**ST. MARY'S UNIVERSITY**

**BUSINESS FACULTY**

**DEPARTMENT OF ACCOUNTING**

# ASSESSING CREDIT RISK MANAGEMENT AND ITS IMPACT ON THE PERFORMANCE OF DASHEN BANK

**BY:**

**SOLOMON TESHOME**

**HYDER ASSEFA**

**JUNE, 2014**

**ADDIS ABABA**

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A SENIOR ESSAY SUBMITTED TO THE DEPARTMENT OF ACCOUNTING BUSINESS FACULTY

ST. MARY'S UNIVERSITY

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# CHAPTER ONE

# INTRODUCTION

## 1.1 BACKGROUND OF THE STUDY

Banking service has a great impact on the growth of a country. Especially in developing countries like Ethiopia, banking service has a great contribution for their development. Banks are financial institutions that accept deposit and make loans. Commercial banks in Ethiopia extend credit (loan) to different types of borrower for many different purposes. For most customers, bank credit is the primary source of available debt financing and for banks; good loans are the most profitable assets (Mishkin, 2004:8).

Even if credit creation is the main income generating activity for banks, it also involves huge risks to both the lender and the borrower. The risk of a trading partner not fulfilling obligation as per the contract on due date or anytime thereafter can greatly jeopardize the smooth functioning of a bank‘s business. On the other hand, a bank with high credit risk has high bankruptcy risk that puts the depositors in jeopardy (danger) that can easily and most likely prompts bank failure (Gerhard, 2009:43).

Credit risk is the most obvious risk in the banking and possibly the most important factor in terms of potential losses. The default of a small number of key customers could generate very large losses and in an extreme case could lead to a bank becoming insolvent. This risk relates to the possibility that loans will not be paid or that investments will deteriorate in quality or go in to default with consequent loss to the bank. Credit risk is not confined to the risk that borrowers are unable to pay; it also includes the risk of payments being delayed, which can also cause problems for the bank (Vedpuriswar, 2009:1)

So, in order to protect their own interest and the wealth of bank shareholders/depositors, banks need to investigate and monitor the activities of borrowers. Adequately managing those risks related with credit is critical for the survival and growth of any financial institutions. In case of banks, the issue of credit risk is even of greater concern because of the higher level of perceived risk resulting from some of the characteristics of clients and business conditions that they find themselves in.

Generally, Credit risk management is a structured approach to mange uncertainties arising from the probability that the borrower will default to pay the money taken as a loan (either the principal or interest or both). Effectiveness in this area has an impact on the profitability, liquidity, solvency, loan portfolio and financial leverage of commercial banks in every country (Tsorhe, 2003:6).

Therefore, taking into consideration availability of more information regarding the issue under study and the long term good performance and profitability of Dashen Bank, the study will focus on credit risk management and its impact on the performance of Dashen Bank Share Company.

Dashen Bank is a privately owned company established in 1995 in accordance with the licensing and supervision of banking business proclamation No 84/1994 of Ethiopia to undertake commercial banking activities. The Bank obtained its license from the National Bank of Ethiopia on 20 September 1995 and started normal business activities on 1 January 1996 with 10 branches (bank brochure). Dashen Bank comes into existence with an authorized and subscribed capital of Birr 50,000,000. As of June 30, 2013, it's paid up capital reached Birr 698,709,000. It operates through its Head Office in Addis Ababa and 115 area banks, 5 Foreign Exchange Bureaus, 780 Point of Sale terminals and 105 Automatic Teller Machines (ATMs) located within and outside Addis Ababa (Dashen Bank Share company annual report 2012/2013).

By the end of June 2011, outstanding loans and advances balance of the Bank was Birr 6.1 billion, growing by 23.4 % over the previous year's level. The distribution of loans and advances covered all major economic sectors. Domestic Trade and Services ranked on top with 32.0% share while the Manufacturing sector took the second spot comprising 23.2% of the aggregate balance. Foreign Trade (Import and Export put together), Real Estate and Transport sectors took the following spots with 15.2%, 9.7% and 7.1% shares respectively (Dashen bank, 2011).

## 1.2. STATEMENT OF THE PROBLEM

Lending function is the core product line of the bank; which in fact, contributes the major share of revenue generating activity for most banks. But this credit creation should be dealt with some caution and prudence as this involves a great deal of risk. Without effective credit risk management, good bank performance or profit will be unthinkable.

If one knows the impact level of credit risk management on profitability, he/she can give a great attention on management of those credit risks. Credit risk management mechanism like screening and monitoring, long-term customer relationship, collateral requirements and credit rationing are important for the success of banks. It determines its profitability, liquidity, solvency and amount of loan portfolio.

The need to know the problems (if any) regarding the overall activities of Dashen Bank share company, the student researcher tried to interview some employees from the head office and observed their feedback. Even though customers are satisfied by international and domestic banking services in the bank, most of credit customers are complaining on the credit management system of the bank. Such incidence makes the student researchers interested to see the credit risk management of Dashen bank so as to address the problem and seek answers to the following basic questions.

## 1.3 BASIC RESEARCH QUESTIONS

The entire effort of the research will try to answer the following research questions.

1. How Dashen bank uses credit risk evaluation and assessment tools to mitigate credit risk exposure?

2. What does Dashen bank's credit administration processes looks like?

3. What are the challenges (if any) that faced by Dashen bank in credit risk management?

4. How does credit risk management affects Dashen banks performance?

## 1.4 OBJECTIVE OF THE STUDY

### General objective

The general objective of this study is to assess credit risk management practices of Dashen Bank and its impact on the Bank's performance.
In line with the general objective, the study will assess the following specific objectives;

### Specific objectives

The specific objectives of this study include the following:

- To explore how the Banks use credit risk evaluation and assessment tools to mitigate their credit risk exposure.
- To assess the banks credit administration process.
- To see the challenges (if any) that faced by the Bank in credit risk management.
- To analyze the impact of credit risk management on performance of the bank.

## 1.5 SIGNIFICANCE OF THE STUDY

The significance of the study is:

- To show the practical application of research from what has been learned theoretically.
- Partially fulfill the requirement for degree of accounting.
- To be used as a reference for further studies.
- To provide Dashen Bank information about credit risk management.
- To give the readers some knowledge about the subject under study.

## 1.6. DELIMITATION OF THE STUDY

The research would be more fruitful if it were conducted widely by including other similar banks. But due to time, labor, and money constraints it would be too tedious and out of the reach of our research objective to include all banks. Thus, the scope of the research will be delimited to the head office of Dashen bank Share Company from 2009-2013. The study confined only to assess the credit risk management practices and its impact on performance of the banks.

