COMPARATIVE ANALYSIS ON CREDIT RISK OF DASHEN BANK AND NIB INTERNATIONAL BANK OF ETHIOPIA

Research paper submitted to department of accounting and finance for partial fulfillment of (BA) degree in accounting and finance.

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Statement of Declaration

I Asefa Yigrem, have carried out independently a research work entitled " ***comparative analysis on credit risk of dashen bank and nib international bank of ethiopia.***in partial fulfillment of the requirement of BA Degree in Accounting and Finance with the guidance and support of the research advisor. I do hereby declare that this research paper is my original work and that it has not been submitted by any other person for an award of degree in this or any other university/institution.

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Approval Sheet

This is to certify that the paper prepared by Asefa yigrem, entitled: comparative analysis on credit risk of dashen bank and nib international bank of Ethiopia and submitted in partial fulfillment of the requirements for the Bachelor degree in Accounting and Finance complies with the regulations of the University and meets the accepted standards with respect to originality and quality. Approved by:

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Examiner: Signature _____ Date_____

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Acronyms

CRM - Credit Risk Management

LDR - Loan to Deposit Ratio

CDR - Cash to Deposit Ratio

LAR - Loan to Asset Ratio

NPTL- Non-performing loan to total loan ratio

NBE - National Bank of Ethiopia

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ABSTRACT

This research paper titled "comparative analysis" was conducted by taking Dashen Bank (DB) and Nib International Bank as case study. The main objective of the study is to evaluate and compare the Credit Risk of Dashen bank and Nib bank for the fiscal period (2011-2015 G.C). To achieve this objective, mainly secondary data sources was used. The secondary data is collected from annual reports, directives, and bulletins of the bank. Descriptive statistical tools are used in analyzing the data collected. This study was used quantitative research approach to examine a stated objective because quantitative research is a systematic and scientific investigation of quantitative properties and phenomena and their relationships and also; the research used comparative analysis and ratio analysis to measure their financial Credit Risk. The ability of banks to formulate and adhere to policies and procedures that promote credit quality and curtail non-performing loans is the means to survive in the stiff competition. To achieve stated objective of study, the research used descriptive research methods. Descriptive research designs focus on describing station at set of circumstance by observing to give scientific description. The researcher also relayed on descriptive method, because of this method is more suitable to describe measure, compare and classify the Credit Risk of Dashen bank and Nib international banks.

Key word. *Credit risk, comparative analysis, dashen bank, Nib international bank. Ethiopia, national bank*

CHAPTER ONE

1 INTRODUCTION

1.1 Background of the study

Credit risk in a financial institution starts with the establishment of sound lending principles and an efficient framework for managing the risk. Policies, industry specific standards and guidelines, together with risk concentration limits are designed under the supervision of risk management committee (Giesecke, 2004). These policies, standards and procedures also govern how credit risk is measured, monitored, reported and controlled. As market conditions change rapidly, adequacy and effectiveness of internal controls should be reviewed at least quarterly (Machiraju, 2003).

The diversity of the business and economic conditions has led to the development of highly sophisticated tools and models to measure the exposure of a financial institutions credit risk. In case of an individual loan portfolio, the probability of default, loss given default or credit rationing are the most commonly used ones to measure the exposure to credit risk. The invention of various credit scoring models that use observed loan applicant's characteristics either to calculate a score representing the applicant's probability of default or to sort borrowers into different risk classes bring the ability to address credit risk on a new level (Richard, 2011).

Credit risk is an investors risk of loss arising from a borrower who does not make payments as promised. Such an event called a default. Another term for credit risk is default risk (Brown and Moles, 2012). Investor losses include lost principal and interest, decreased cash flow, and increased collection costs, which arise in a number of circumstances: consumer does not make a payment due on a mortgage loan, credit card, line of credit, or other loan, a business does not make a payment due on a mortgage, credit card, line of credit, or other loan, a business or consumer does not pay a trade invoice when due, a business does not pay an employees earned wages when due, a business or government bond issuer does not make a payment on a coupon or principal payment when due, an insolvent insurance company does not pay a policy obligation, an

insolvent bank won't return funds to a depositor, and a government grant bankruptcy protection to an insolvent consumer or business.

