss of credit risk which might be faced during its credit operation. As it is revealed on the finding of the study, the credit monitoring procedure of the bank is not regularly reviewed and updated. This leads the bank to follow and implement outdated credit monitoring procedure. Moreover, there is lack of adequate risk management training for concerned staffs as required and adequate number of staffs in credit management department of the bank. Due to this, the bank fails to improve the understanding of the concerned staffs and the quality credit business operation. In turn this would hinder the credit risk management practice of the bank.

5.2 Conclusion

Based on the finding of the research, it has been concluded that the employees of the bank working in credit department are Bachelor degree and post graduate level. In addition, they have also appropriate professional experience for the area. Followed by their education and experience, it would help the bank to enhance its service delivery and become effective and more competitive by minimizing the risk associated with the credit business operation.

The bank identifies all credit risk properly and measures the entire expected loss of credit risk both at individual and portfolio level. This enables that the bank to develop and maintain necessary data on the nature and type of credit risks and the amount of expected losses as it would help to manage credit risk in proper way and to have earlier estimation of expected loss of defaults, expected contribution and capital requirement to develop financial stability. However, there is lack of proper and adequate measurement of unexpected loss of credit risk. Due to this the bank unable to develop and maintain necessary data regarding to the amount of unexpected losses and this leads the bank to conduct wrong decision on loan management and it would be a cause for financial distress since it has not adequate information on the amount of unexpected losses.

The bank is currently working on sound credit granting process so that the bank conducts comprehensive analysis such as analysis on customer reputation, financial analysis, business analysis, industry analysis and economic analysis. This would help the bank to learn the financial capacity of the clients by analyzing the financial reports to understand profitability, cash flow, liquidity, and leverage of the company and to learn what the company does and how it operates. Then examine how it fits into its industry and how it is affected by economic conditions. All this information is relevant to know the client's status on the ability to meet their commitments. Adequacy, marketability and enforceability of collateral requirement is also properly evaluated and measured by the bank. This would help the bank to mitigate its risk on default loan. Therefore, collateral requirements is one of the credit risk management tool that refers to properly promised to the lender as compensation if the borrower defaults, it lesser the lender‘s losses in the case of a loan default and it may be seen as a strategic instrument to control borrower incentives for repayment of the debt. In addition to this the bank diversifies its credit exposure to different industry sectors and geographical area. This enables the bank to minimize

the risk level that related with the specific type of industry and geographical area. Apart from this the bank's credit professionals do not conduct a face to face meeting to discuss the customer's history and future plans. Due to this the bank might be loose some relevant information that raised on the meeting to know about the customers future plans and history.

Regarding to the credit monitoring and evaluation practice of the bank, the finding of the research revealed that loan terms and conditions has been strictly monitored, the bank uses a loan covenant checklist that routinely tracks its customer's adherence to covenants and the bank regularly reviews and monitors the performance of credit quality both at individual and portfolio level. As far as the bank is working to assure the quality of credit business operation; the bank implemented its own internal risk rating or grading system to support the loan processes by classifying borrowers based on their risk level. However, proper reviewing and updating of credit monitoring procedure has greater significance in the proper management of credit business operation yet the data obtained from the respondents showed that the bank does not reviewed and updated the credit monitoring procedure regularly. This would expose the bank to follow and implement outdated credit monitoring procedure.

The bank is working by taking immediate corrective action for credit default sign, updating credit policy on regular basis, taking policy measures to solve loan recovery problem, keeping its actual risk profile and generally the overall credit controlling mechanisms of the bank is in good conditions. However, the bank is not giving adequate risk management training for concerned staffs as required and there is also lack of adequate number of staffs in credit management department. Consequently, it is possible to conclude that lack of risk management training and adequate number of staffs negatively affects credit risk management practice of the bank. Hence the bank has to arrange and deliver training programs that enables them to properly evaluate the creditworthiness of clients before loans are disbursed.

5.3 Recommendation

The following are some of the suggestion that I would like recommend to Oromia International Bank management and concerned parties

- The bank's credit professionals are advisable to conduct a face to fac (formal) meeting to discuss the customer's history and future plans before the loan is granting. This is very essential to know the background of the customer and it is also one of the best ways to get to know the customer's needs and establish the bank as a valued financial institution is through face-to-face meetings to discuss the customer's history and future plans.

- The bank should review and update the credit monitoring procedure consistently. This is because regular reviewing and updating of credit monitoring procedure has assumed greater significance in the effective management of credit risk and this would help the bank to consider the new events on credit business operation by working with the latest credit monitoring procedure on regular basis.

- The bank should quantify or measure the entire unexpected loss of credit risk by considering the causes like losses due to a sudden downturn in market conditions, falling interest rates, natural disasters resulting in major business failures. This is because the purpose of the credit risk measurement is the quantification of potential losses from credit operation. It would help the bank to obtain the required data regarding to the amount of unexpected loss and this would help the bank to manage the credit risk properly.
- The credit risk management team should always comprise adequate number of well trained, skilled, and knowledgeable staff to improve on accuracy, reliability, efficiency and effectiveness of required service to the customer lack of having trained and competent staff may lead the bank to poor service quality, misconduct, customer complaints and employee disputes and it can may result in adverse publicity. Hence the bank should give attention to hire new employees to adequately staffed the credit management department and arrange short term or/and long-term training to update and enhance the employees understanding about credit risk management.