### 1.7. RESEARCH DESIGN AND METHODOLOGY

#### 1.7.1 RESEARCH DESIGNS

The type of study in which the student researcher used is descriptive research study which describes the activities of Dashen bank in relation with its credit risk management. The purpose of descriptive research method is to collect detailed and factual information that describes an existing phenomenon such as current conditions, attitudes, interests, feelings and characteristics.

#### 1.7.2. POPULATION AND SAMPLING TECHNIQUE

The total population of the study includes 33 respondents; that is, the whole (30) credit service employees of the bank who are situated at the Head Office, and a manager and 2 board members. Therefore, by using the non probabilistic purposive method of sampling technique, the student researcher would take the total population to be determined as the sample size.

#### 1.7.3. TYPE OF DATA TO BE COLLECTED

The data sources for the study are primary and secondary data sources. The primary data were collected from the employees and the management of Dashen Bank share company where as the secondary data will be collected from literature and relevant reports of managing credit risk in the bank.

#### 1.7.4. DATA COLLECTION INSTRUMENTS

In order to collect data from the primary sources, interview and questionnaire were used. Interview helps to get detailed information from the respondents. Both structured and unstructured types of Interview will be used. While questionnaire helps to get a clear and meaningful answer using the subject's own knowledge or feeling, both open and close ended types of questionnaire will be used.

Among secondary data sources, the student researcher collected data from the bank's annual reports, publications, other research materials, and various websites for the proper accomplishment of this study

### 1.7.5. DATA ANALYSIS METHODS

The analyses are carried out after collecting the necessary data from different sources mentioned above. The student researcher used quantitative type of data analysis method. The outputs of the data gathered presented through charts, tabular and graphics by using computer programs and thus fully interpreted.

## 1.8. Limitation of the Study

The student researchers tried their maximum effort for the successful accomplishment of the objectives of the study. In doing so, however, the following factors were some of the problems that hinder the objective of our senior essay.

- Lack of cooperativeness from respondents in providing some written confirmations about their response.
- Shortage of reference materials while collecting our secondary data.
- Dalliance of respondents while filling the questionnaire takes much of our limited time to complete our study as per our schedule.

## 1.9. ORGANIZATION OF THE STUDY

The study will be organized in four chapters. Chapter one incorporates introduction, backgrounds of the study, statements of the problems, the objectives of the study, the significance of the study and other related contents in the chapters. Chapter two will have related literature review. The third chapter comprises the analysis of the study and the last chapter will have the major findings, conclusion and recommendation of the study.

# CHAPTER TWO

# REVIEW OF RELATED LITERATURE

## 2.1 Definition of Credit and Credit Management

The word credit has originated from the Latin word ‘Credo’, which means ‘I believe’. Credit is a matter of faith in the person and no less than in the security offered. In the words of Cole; “Credit is purchasing power not derived from income; but credited by financial institutions either as an offset to idle income held by depositors in the banks or as a net addition to the total amount of purchasing power” (Cole,1985:308).

For a modern economy, credit is inevitable. In advanced countries of the west, even for the purchase of consumer goods, credit is obtained by people and it is provided without much inconvenience to them by the banks (Tsorhe, 2003:93).

According to Edwards (1990:24) Credit management is the process for controlling and collecting payments. Credit management system will help to reduce the amount of capital tied up with debtors (minimize the exposure to bad debts).

Moreover, once the design to establish a credit department has been made, attention must be directed towards the responsibilities, duties, and goals of the credit manager. A credit manager is an individual within a business organization responsible for evaluating customer application for credit and who holds the power to commit business resources in a credit transaction. Although the credit manager is used in many business credit situations, this definition also applies to many others whose titles might be loan officer. A credit manager will decide, based on the information provided, if a customer will be allowed the credit. The common link is the challenge to evaluate risk and decide if a credit relationship is possible between the creditor and the applicant.

Line of credit are often extended by banks, financial institutions, and other licensed customer lender to credit worthy customers (though certain special purpose line of credit may not have credit worthiness requirements) to address liquidity problems, such a line of credit is often called personal line of credit. The term is also used to mean the credit limit of a customer, that is, the maximum amount of credit customer is allowed (Powel, 2005:133).

### 2.2 The Credit Management Process

As stated on William (1995:19) the credit management process is a series of steps that involves promoting credit, analyzing the risk of credit applicants, and collecting the payments after the debt is created. Creditors of an organization (including banks, trade, creditors, and holders of organization bonds) may be concerned about the possibility of an organization ability to repay debt becoming so impaired following the death or disability of an employee. Terms on which these creditors are willing to lend the organization may be favorably affected if steps are taken to reduce the likelihood of the impairment.

However, creditors are usually unreserved by unethical actions of a borrower because of the potential business fallout and subsequent risk of default on any loans. To some significant degree, therefore, according to William (1995:21) companies recognize that the following ethical strategies and ethical conducts are good for business:

**Financial Statement Analysis:** involves the calculation of various financial ratios, and other computations, using numbers drawn from financial statements. The results are used to evaluate the liquidity, profitability, and financial health of the firm applying for credit.

**A Credit Investigation:** involves a series of steps undertaken to verify information on the credit application and determine how the customer has handled past financial obligations. Usually the credit manager will verify the income and financial statement health of the applicant. The credit manager will contact commercialized reporting agencies during the stage of the credit management processes because, this agencies collect, retain, and sell information about the credit histories of consumers and business.

**Credit Decision:** is a judgment made by credit manager to accept or reject an application for a credit. The ability to make a good decision is based on a combination of art and science. This science often involves the ability to analyze the financial health of the applicant. The art involves with experience and include the ability to ask the right questions to predict payment results

**Control Functions:** are used to monitor a credit. Control activities involve "watching" the dispersed credits to verify that payments are being made as planed and that the relationship between the customer and the credit grantor to be productive.

**Collection Activities:** include any efforts to get credit be paid back in a timely manner. This is one of the most important aspects of effective credit management. Research shows that the longer a credit goes without payment the more difficult it becomes to collect a loan account.

## 2.3 Importance of Credit

In fact, no economy can function without credit. According to Fight (2004:115), credit is the very life-blood of the modern economic system which serves the economy in different ways which includes:

1. Credit provides the most convenient and economic medium of exchange by either supplementing or superseding other forms of money.
2. It facilitates the production and exchange of goods and services.
3. It increases the level of aggregate demand and level of consumption in the country.
4. It promotes thrift by providing productive channels of employment for saving in the economy.
5. It facilitates development of large-scale enterprises and specialized industries.
6. It facilitates the optimal use of the capital resources of the economy.
7. It influences the level of output and employment in the economy by influencing the rate of capital formation in the country, especially during the periods of trade cycles.
8. It provides the financial system with powers to render useful services to the economy in providing a system of exchange and a system of capital supply.
9. It benefits the society as a whole.