Adequately managing credit risk in financial institutions (FIs) is critical for the survival and growth of the FIs. In the case of banks, the issue of credit is of even of greater concern because of the higher levels of perceived risks resulting from some of the characteristics of clients and business conditions that they find themselves in. They also provide loans, credit and payment services such as checking accounts, money orders and cashier's checks. Banks also may offer investment and insurance products and a wide whole range of other financial services, which they were once prohibited from selling (Perro, &Ruoff, 2001).

Credit risk management is a structured approach to managing uncertainties through risk assessment, developing strategies to manage it and mitigation of risk using managerial resources. The strategies include transferring to another party, avoiding the risk, reducing the negative effects of the risk, and accepting some or all of the consequences of a particular risk. The objective of risk management is to reduce the effects of different kinds of risks related to a pre-selected domain to the level accepted by society. It may refer to numerous types of threats caused by environment, technology, humans, organizations and politics.

1.2 STATEMENT OF THE PROBLEM

Issues of credit risk gained increasing attention in the world. Poor credit risk management was contribute to banks failure. It is critical issue for every bank to manage credit. Many countries are suffering from non-performing loan in which banks are unable to get profit out of loans. An increased exposure to credit risk reduces bank profitability (Kayode, Obamuyi, Owoputi, AdemolaAdeyef, 2015). Increasing amount of non-performing loans in the credit portfolio is unfavorable to banks in achieving their objectives. Non-performing loan is the percentage of loan values that are not serviced for three months and above (Ahmad and Ariff, 2007).

Poor risk management lead to the accumulation of non-performing loan under which the generated profit are note eroded through loan provision but also soundness, safety and stability of bank While effective Credit risk management improve Credit performance through establishing appropriate Credit risk environment, maintaining Credit limit at

acceptable level, undertaking sound Credit granting process, proper monitoring and controlling credit risk as well as optimizing risk-return of the bank. Therefore, it is important to examine Credit risk management system and practice of Ethiopian Commercial banks to initiate top-level management and regulatory bodies to take policy measure toward maintaining adverse effect of Credit function (Richard, 2011).

Based on the above idea, this study was attempt to examine the determinant of credit risk management of commercial banks in Ethiopia. This is because as indicated above, several scholars and the survey result of National Bank of Ethiopia (NBE) in (2010), such as, even though commercial banking system in Ethiopia has been witnessing a significant expansion over the past ten years than before however banking industry still Underdeveloped: in this regards the study were reveal lack of credit risk management practice were one of the major challenging factor of the sector. The survey believes that such growth should be matched with strong credit risk management practices. Accordingly, this research believes that to tackle credit risk management practice of commercial banks an academic study should focus on the area.

Hence, as far as the researcher knowledge, from the importance of sector for the development of the country, little studies were done to examine determents of credit risk of commercial banks in Ethiopia by Tilahun & Rafisa (2014) investigated only bank specific determinants of credit risk management in Ethiopian commercial banks during the period 2007 to 2011, such credit growth, bank size, operating inefficiency, ownership, profitability, capital adequacy, and bank liquidity. The regression results revealed that credit growth and bank size have negative and statistically significant impact on credit risk. Whereas, operating inefficiency and ownership have positive and statistically significant impact on credit risk. Finally, the results indicate that profitability, capital adequacy and bank liquidity have negative but statistically insignificant relationship with credit risk.

Tsegaye & Nigatu (2016), investigate only the macroeconomic and bank specific factors in Ethiopia commercial banks during the period 2003 to 2009 such as leverage, operating inefficiency, loan growth, ownership, loan to deposit ratio, GDP, Inflation and market interest Rate The study showed that leverage, operating inefficiency, loan growth, ownership and loan to deposit ratio are significant determinants of credit risk of

Ethiopian commercial banks in the test period. The empirical finding of the study also showed an existence of a clear difference on credit risk level between government and private owned commercial banks.

Recently there are attempts being made to see the determinant of credit risk on the commercial banks in Ethiopia, as there are high loan provision expenses though declining, which is above the standard. According to the study conducted by Tsegaye & Nigatu (2016) on determinates of credit risk of commercial banks in Ethiopia, the credit risk level of Ethiopia was 7.08%, which is very high relative to the international standard 2% risk level of commercial banks. This indicates that still it needs further investigation on the factors of credit risk of commercial banks in Ethiopia

Thus, due to the severity of credit risk problem and absence of empirical studies in Ethiopia commercial banks relating to this topic incorporating crucial microeconomic factors, Hence, the study tried to analyze and compare the financial statements of dashen bank and Nib international bank it focusing on answering the following questions.