- Even if the Non-performed loan (NPL) position is within the limit of National Bank of Ethiopia (which is below 5%), the bank should improve the existing credit risk management practice and its NPL position by taking and applying the above proposed recommendation.

Recommendation for Further Studies

Current studies focus on assessment of credit risk management practice of Oromia International Bank and lack detailed information on the overall credit management practice of the bank. Further studies can therefore be conducted in this dimension.

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Annex- Questioner

Dear respondents, the objective of this questionnaire is to collect data relating to “The credit risk management practice of Oromia International Bank.” For fulfillment of master’s degree program in MBA Accounting and Finance for school of graduate studies Department of Accounting and Finance at St Mary University.

I believe that your input that means information or data obtained from your side is very important for the success of this study. Therefore, I appreciate your support to give me your time for the success of this research paper. I assure you that all the information to be shared by you will be used only for academic purpose and kept as confidential. For further inquiry and need my assistance while you fill the questionnaire please contact me: E-mail dbelete04@gmail.com, Tel 0904-132697.

Thank you for your cooperation

Please use this mark in the box "√" Where it applies

Part One: - Personal Information

1. Job Title: ________________________________

2. Highest educational level obtained

   High school complete ☐ Bachelor Degree ☐

   Certificate ☐ Master's Degree ☐

   Diploma ☐ PhD ☐

3. Area (field of specialization) or major field of study

   Accounting ☐ Economics ☐

   Management ☐ Business Administration ☐

   Others Please Specify ______________________________

4. Years of work experience

   < 1 Year ☐ 1-5 years ☐

   6-10 years ☐ More than 10 ☐

Part Two: - Information on Credit Risk Management Practice of the Bank

1= strongly disagree, 2= disagree, 3=Neutral, 4=Agree, and 5 = strongly agree

1. Identification practice of credit risk

Factors	1	2	3	4	5
1. The bank identifies all of the risks inherent with the credit products and activities.					
2. The bank quantifies all of the risks inherent with the credit business at individual level					
3. The bank quantifies all of the risks inherent with the credit business at portfolio level					
4. The bank measures the entire unexpected loss of credit risk.					
5. The bank measures the maturity of all exposure risks associated with the credit business.					

Please give any experience, comment or opinion about credit risk identification practices which is applicable at your Bank.

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2. Credit granting process

Factors	1	2	3	4	5
1. Bank's credit professionals always conduct a face to face meeting to discuss the customer's history and future plans.					
2. Your bank always provides expertise advise in the event of loan work out situation with a customer					
3. The bank perfectly analyzes the reputation of the customer before granting the loan.					
4. The bank conducts comprehensive financial analysis of the customers before granting the loan.					
5. Adequacy of collateral requirement is properly evaluated and measured.					
6. Marketability of collateral requirement is properly evaluated and measured.					
7. Enforceability of collateral requirement is properly evaluated and measured.					

8. The bank has established credit limit for all types of credit services.					
9. The entire economic factors will be analyzed before the loan is granted					
10. Nature of the business is properly analyzed before the loan is granted					
11. Nature of the industry is properly analyzed before the loan is granted					
12. The bank diversifies its credit exposure to different industry sectors.					
13. The bank diversifies its credit exposure to different geographical area.					

Please give any experience, comment or opinion on credit granting process which is applicable at your Bank.

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3. Credit risk monitoring process

Factors	1	2	3	4	5
1. The bank strictly monitors loan terms and conditions that have been stipulated at the time of loan approval.					
2. The bank uses a loan covenant checklist that routinely tracks its customer's adherence to covenants.					
3. The bank regularly reviews and monitors the performance of Credit quality at individual level					
4. The bank regularly reviews and monitors the performance of credit quality at portfolio level					
5. Credit file is regularly updated in our bank.					
6. The bank has properly applied its own internal risk rating system.					
7. Credit monitoring procedure is regularly reviewed in our bank.					
8. Credit monitoring procedure is regularly updated in our bank.					

Please give any experience, comment or opinion on credit risk monitoring process which is applicable at your Bank.

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4. Credit risk controlling practice

Factors	1	2	3	4	5
1. The bank constantly takes immediate corrective action for credit default sign.					
2. Credit policy is regularly updated in our bank.					
3. Policy measures have been taken regularly to solve loan recovery problem.					
4. The bank maintains the actual risk profile at or under its risk tolerance.					
5. Credit policy is consistently applied in all credit activities of the bank.					
6. The bank constantly monitors the financial condition of counterparties and action taken as required.					
7. The bank actively responds to new information in all aspect of credit products and activities.					
8. The bank gives adequate risk management training for concerned staffs.					

Please give any experience, comment or opinion on credit risk controlling practice which is applicable at your Bank.

Thank you for your response!