## 2.4 The Process of Credit Creation

According to Vaish (1985:284), banking implies borrowing and lending of money. The bank borrows money from some people and lends it to others. The banker canalizes the accumulated funds or deposits received in various accounts (Current, Fixed and saving) into productive uses in the form of loans, advances, overdraft facilities and cash credits against approved securities. The bank needs to apply great caution while investing its funds, for it is on the liquidity of these funds that the soundness of a bank depends. The bank, thus, selects such investments from where money can be easily called back.

The bank after retaining a certain portion of its deposits, lends money to the parties who require funds for investment or other purposes in the form of loans. The loans can be ordinary in the sense that these are given for a specified period to a person or firm against some collateral security. The loan amount is credited to the account of the borrower who can withdraw it according to his requirements. The bank can recall such loans as and when it desires to do so. Then there can be cash credit facilities. Under this account, the bank gives loans to the borrowers against certain securities. The bank does not give the entire amount of loan at the time but it opens an account in the name of the debtor and allows him to withdraw the money from time to time up to a certain limit determined by the value of the stocks kept in the debtors go down (Williams, 1974:127).

Even though the go down remains in the possession of the bank, the debtor cannot overdraw the amount and the bank charges interest only on the amount withdrawn from its account. Such loans are very popular in India. Then there are overdraft facilities granted by the bank to its customer who are liable. Under this facility, an account holder can overdraw the amount through cheques and has to pay interest on the amount overdrawn by him. Another type of lending facility, which is very popular with modern banks in that of discounting the bills of exchange, if the holder of a bill of exchange requires money, he can get it discounted from the bank that after deducting certain commission pays the present price of the bill to him. The bank can secure its payment from the party concerned on the maturity of the bill (Edward, 1990:165).

### 2.5 Types of Credit Risks

As stated on Miller (2012:206), credit risk encompasses both the possibility that a borrower will default by failing to repay principal and interest in a timely manner, and the possibility that the credit quality of the obligator will deteriorate, leading to an economic loss. In addition, in his classification, the following are the major types of credit risks:

#### 2.5.1 Default Risk

Although the concept of default seems clear- failure to repay in accordance with the terms of the lending agreement – it is not as simple as it may seem at first blush. Most financial institutions allow for default status to be applied on the subjective basis that repayment is highly unlikely. Certainly, if a company files for bankruptcy one should not wait until a scheduled payment date to assign default status. However, many more subtle and complex issues arise. Cross-default situation arise when an obligatory defaults to one set of creditors, or on one set of obligations, but not all

#### 2.5.2 Transaction Risk

It focuses on the volatility in credit quality and earnings resulting from how the bank underwrites individual loan transactions.

#### 2.5.3 Intrinsic Risk

It focuses on the risk inherent in certain lines of business and loans to certain industries. Intrinsic risk addresses the susceptibility to historic, predictive, and lending risk factors that characterize an industry or line of business. Historic elements address prior performance and stability of the industry or line of business. Predictive elements focus on characteristics that are subject to change and could positively or negatively affect future performance. Lending elements focus on how the collateral and terms offered in the industry or line of business affect the intrinsic risk.

### 2.5.4 Concentration Risk

Concentration Risk is the aggregation of transaction and intrinsic risk within the portfolio and may result from loans to one borrower or one industry, geographic area, or lines of business. Bank must define acceptable portfolio concentrations for each of these aggregations. Portfolio diversify achieves an important objective. It allows a bank to avoid disaster. Concentrations within a portfolio will determine the magnitude of problems a bank will experience under adverse condition.

## 2.6 Credit Risk Management Mechanisms

According to Vaish (1985:294), accurate estimate of credit risks are critical to the determination of profitability because returns are small relative to the risks taken. The key parameters that define the risk of an individual credit exposure are the default probability, the exposure at default, and the loss in the event of default. Default rates can be developed either from market-based measures or from historical default rates associated with risk ratings. To ensure consistency in assigning risk ratings, rating philosophies must be specified and clearly communicated. Measures of exposure upon default can vary depending on the credit quality and maturity of commitments.

Determination of loss in the event of default will vary depending on whether the loan is senior or subordinated and secured or unsecured, and whether losses occur at the time of downturns in the economy. Although information on these parameters is reasonably available for public debt, historical data for privately held bank debt is more difficult to obtain. Judgments are required in defining default events and exposures, and in calculating economic loss. To calculate possible levels of portfolio loss, it is necessary to measure the extent to which individual companies may default at the same time. Default correlations are the key parameters needed to determine overall portfolio credit risk (Edward, 1990:198).

### 2.6.1 Credit Risk Mechanisms in Banking Industry

Banks make profit from the spread between the interest rate they charge to borrowers and the interest rate they pay to depositors. Lending has always been the primary functions of banks, and accurately assessing a borrower‘s credit worthiness has always been the only method of lending successfully (Fight, 2004:219).

As identified by Mishkin (2004:126), to insure reasonable profit, banks attempt to make loans that will be fully repaid with interest on due date. Therefore, banks are directly concerned about borrowers repaying their loans on a timely basis so that the value of the banks can be maximized. If banks don‘t manage credit risks effectively, they won‘t be profitable and won‘t be in business very long. Banks can reduce their exposure to credit risk on different loans by applying major credit risk management principles. Mishkin (2004:126) also outlined the following credit risk management mechanisms.

1. **Screening and monitoring**: Adverse selection in loan market requires the lenders screen out the bad credit from the good ones so that loans are profitable to them. Once a loan has been made, the bank‘s has to monitor or follow up the borrowers activities.

2. **Long-term Customer Relationship**: if the borrower has borrowed previously from the bank, the bank has a record of the loan payments. This reduces the costs of information collection and makes it easier to

screen out bad credit risks. Long-term relationship enables banks to deal with even unanticipated moral hazard contingencies.

3. **Collateral Requirements**: is an important credit risk management tool. Collateral, which is properly promised to the lender as compensation if the borrower defaults, it lesser the lender‘s losses in the case of a loan default.

4. **Credit Rationing**: is one way of credit risk management that refers refusing to make loans even though borrowers are willing to pay the stated interest rate or even a higher rate.

## 2.7 Measurements of Bank Performance

According to Nimmo (2003:227), banking performance refers the ability of banks in provision of quality banking services to customers. The performance of bank will be measured by using different measuring variables which are the core performance indicators in the banking industry. This includes:

1. **Profitability:** is the efficiency of banks at generating earnings which will be measured by Profitability ratios which focus on profit of the bank. The ratio includes: Return on Asset & Return on Equity.

2. **Bank Liquidity:** is the ability to meet its financial obligations as they come due. Bank lending finances investments in relatively illiquid assets, but it fund its loans with mostly short term liabilities.

3. **Bank Solvency**: is the banks long run ability to meet all financial obligations. A solvent business has a positive net worth. Solvency indicators include the debt-to-asset ratio and debt-to-equity ratio.