1.3 Research Question

1. How the trends of capital adequacy ratio affect banks?
2. How the trends of non-performing loan ratio affect banks?
3. How loan to deposit ratio affect both banks?
4. How cash to deposit ratio affect both banks?
5. How loan to asset ratio affect both banks?

1.4 OBJECTIVE OF THE STUDY

1.4.1. General Objective

The main objective of this study is to evaluate and compare the credit risk of Dashen bank and Nib international bank of Ethiopia.

1.4.2 Specific Objective

In order to achieve the general objective, the study was considering the following specific objectives**.**

- ✓ To compare the loan to asset ratio of both banks.
- ✓ To compare the loan to deposit ratio of both banks.
- ✓ To compare cash to deposit ratio of both banks.

- ✓ To compare the trend of capital adequacy ratio of both banks.
- ✓ To assess the trend non- performing loan ratio of both banks.

1.5 Significance of the Study

The importance of this study is to enhance the competitive position of in relation to credit risk in Dashen bank and Nib international bank of Ethiopia by finding ways that improve the credit of the bank.

- The researcher also believes that the result of this study would pave the way for additional knowledge to credit managers in designing new credit management and for planning and controlling procedures in credit activities.
- It helps the clients of the institution by informing necessity of paying credit according to agreements, in preventing unnecessary payments.
- Finally, the study helps for further researchers as reference who wants to conduct study on the area of credit management of financial institutions particularly Dashen and Nib international banks.

1.6 Scope of the Study

Due to financial and time constraints the scope of the study was conduct on Dashen bank and Nib international bank of Ethiopia Besides, it also conceptually delimited on the evaluation of credit risk management analysis or policy, procedures and system of these two banks.

1.7 Limitation of the Study

Any type of research may have its limitation. The degree of limitation would be depending on the situation. The student researchers were face different problem that makes hard to conduct the study. Therefore, the following problems were the majors;

- ➢ Lack of sufficient time and information.
- ➢ Financial constraint may.

1.8 organization of the paper

The research paper had composed of five chapters. The first chapter outline introduction of the study that include background of the study, statement of the problem, objective of the study, scope and significance of the study, The second chapter of the paper is the literature review, the third chapter focus on methodology the research, the fourth chapter

deals with data analysis and presentation and The last fifth chapter deals with conclusion and recommendation based on the finding.

CHAPTER TWO

LITERATURE REVIEW

2.1The Review of Related Literatures

2.1.2 What is Credit?

Credit is the trust which allows one party to provide resources to another party where that second party does not reimburse the first party immediately (thereby generating a debt), but instead arranges either to repay or return those resources (or other material of equal value) at a later date (Sullivan *et al.*, 2003). The resources provided may either be financial (e.g. granting of loans), or they may consist of goods or services (e.g. consumer credit). Therefore, credit encompasses any form of deferred payment which is extended by a creditor, also known as the lender, to a debtor also known as a borrower. Credit is advanced to beneficiaries who promise to pay in a future date. Individual's enterprises and other corporate entities have different reasons for accessing credit. Therefore, the purpose and the nature of credit have been categorized into short term, medium term and long term loans. Briefly, short term loans are advances (e.g. personal loans) extended with a repayment period of not more than five (5) years. Medium term loans (designed for Small and Medium Enterprises) have a repayment period that falls between five (5) and ten (10) years.

Long term loans (for giant corporate entities) as the name implies have a repayment period of more than ten (10) years. In Ghana most of the credit accessed fall within the short and the medium term. Advancing credit is key to banks operations, weighing significantly within the asset balance file. It has the potential of generating huge profit, but equally high risk. Practice show that credit risks are the highest registered in time by banks, in connection with losses. Credit risk is an investor's risk of loss arising from a borrower who does not make payment as promised (Bluhn, et.al. 2002).

2.2 Risk in banking industry

As per different author risk is the possibility of suffering harm or loss; danger. So when we say risk in bank we mean that uncertainties that can make the banks to loose and be bankrupt.

2.3 Credit risk in banking

Credit in bank **is** a contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some later date. However, Credit risk is defined as the probability that some of a banks 'assets, especially its loans, will decline in value and possibly become worthless. It arises from non-performance by a borrower, either inability run unwillingness to performing the pri-committed contracted manner. (JoanSelormTsorhe). Or else as per (R.S.Raghavan, 2003) Credit Risk is the potential that a bank borrower/counter party fails to meet the obligations on agreed terms. There is always scope for the borrower to default from his commitments for one or the other reason resulting in crystallization of credit risk to the bank.

2.4 Components of credit risk in banks:

The credit risk in a bank's loan portfolio consists of three components;

(1) Transaction Risk

(2) Intrinsic Risk

(3) Concentration Risk

(1) Transaction Risk: Transaction risk focuses on the volatility in credit quality and earnings resulting from how the bank underwrites individual loan transactions. Transaction risk has three dimensions: selection, underwriting and operations.

(2) Intrinsic Risk: It focuses on the risk inherent in certain lines of business and loans to certain industries. Commercial real estate construction loans are inherently more risky than consumer loans. 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.

(3) 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. Concentration within a portfolio will determine the magnitude of problems a bank will experience under adverse conditions.

2.5 Credit Risk management 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 (Andrew Fight, 2004). 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 manages credit risks effectively, they won ‘t be profitable and won ‘t be in business very long. Bank can reduce their exposure to credit risk on different loans by applying major credit risk management principles (as identified by Fredrick S. Mish kin). These are:

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.

2.6 Impact of credit risk management in bank

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. Bank need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Bank

2.7 Credit Risk Performance Measurement in Bank

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 ask any person in the banking industry how important it is, he or she 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. Risk 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.

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, right? Not necessarily.

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. Moreover, there is also that risk of regulatory non-compliance that the bank would have to deal with as well. Striking a balance is then very important here.

By financial definition, credit risk management pertains to that process of assessing the risks that come with any investment. For the most part, risk comes in the form of investments and the allocation of capital. These risks should be assessed so that a reliable and sound investment decision would be achieved. Risk assessment is also an important factor to consider when you are aiming for a certain position in balancing risks and returns.

Bank 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. We have to take into consideration the second Basel Accord which states that the more risks the bank, is exposed to, the greater the amount of capital it should hold in its reserves.

The determination of the risks involved here entails several practices. For starters, banks need to come up with certain estimates as to the figures to keep and the ones to make available for loans. Also, banks have to monitor the performance of the bank, as well as evaluate it. Always remember that portfolio analyses and loan reviews are a must when it comes to efficient credit risk performance measurement. (Tags: banking performance, performance measurement, 2000) 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.

Bank 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 p roactively 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 (Focus Group, 2007).

2.8 Credit Risk Management Practice

Banks have different credit risk management policies or philosophies same do the risk management practices differ from the financial institution to another despite the fact that they can open to the same risk. The policies and philosophies each and every bank has their individual level of risk that they can decide to let go based on how it is out lined in their risk management policy. To exit from firms in the same industry but the implementation in practices differs practices is not consistent with theory in most cases because of data limitation for most industries, it difficult to describe which firms manage more risk than others or whether firms language in dynamic risk management strategies and more importantly it cannot be reliably tested whether firms language in dynamic risk management strategies and more importantly it cannot be reliability tested whether a firms management practices conform with existing essential of theories (Tufano, 1996).

2.8.1 Credit risk management principles

1. While financial institutions have faced difficulties over the years for a multitude of reasons, the major cause of serious banking problems continues to be directly related to lax credit standards for borrowers and counter parties, poor portfolio risk management, or a lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of a bank's counter parties.

2. Credit risk is most simply defined as the potential that a bank borrower or counter party will fail to meet its obligations in accordance with agreed terms. 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. Bank need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Bank should also consider the relationships between credit risk and other risks.

2.8.2 The Credit Process

Old field and Santomero (1997) investigated risk management in financial institutions. In this study, they suggested four steps for active risk management techniques:

The establishment of standards and reports;

The imposition of position limits and rules (i.e. contemporary exposures, credit limits and position concentration);

The creation of self-investment guidelines and strategies; and

The alignment of incentive contracts and compensation (performance-based compensation contracts).

Loan that constitutes a large proportion of the assets in most banks' portfolios are relatively illiquid and exhibit the highest credit risk (Koch and MacDonald, 2000). The theory of asymmetric information argues that it may be impossible to distinguish good borrowers from bad borrowers (Auronen, 2003), which may result in adverse selection and moral hazards problems. Adverse selection and moral hazards have led to substantial accumulation of non-performing accounts in banks (Bester, 1994; Bofondi and Gobi, 2003). The very existence of banks is often interpreted in terms of its superior ability to overcome three basic problems of information asymmetry, namely ex ante, interim and ex post (Uyemura and Deventer, 1993). The management of credit risk in banking industry follows the process of risk identification, measurement, assessment, monitoring and control. It involves identification of potential risk factors, estimate their consequences, monitor activities exposed to the identified risk factors and put in place control measures to prevent or reduce the undesirable effects. This process is applied within the strategic and operational framework of the bank.