4. **Loan Portfolio:** is total of all loans held by a bank or finance company on any given day. The value of a loan portfolio depends on both the principal and interest owed and the average creditworthiness of the loans(Westerfield,2008:228).

## 2.8 Credit Risk Mitigation

A number of techniques are available to banks to assist in the mitigation of credit risk. Collateral and guarantees are the most commonly used. Notwithstanding the use of various mitigation techniques individual credits transactions should be entered into primarily on the strength of the borrower‘s repayment capacity. Banks should also be mindful that the value of collateral might well be impaired by the same factors that have led to the diminished recoverability of the credit. Banks should have policies covering the acceptability of various forms of collateral, procedures for the ongoing valuation of such collateral, and a process to ensure that collateral is, and continues to be, enforceable and realizable.

## 2.9 Credit Policies, Procedures, and Limits

The foundation for effective credit risk management is the identification of existing and potential risks in the bank‘s credit products and credit activities. This creates the need for development and implementation of clearly defined policies, formally established in writing, which set out the credit risk philosophy of the bank and the parameters under which credit risk is to be controlled. Measuring the risks attached to each credit activity permits a platform against which the bank can make critical decisions about the nature and scope of the credit activity it is willing to undertake A cornerstone of safe and sound banking is the design and implementation of written policies and procedures related to identifying, measuring, monitoring and controlling credit risk Credit policies establish the framework for lending and guide the credit-granting activities of the bank.

The policies should be designed and implemented with consideration for internal and external factors such as the bank‘s market position, trade area, staff capabilities and technology; and should particularly establish targets for portfolio mix and exposure limits to single counterparties, groups of connected counterparties, industries or economic sectors, geographic regions and specific products. Effective policies and procedures enable a bank to: maintain sound credit-granting standards; monitor and control credit risk; properly evaluate new business opportunities; and identify and administer problem credits. Credit policies need to contain, at a minimum:

1. A credit risk philosophy governing the extent to which the bank is willing to assume credit risk;
2. General areas of credit in which the bank is prepared to engage or is restricted from engaging;
3. Clearly defined and appropriate levels of delegation of approval, and provision or write off authorities; and
4. Sound and prudent portfolio concentration limits.

## 2.10 Banks Profitability and Its Measurement

Like all businesses, banks profit by earning more money than what they pay in expenses. The major portion of a bank's profit comes from the fees that it collects for its services and the interest that it earns on its assets. Its major expense is the interest paid on its liabilities (Girum, 2008:06).

The major assets of a bank are its loans to individuals, businesses, and other organizations and the securities that it holds, while its major liabilities are its deposits and the money that it borrows, either from other banks or by selling commercial paper in the money market. And profitability of any business area can be measured through return on assets (ROA) and return on equity (ROE). Profitability is the dependent variable of this study. The researcher tries to evaluate the profitability of commercial banks in Ethiopia (Girum, 2008:06).

## 2.11 Relationship between Credit Risk Management and Bank Performance

As per different researchers and authors, Credit risk is the most significant of all risks in terms of size of potential losses. As the extension of credit has always been at the core of banking operation, the focus of banks risk management has been credit risk management. When banks manage their risk better, they will get advantage to increase their performance. Better risk management indicates that banks operate their activities at lower relative risk and at lower conflict of interests between parties (Santomero, 1997:286).

According to Supriyatna (2007:310), better bank performance increases their reputation and image from public or market point of view. The banks also get more opportunities to increase the productive assets, leading to higher bank profitability, liquidity, and solvency. Therefore, Effective credit risk management should be a critical component of a bank‘s overall risk management strategy and is essential to the long-term success of any banking organization. It becomes more and more significant in order to ensure sustainable profits in banks.

## 2.12 Credit Risk Performance Measurement in Banks

Risks come in any line of business. In the banking industry, you could safely say that these institutions deal with risks every single workday. Moreover, just about all of these risks are financial in nature. Thus, there is a need to balance risks and returns of investments altogether. The banking industry is not exempted from credit risks at all. There is then a need to implement efficient credit risk performance measurement. Credit risk performance measurement is very important in the industry of banking. In fact, if you would tell you that this aspect has an impact on the overall success of the bank itself. Thus banks and other financial institutions, especially the ones that are delving in the business of lending, should pay attention to this aspect (Westerfield, 2008:235).

With the many options of banks in today's market, for a bank to garner a large customer base, it should consider offering a lot of reasonable loan products. This means the loan products would be offered at low interest rates. This is because pegging interest rates that are too low would also incur losses for the bank. After all, banks should have substantial capital in terms of reserves. There should be balance to this, actually. If a bank has too much capital in its reserves, then there is that risk that the bank might miss out on its investment revenue. On the other hand, if a bank has too little capital to begin with, this would only lead to financial instability (Williams, 1974:145).

Banks constantly have to deal with the risk of a client defaulting payment of his loan. This is one risk that banks would have to expect, however, unfortunate the case may be. And this is just one of the many risks that banks have to deal with each day. Thus, it is only logical for banks to keep a substantial portion of its capital in its reserves so as to maintain economic stability and protect its own solvency (Westerfield, 1995:237).

## 2.13 Profitability Measures of Banks

The habitual measures of the profitability of any business are return on assets (ROA) and return on equity (ROE). Assets are used by businesses to generate income. Loans and securities are a bank's assets, and are used to provide most of a bank's income. However, to make loans and to buy securities, a bank must have money, which comes primarily from the bank's owners in the form of bank capital, from depositors, and from money that it borrows from other banks or by selling debt securities. However, not all assets can be used to earn income, because banks must have cash to satisfy cash withdrawal requests of customers. The ROA is determined by the amount of fees that it earns on its services and its net interest income (Westerfield, 2008:247).

## 2.14 Impacts of Credit Risk Management on Performance

In the words of David (1997:204), it is important that the investor knows credit risk of a bank, if he has Investments in any bank or is contemplating making one. The ratio of non-performing loans to total loans should be on the decrease. This indicates that the bank is recovering most of its loans and as such is maximizing its assets to generate profits.

The loan profile detailing amount of performing and non-performing loans could be gotten from their annual reports and accounts statements. The goal of credit risk management is to maximize a bank‘s risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions.

Banks should also consider the relationships between credit risk and other risks. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization.

Banks and financial institutions gave importance to the credit risk and considered as an essential factor in the financial sector that is needed to be managed. When banks recognized the credit risk, it means that there is a possibility that a borrower or counter party tends to fail in meeting the obligations in accordance with the agreed terms. Credit risk in banks or any financial institution deals with lending to corporate, individuals, and other banks or financial institutions.