Bank must have a process to analyze beneficiaries' ability to service a facility advanced to them. In some instances, stringent policies must be put in place to prevent individuals that involve in fraudulent activities or crimes from accessing a facility. This can have achieved through a number of ways for example using reliable source of references, accessing credit bureaus, or becoming familiar with individuals responsible for managing a company and checking their references and financial conditions. Bank should desist from advancing credit to reputable borrowers simply because they are known to the institution. Each loan application document should carefully be analyzed by a competent credit officer with the appropriate expertise commensurate with the size and complexity of the transaction. Therefore, there should be a policy to specify the type of information and documentation necessary for a new credit approval, credit renewals, and/ or change in terms and conditions of previously approved credits. The process of advancing credit is associated with many risks that financial institutions have to deal with.

2.8.2.1 Source of Credit Risk

There are two main sources of credit risk factors. These are external and internal risk factors. The external risk factors are discussed below as follows:

2.8.2.2 Economic Conditions

Change in national income and unemployment will have impact on credit risk through change in business cycle, exchange rate, interest rate, credit availability and credit quality. Liquidity crunch or financial problems has the ability to impact borrowers' ability to fulfill their obligation. In addition, legal and regulatory change could cause financial institutions to change how they oversee a transaction, as well as the quality and ability of debt collection. (Uyemura and Deventer, 1993).

2.8.2.3 Competition

Competition among financial institutions in terms of growth, profitability and the desire to be a market leader have the ability to cause financial institutions to lower their standards or improperly price their loan products. This could result in higher cost of increasing non- performing loans.

The internal risk factors of credit risk include;

2.8.2.4 Underwriting standards

This is a process to determine what type of, to whom, for what purpose and when credit should be granted. Proper credit approval process should comprise proper guidelines on both form and methodology in evaluating borrowers' credit worthiness, setting up of credit line and interest rate appropriate to borrowers' risk and credits. Lenient credit underwriting can incur losses to financial institutions especially when debt repayment cannot be demanded or collateral cannot be seized in time. Many credit risks arise from deficiency in underwriting standards and credit monitoring.

2.8.2.5 Competence of staff

Credit officers without the necessary expertise in the activities they are responsible for, be it credits, investment, management of problem assets or new products, can lead to poor lending practice, ineffective administration, and eventually, loss to financial institutions. (Uyemura and Deventer, 1993).

2.8.3 Credit analysis and appraisal

When evaluating loan bankers cite the 5Cs of credit. These are: character, capital, capacity condition, and collateral

A. Character

It is the most important element yet difficult to assess. A loan officer essentially must determine the customers desire to repay a loan.

The only quantitative information available is the borrower application and credit record. If borrower is a bank customer the officer can examine internal information regarding the customers historical account relationship. If a borrower is not a current customer, the officer must solicit information from local credit bureaus or other businesses that have extended credit to the individual. Banks also replay heavily on subject appraisal of the borrowers' character. They normally obtain personal references, verify employment and check the accuracy of the application. This is necessary because fraud is prevalent and relatively easy for an individual disguise past behavior. If the officer determines that a potential customer is dishonest the loan is rejected automatically.

B. Capital

Refers to individual wealth position and it is closely related to capacity, an individual financial ability to meet loan payment, in addition to normal giving expenses and other debt obligation for all most all customer loans, the individual's income service as the primary source of repayment.

Loan officer projects what income will be available after other expenses and compares this with periodic principal and interest payments on the new loan. To ensure adequate coverage, the lender often imposes minimum down payment requirements and maximum allowable debt service to income ratios. The loan officer verifies that the borrowers equal that stated on the application and assesses the stability of income source.

C Capacity

Capacity is the ability to repay debts as scheduled. For households, the employment of the working member provides most of the income which is spent for customer expendables, and debt repayment. The analysis must consider the effects of unusual events such as prolonged illness or unemployment on the economic capacity of household.