Credit risk management needs to be a robust process that enables the banks to proactively manage the loan portfolios to minimize the losses and earn an acceptable level of return to its shareholders. The importance of the credit risk management is recognized by banks for it can establish the standards of process, segregation of duties and responsibilities such in policies and procedures endorsed by the banks.

## 2.15 Credit Risk Management for Ethiopian Banks

This was disclosed at a one-day seminar on credit and risk management, held on Thursday, February 14, 2012 at the Sheraton Addis and organized by Zemen Bank in collaboration with Venture and Harland Financial Solutions. The Bank is also taking the lead in the country in implementing the Basel II Framework. The Basel II Framework describes a more comprehensive measure and minimum standard for capital adequacy that national supervisory authorities are now working to implement through domestic rule-making and adoption procedures. It seeks to improve on the existing rules by aligning regulatory capital requirements more closely to the underlying risks that banks face (Girum, 2008:04).

Basel II requires banks to collect more data about customers and consistently use best practices for credit risk management. Participants at the seminar were credit officials from both private and government banks and from the Ministry of Capacity Building. The purpose of organizing the seminar was to create awareness among other banks so that they too would benefit by using the software.

At the seminar, Harland Financial Solutions Worldwide and Kenya Commercial Bank presented a Credit Risk Symposium for Ethiopian banks.

Harland Financial Solutions Worldwide is a global software company with over 7,000 financial institution customers and delivers Credit Quest solutions for credit risk management for banks worldwide. The full day symposium also covered the Evolution of Credit Risk and Lending Systems, Regulatory Requirements for Lending and Credit Risk Systems (Basel II), a demonstration of the Credit Quest product and a Case Study of KCB‘s implementation of Credit Quest (Girum, 2008:07). According to Girum (2008:09), the Basel committee pointed out the following principles to evaluate bank's credit risk management system, and some of these principles which are related with this study will be discussed in subsequent sections.

**A. Establishing an Appropriate Credit Risk Environment**

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

Principle 2: Banks should identify and manage credit risk inherent in all products and activities. Banks should ensure that the risks of products and activities new to them are subject to adequate risk management procedures and controls before being introduced or undertaken, and approved in advance by the board of directors or its appropriate committee.

**B. Operating Under a Sound Credit Granting Process**

Principle 3: Banks must operate within sound, well-defined credit-granting criteria. These criteria should include a clear indication of the bank's target market and a thorough understanding of the borrower or counterparty, as well as the purpose and structure of the credit, and its source of repayment.

Principle 4: Banks should have a clearly-established process in place for approving new credits as well as the amendment, renewal and re-financing of existing credits.

Principle 5: All extensions of credit must be made on an arm's-length basis. In particular, credits to related companies and individuals must be authorized on an exception basis, monitored with particular care and other appropriate steps taken to control or mitigate the risks of non-arm's length lending.

**C. Maintaining an Appropriate Credit Administration, Measurement and Monitoring Process**

Principle 6: Banks should have in place a system for the ongoing administration of their various credit risk-bearing portfolios.

Principle 7: Banks must have in place a system for monitoring the condition of individual credits, including determining the adequacy of provisions and reserves.

Principle 8: Banks are encouraged to develop and utilize an internal risk rating system in managing credit risk. The rating system should be consistent with the nature, size and complexity of a bank's activities.

Principle 9: Banks must have information systems and analytical techniques that enable management to measure the credit risk inherent in all on- and off-balance sheet activities. The management information system should provide adequate information on the composition of the credit portfolio, including identification of any concentrations of risk.

Principle 10: Banks must have in place a system for monitoring the overall composition and quality of the credit portfolio.

Principle 11: Banks should take into consideration potential future changes in economic conditions when assessing individual credits and their credit portfolios, and should assess their credit risk exposures under stressful conditions.

**D. Ensuring Adequate Controls over Credit Risk**

Principle 12: Banks must establish a system of independent, ongoing assessment of the bank's credit risk management processes and the results of such reviews should be communicated directly to the board of directors and senior management.

Principle 13: Banks must have a system in place for early remedial action on deteriorating credits, managing problem credits and similar workout situations.

**E. The Role of Supervisors**

Principle 14: Supervisors should require that banks have an effective system in place to identify measure, monitor and control credit risk as part of an overall approach to risk management. Supervisors should conduct an independent evaluation of a bank's strategies, policies, procedures and practices related to the granting of credit and the ongoing management of the portfolio. Supervisors should consider setting prudential limits to restrict bank exposures to single borrowers or groups of connected counterparties.

# CHAPTER THREE

## DATA PRESNTATION, ANALYSIS AND INTERPRETATION

In this chapter, the data collected by the student researchers' self-completion questionnaires will be presented. In doing so, we use both primary and secondary data collection instruments. Consequently, 16 open ended and close ended questions and 8 structured types of interviews were distributed to all credit risk management employees and management members of Dashen Bank. As a result, from all 30 respondents 100% responses were collected.

**Table 3.1 Background of Respondents**

| No. | Items | Options | No | % |
|---|---|---|---|---|
| 1 | Sex | Male | 21 | 70 |
| | | Female | 9 | 30 |
| | | Total | 30 | 100 |
| 2 | Educational Background | Certificate | – | – |
| | | Diploma | 3 | 10 |
| | | Degree | 26 | 86.67 |
| | | 2$^{nd}$Degree & Above | 1 | 3.33 |
| | | Total | 30 | 100 |
| 3 | Work experience in Banking and Risk Management Area | Below 3 years | – | – |
| | | 3-6 years | 3 | 10 |
| | | 6-9 years | 18 | 60 |
| | | Above 9 years | 9 | 30 |
| | | Total | 30 | 100 |
| 4 | Present Work Position (Title) | Loan officer | 5 | 16.67 |
| | | Chie fin. Officer | 4 | 13.33 |
| | | Manager | 3 | 10 |
| | | Accountant | 5 | 16.67 |
| | | Auditor | 3 | 10 |
| | | Staff | 10 | 33.33 |
| | | Total | 30 | 100 |

As shown in Item 1 of table3.1, 21(70%) of the respondents are male while the remaining 9(30%) of the respondents are females. From this, one can conclude by saying males are dominant in number compared with females in the organization.

In addition, when we look at their educational background as shown in item 2 of table 3.1, 26(86.67%) are degree holders, 3(10%) of the respondents are Diploma holders, and 1(3.33%) of the respondent possesses 2nd degree. From this it can be noted that, most of the respondents to be positioned in the risk management area, employees are required to fulfill the Bank's minimum requirement of Degree Qualification.

Item 3 of table 3.1 shows the work experience of respondents in the bank. In the result, we noted that 18(60%) of the respondents have working experience in banking sector above 9 years, those who have 3-6 years of experience were 3(10%), and those with an experience below 3 years were null(0). From this, one can conclude by saying most of the respondents who work in banking and credit risk management area are more experienced people and the organization's credit activities are effectively performed.

In addition, item 4 of table 3.1 shows that the present work position of respondents in Dashen Bank. In the result, 10(33.33%) of the respondents are staffs working in credit related areas, 5(16.67%) are Junior and Senior Accountants, those who possessed the same 5(16.67%) work positions were Loan Officers, 4(13.33%) of the respondents were chief financial officers who control the repayments of credits, and the remaining 6(20%) of the respondents were managers and Auditors, both of them accounts 3(10%) of the total respondents. Thus, one can conclude by saying that most of the services of the credit management department of Dashen Bank are performed by staff members. .

**Table 3.2 Credit Risk Management**

| No | Items | Options | No | % |
|---|---|---|---|---|
| 1 | Types of Credit risks that highly affect profitability of Dashen Bank. | Default Risk | 26 | 86.67 |
| | | Transaction Risk | 1 | 3.33 |
| | | Concentration Risk | 2 | 6.67 |
| | | Intrinsic Risk | 1 | 3.33 |
| | | Total | 30 | 100 |
| 2 | Importance of credit risk management mechanisms in reducing credit risks. | Screening and Monitoring | 3 | 10 |
| | | Credit Rationing | 3 | 10 |
| | | Collateral Requirements | 9 | 30 |
| | | Long-trm customer R /ship | 15 | 50 |
| | | Total | 30 | 100 |
| 3 | Challenges in Credit Risk Management activities. | Yes | 30 | 100 |
| | | No | – | – |
| | | Total | 30 | 100 |
| 4 | Impacts of Credit Risk Management towards Performance and Profitability | Negative | – | – |
| | | Positive | 30 | 100 |
| | | Total | 30 | 100 |
| 5 | Credit administration processes in Dashen Bank. | Promoting credit | 10 | 33.33 |
| | | Verifying & analysis of credit application. | 10 | 33.33 |
| | | Verifying payment of credit | 10 | 33.34 |
| | | Total | 30 | 100 |
| 6 | Application of credit evaluation & assessment tools. | Yes | 30 | 100 |
| | | No | - | - |
| | | Total | 30 | 100 |

The respondents were asked to identify among the many types of credit related risks, which type of credit risk highly affects the profitability of Dashen Bank. As a result, as can be shown on item 1 of table 3.2, 26(86.67%) of respondents forward their response by choosing Default Risk, those who answered Concentration Risk are 2(6.67%), and those who select Transaction Risk and Intrinsic Risk are 1(3.33%) each. Here it can be concluded that, the reason behind the respondents' choice among the given alternatives is, risks such as Transaction Risks, Concentration Risks, and Intrinsic Risks are under the control of the Bank and thus can be reduced to a low level by the proper implementation of the Bank's Credit risks management policies and mechanisms whereas, Default risk- which is the failure to repay in accordance with the terms of the lending agreement- depends on the creditors' willingness to repay, efficiency and effectiveness attached to its activities.

The respondents were also asked to select the type of credit risk management mechanism that is most important to Dashen Bank in reducing an exposure to credit risks. As can be seen in item 2 of table 3.2, 15(50%) of the respondents replied that Long-term customer Relationship is the most important mechanism for the Bank for it helps to reduce the cost of information collection and makes things easier to screen out bad credit risks. Whereas those 9(30%) replied by choosing Collateral Requirement as the most important mechanism reason out that, in cases borrower defaults, collateral is necessary for reducing the Bank's losses.

However, respondents replied to Screening and Monitoring alternative 3(10%) and those who replied to Credit Rationing alternative 3(10%) reason out that unless the bank has a good monitoring or follow up for the loans it has made, its loans cannot be profitable and it should refuse to make loans even though borrowers are willing to pay a higher interest.

As can be seen in item 3 of table 3.2, the Student Researchers were also interested in knowing whether there are any challenges that Dashen Bank faces in its Management of Credit Risk or not. As a result responses from 30(100%) of the respondents shows that, in its history, Dashen Bank faces a number of challenges that emanate from credit risk management activities. Accordingly, the respondents' pointed out that lack of technology to manage the portfolio data, misinterpretation of policies, and effects of changing in government policy, are the major challenging factors which have an equal and proportionate share of negative impact on Credit Risk Management activities of Dashen Bank.

As it can be seen on item 4 of table 3.2, the Student Researchers asked the respondents to identify the direction of the impact of credit risk management towards performance and profitability. Thus, the results from 30(100%) of the total respondents shows that implications of "positive" impact of credit risk management on the performance of their bank. The respondents indicated that the effective management of credit risk is a critical and an essential to the long-term success of their bank, in addition they reason out that credit risk management enables Dashen Bank to establish the standards of process, segregation of duties and responsibilities, such as in policies and procedures endorsed by their bank. From this, one can conclude by saying that better management of credit risk indicates operating activities at a lower relative risk and hence it will have a higher Return on Assets. In other words, the bank can maximize its risk adjusted Rate of Return on Assets.

The respondents were also asked related question on how Dashen Bank uses its credit administration processes. As shown in item 5 of table3.2, responses from 30(100%) of respondents replied that credit administration processes such as, promoting credit, verifying and analysis of credit applicants, verifying the payment of credits as per the agreement, are conducted with an equal and proportional (33.33%) manner on their bank's daily activities. From this it can be concluded that, performing these series of activities not only strengthens the bank, also helps in controlling the unethical actions of borrowers.

In connection with risk assessment and evaluation tools, in item 6 of table 3.2 the student researchers forwarded a question on how does Dashen Bank uses its credit risk assessment and evaluation tools in mitigating its credit risk exposures. As a result, responses from 30(100%) of respondents show that through the application of internal credit rating system and looking into factors like types of loan services (term loan, merchandise loan, advance on export bill), quality of management, and customer's relationship with the bank, the bank reduces can risk exposure. From this, it can be concluded that the Bank has developed internal credit rating system to manage and reduce credit risk. This shows well-managed credit risk rating system promotes not only bank safety; it also facilitates soundness in informed decision making.

**Table 3.3. Factors Related with Credit Risk Management**

| No | Items | Option | No | % |
|---|---|---|---|---|
| 1 | Implementation of credit risk management mechanisms | Yes | 30 | 100 |
| | | No | - | - |
| | | Total | 30 | 100 |
| 2 | Organs of the bank that approve credit facility requests. | Chief executive officers | - | - |
| | | Board/Committee | 27 | 90 |
| | | Executive management committee | 3 | 10 |
| | | Total | 30 | 100 |
| 3 | Provision of trainings facility to credit service employees. | One time per year | 20 | 66.66 |
| | | Two times per year | 10 | 33.34 |
| | | Total | 30 | 100 |

As it can be seen in item 1 of table 3.3 the Student researchers also forward a yes/no question to ask the respondents if their organization's credit risk management mechanisms are properly implemented or not. Thus, the results from 30(100%) of the respondents shows that all of them answered "yes." They also reason out that the core factor for the growth of their bank is the proper implementation of risk management mechanisms. From this it can be concluded that proper implementation of risk management mechanisms have a positive impact on the growth of the bank.

As it can be seen in item 2 of table 3.3 the respondents were also asked to identify which organ of the bank has the authority to establish credit request facilities in their organization. The results from 27(90%) of the respondents forward their response by pointing the Board or committee assigned by the top-level management and the rest 3(10%) pointed out the executive management team as having the authority to approve the credit facility requests from customers. From this it can be concluded that the board is more responsible in reducing the Bank's exposure to credit risks.

Since the purpose of training is to improve knowledge, skill and attitudes towards job Satisfaction it is better to know how often Dashen Bank facilitates trainings for employees who work in credit related areas. Hence, as can be seen in item 3 of table 3.3, we forward a question to our respondents. As a result, most of the respondents 20(66.66%) of respondents pointed out that, their organization facilitates a risk management training course one times per year. Whereas, 10(33.34%) of the respondents replied that the bank facilitates a risk management training course two times per year. Thus, it can be concluded that the Bank facilitates trainings to employees at least one times per year which enables employees to understand the credit risk management practices and to do better effort on behalf of the Bank's benefit.

The Student Researchers also forwarded credit risk related type of questions in an interview to find out the impact of poor credit risk management. Thus, the results from total interviewees show that implementing better risk management means better profitability and operating activities at a lower relative risk; and hence, getting a higher Return on Assets because credit is the core of their bank's operation. From this one can conclude by saying that the better the management of credit risk, the lower relative risk and hence the higher will be the Return on Assets or the risk adjusted Rate of Return on Assets.

In connection with risk assessment and evaluation tools, the student researchers forwarded an interview question on how does Dashen Bank uses its credit risk assessment and evaluation tools in mitigating its credit risk exposures. As a result, responses from 3(100%) of interviewee respondents show that through the application of internal credit rating system and looking into factors like types of loan services (term loan, merchandise loan, advance on export bill), quality of management, and customer's relationship with the bank, the bank reduces can risk exposure. From this, it can be concluded that the Bank has developed internal credit rating system to manage and reduce credit risk. This shows well-managed credit risk rating system promotes not only bank safety; it also facilitates soundness in informed decision making.

The student researchers were also interested in evaluating Customers satisfaction about the credit service of Dashen Bank through an interview question. As a result, the 3(100%) of respondents replied by saying "yes" and reason out that, most of credit customers of the bank are familiar with and understand the credit administration processes (promotion of credit, verifying and analysis of credit application, and verifying payment) of the bank, and get credit services within a short period of time. From this it can be concluded that credit customer's satisfaction can be derived from transparency of credit administration processes.

The respondents were also asked related question on how transparent is their Bank's credit administration processes. As a result, 3(100%) of interviewee respondents replied that credit administration processes such as, promoting credit, verifying and analysis of credit applicants, verifying the payment of credits as per the agreement, are conducted with an equal and proportional manner on their bank's daily activities. From this it can be concluded that, performing these series of activities not only strengthens the bank, also helps in controlling the unethical actions of borrowers.

The Student Researchers were also interested in knowing whether there are any challenges that Dashen Bank faces in its Management of Credit Risk or not. Responses from 3(100%) of the Interviewees shows that, in its history, Dashen Bank faces a number of challenges that emanate from credit risk management activities. Accordingly, the respondents' pointed out that lack of technology to manage the portfolio data, misinterpretation of policies, and effects of changing in government policy, are the major challenging factors which have an equal and proportionate share of negative impact on Credit Risk Management activities of Dashen Bank.

Since the purpose of training is to improve knowledge, skill and attitudes towards job Satisfaction it is better to know how often Dashen Bank facilitates trainings for employees who work in credit related areas. Hence, in our interview we forward a question to our three interviewee's respondents. As a result, most of the respondents 2(66.66%) of respondents said that, their organization facilitates a risk management training course one times per year. Whereas, one of the interviewee said the bank facilitates a risk management training course two times per year. Thus, it can be concluded that the Bank facilitates trainings to employees at least one times per year which enables employees to understand the credit risk management practices and to do better effort on behalf of the Bank's benefit.

Finally, the student researchers interviewed our respondents to forward their recommendation on the future profitability of their bank. As a result, most of the respondentes 3(100%) said that there are many ways in which Dashen Bank can be more profitable. Setting up a particular credit risk management teams, making regular revision of risk management plans, clearly allocating credit risk management responsibilities, strictly obey in credit risk management policy, listening to problems from employees, providing training courses, and allocate appropriate resources are some of the ways.

# CHAPTER FOUR

## SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This paper examines about Credit Risk Management and its impact level on the performance of Dashen Bank. The paper also tries to address the following basic research questions:

1. How Dashen bank use credit risk evaluation and assessment tools to mitigate credit risk exposure?
2. What are Dashen banks credit administration processes?
3. What are the challenges (if any) that faced by Dashen bank in credit risk management?
4. How does credit risk management affects Dashen banks performance?

In doing so, the student researchers used both primary and secondary data collection instruments. Consequently, 8 interview questions were forwarded to three managers and board members. 16 questionnaires were prepared and distributed to all 30 employees who work in credit related work area. Finally, all employees of the bank who are working in credit unit filled and returned the questionnaire.

## 4.1 SUMMARY

Based on the data presentation, analysis, and interpretation shown in chapter three, the following are summaries of the major findings:

- There are a number of credit related risks which have a significant effect on the performance and profitability of Dashen Bank. Results from the respondent's show that Default Risk identified to posses 26(86%) of risk level, and Concentration Risk 2(6.67%), whereas, Transaction Risk, and Intrinsic Risk each share a risk level of 1(3.33%).

- Credit risk exposures can be reduced to a minimum level through the application of different risk reduction mechanisms. Among the most important mechanisms implemented by Dashen Bank, 15(50%) of the total respondents ranked Long term customer relationship as the most important mechanism; Whereas, mechanisms such as Collateral Requirement, Screening and Monitoring, and Credit Rationing each share an importance level of 9(30%), 3(10%), and 3(10%) respectively.

- The Student Researchers tried to identify the direction of the impact of credit risk management towards the performance and profitability Dashen Bank. Thus, results from 30(100%) of the total respondents clearly show, an effective management of credit risk is a critical and an essential element to the long-term success and it does have a “positive” impact on the performance and profitability of their bank.

- In its History, Dashen Bank faces a number of challenges that emanate from credit risk management activities. Thus, results from interview managers 3(100%) of respondents show that lack of technology to manage the portfolio data, misinterpretation of credit policies, and effects of changing in government policy, are among the most challenging factors.

- Developing a well managed internal credit rating system is an important tool in promoting Dashen Bank’s safety and soundness in informed decision making. However, the results from interviewees of the management body show that, in order to get the required level of output, the system should be developed by looking different factors like the type of loan requests (term loan, merchandise loan, advance on export bill), the customers relationship with the bank, and the ability of management in properly managing credits.

- Since the purpose of training is to improve the knowledge, skill, and attitudes of employees towards job satisfaction, we tried to know how often Dashen Bank facilitates training opportunities particularly for those assigned in credit risk management positions. Accordingly, the results of interviewees confirmed that, the bank facilitates training courses one time per year.

## 4.2 Conclusions

Based on summary of the findings the following conclusions are drawn.

- Among the many types of Credit related risks that affect the performance and profitability of Dashen Bank, Default risk posses the highest risk level and is also difficult to the bank to reduce it at a minimum risk level. This is because of its dependency on the creditors' willingness to repay, efficiency and effectiveness attached to their activities.

- Credit Risk exposures are reduced in Dashen Bank through the application of Risk Management Mechanisms such as, Long term customer Relationship, Collateral requirement, Screening and monitoring, and Credit Rationing. As it helps in reducing the cost of information collection and making things easier in screening out bad credit risks, Long term customer relationship is the most important for the Bank than a property promise (collateral) or other mechanisms.

- An Effective Management of Credit Risk is a critical and an essential to the long-term success of Dashen Bank. In addition, it also enables the Bank to establish the standards of process, segregation of duties and responsibilities to employees assigned on the implementation of credit policies and procedures endorsed by the bank.

- Dashen Bank faced a number of challenges that emanate from credit risk management activities. Factors such as lack of technology to manage the portfolio data, misinterpretation of credit policies, and effects of changing in government policy, are the major challenging which have an equal and proportionate share of negative impact on Credit Risk Management activities of the Bank.

- Promoting Bank safety and facilitating soundness in informed decision making achieved through the development of a well managed Credit Risk Rating System. Credit rating system also helps in measuring and differentiating the level of credit risk attached in individual credits and groups of credits. It also allows the bank's management and credit examiners' to monitor changes and trends in risk levels.

- In order to have a good understanding of credit risk management practices and to be efficient in accomplishing the Bank's benefit, Dashen Bank provides Employees assigned on Credit related services training opportunities at least one times per year.

## 4.3 Recommendations

Based on the Summary of the findings and Conclusions the following Recommendations are forwarded.

- Credit risk, particularly Default risk is the most difficult to control and to manage properly; it also had a significant negative impact on the performance and profitability of Dashen Bank. Hence, mechanisms implemented to reduce an exposure to this type of risk and other credit related risks should be strengthened for the long run success of the Bank.

- In order to assess and evaluate its Credit risk exposures, Dashen Bank developed an internal credit rating system. However, due to improper application of the system, the bank couldn't get an effective output from the system. Therefore, to enable the bank capture risks without delay and to have a perfect estimate of expected loss, the system should be programmed in a way that clearly define rating thresholds, review ratings periodically, preferably at half yearly intervals.

- Employees of Dashen Bank, especially those assigned in the areas of Credit Risk Management are required to update themselves with current information about government credit policies and regulations. However, training schedules of the bank are not enough in accomplishing these objectives. Therefore, to make employees understand the risk management practices and enabling them to do better to the bank's benefit, the bank should revise its training schedule and improve the Capacity of employees.

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# APPENDIX 1

Questionnaire to be filed by the staff of Credit Management of Dashen Bank share Company.

This questionnaire is prepared by a student researcher, prospective graduate of year 2014 in the field of accounting. The purpose of the questionnaire is to produce a paper in title "Credit Risk Management and Its Impact on the Performance of Dashen Bank S.C." which is a requirement for partial fulfillment of BA degree in Accounting. I would like to say thank you in advance for your cooperation. All information that you provide to this study will be kept strictly confidential.

**Remark**

- You may not require writing your name.
- Put ☑ mark in the boxes accompanied by various choices, to mark your answer.
- Use the blank spaces to write your answers for open ended questions.

I. Background of the respondents

1. Sex

   Male ☐ Female ☐

2. Educational Background

   Diploma ☐ Degree ☐ above Degree ☐

3. Work Experience

   1-2 Years ☐ 3-5 Years ☐

   6-10 Years ☐ Above 10 years ☐

4. What is your present position (title)? ________________________________

1. Do you think the credit approval procedures are exhaustive and transparent to customers?

   Yes No

   If your answer is 'No' state the reason ______________________________

   ________________________________________________________________

2. Which organs of the bank approved credit facility request by prospective borrowers?

   Branch credit Committee ☐ Managers Credit ☐ Committee

   Executive Management Credit Committee ☐ Board Committee ☐

   If others please specify

   ________________________________________________

3. How long it takes to process a credit?

   <15 days ☐ 15-30 days ☐ More than a month ☐

4. How do you evaluate the loan processing time compared to other similar commercial banks?

   Very good ☐ Good ☐ Fair ☐ Poor ☐ Very Poor ☐

5. Is the bank credit operation manual properly implemented?

   Yes ☐ No ☐

   If your answer is 'No' state the reason ______________________________

   ________________________________________________________________

6. What internal factors prevail affecting fast and timely decision of credit? (Please rank them 1 from the most severe problem to 4 to the last).

   1. Centralized decision making process
   2. Lack of adequate man power
   3. Delay in obtaining credit information
   4. Submission of incomplete data by the prospective borrower

   If others please specify

   ________________________________________________

7. How do you evaluate the bank credit management policy in dealing with non-performing loan?

   Very good ☐ Good ☐ Fair ☐ Poor ☐ Very Poor ☐

8. How do you evaluate the bank's support when customers default due to unforeseen circumstances?

   Very good Good ☐ Fair ☐ Poor ☐ Very Poor

9. What are the significant challenges that face credit management activities?

Thank you!

## Interview Questions

Interview will be made with Staffs of credit service department

1. Are perspective customers provided with complete check lists to enable them present all the necessary documents when loading application?
2. If “No” please state the problem.

   ______________________________________________________________
3. Do you think that the policy and procedures are well defined to provide fast response to the prospective customers? It ’No’ please state the reason.
4. Are the credit policy and procedures of the bank complete to handle day to day activities of credit operations? If ‘No” state weaknesses that should be addressed.
5. Is the Bank’s credit operations manual properly implemented? If ‘No’ state the reason.
6. Is the Bank’s organizational hierarchy’s appropriate and convenient for fast processional of loans and advances?
7. Do you think that customers are satisfied by the credit service provided by the bank? If ‘No’ please state the reason.
8. What are the significant challenges of which can face credit management?
9. If you have additional suggestions please mention.

Thank you