D. Condition

Refers to the impact of economic events of the borrower's capacity to pay when some income source disappears as business activity declines. Borrowers may be subject to unfavorable economic condition beyond their control. Repayment depends up on not only character, capacity, and collateral, but that over which the borrowers exercise, little or no control. The long run and short run business cycle affects nearly all persons and individuals, but certain industries are especially phone to oscillate between, looking for early signs of weakness which lead to unemployment, say declines and operating losses.

E. Collateral

The importance of collateral is in providing a secondary source of payment. Collateral may be in the form of the asset financing by the loan.

Other assets owned by the individual or the personal guarantee of a consigner on the loan. Collateral gives banks another source of repayment if the borrower's income insufficient. Normally, a loan is not approved simply because the collateral appears solid. Often the collateral disappears or deteriorates in value prior to the bank taking possessions as with a damaged or order automobile. Finally the bankruptcy code enables individual to protect a

wide range of assets from creditors, and it may be difficult to obtain a judgmental (Timothy, 2011).

2.8.4 CREDIT RISK MANAGEMENT PROCESS

The word process cannot a continuing activity or function towards a particular result. The process in fact the last of the four wings in the entire risk management edifice the other three being organizational structure principles and policies. In effect it is the vehicle to implement the banks risk principles and policies aided by banks organizational stricter, with sole objective of creating and maintaining a healthy risk culture in the bank. The risk management process has four components. Source :(Pesos (1981), bank management and financial service 6th edition. McGraw hill published company)

2.8.4.1 Risk Identification

While identifying risks, the following points have to be kept in mind.

- ✓ All types of risk (potential and existing) must be identified and their likely effect in the short run be understood.
- ✓ The magnitude of each risk segment may vary from bank to bank.
- ✓ The geographical area covered by the bank may determine the coverage of its risk content. A bank that has international coloration may experience different intensity of credit risk in various counties when compared with pure domestic operations and its overseas arms.

2.8.4.2 Risk measurement

Measurement means weighing the content and or value, intensity, magnitude of any object against a yardstick. In risk management it is necessary to establish clear way of evaluating various risk categories, without which identification would not serve any purpose. Using quantitative techniques in qualitative framework will facilitate the following objectives.

- ✓ Finding out and understanding the exact degree of risk elements in each category in the operational environment.
- ✓ Directing the efforts of the bank to mitigate the risks according to the vulnerability of a particular risk factor.

Taking appropriates in planning the organizations future trust areas and line of business and capital allocation. The system used to measure risk depend upon the nature and complexity of a risk factor .While a very simple qualitative assessment may be sufficient in some cases, sophisticated methodological/statistical may be necessary in order for a quantitative values.

2.8.4.3 Risk monitoring

Keeping close track of risk identification measurement activities in the light of the risk, principles and policies is a core function in a risk management system. For the success of the system, it is essential that the operating wings perform their activity within the broad contours of the organizations risk perception. Risk monitoring activity should ensure the following

- Each operating segment has clear lines of authority and responsibility.
- When the organizations principles and policies are breached even if they may be to its advantage, must be analyzed and reported, to the concerned authorities to aid in the policy making.
- There must be action plan to deal with major threat areas facing the bank in the future.
- The activities of both the business and reporting wings are monitored striking a balance at points in time.

2.8.4.4 Risk Control

There must be appropriate mechanism to regulate or guide the operation of the risk management in the entire bank through a set of control devices. These can be achieved through a lot of management processes such as:

- Assessing risk profile techniques regularly to examine how far they are effective in mitigating risk factor in the bank.
- Analyzing internal and external audit feedback from the risk angle and using it to activate control mechanisms
- Segregating risk areas of major concern form other relatively in significant areas and exercising control over them.

- ❖ Putting in place a well-drawn out risk focused audit system to provide input on restraint for operating personal so that they do not take needless risk for short term interests. It is evident, therefore, that the risk management through all its four wings depends up on the nature of the organizations activity, size and objective. But it still remains a fact that the important of the entire process is paramount.

2.8.5 Goals of Credit Risk Management

The international regulatory bodies felt that a clear and well laid risk management system is the first prerequisite in ensuring the safety and stability of the system. The following are the goals of credit risk management of any bank/financial organization.

- ➢ Maintaining risk return discipline by keeping risk exposure within acceptable parameters.
- ➢ Fixing proper exposure limits keeping in view philosophy and risk appetite of the organization.
- ➢ Handling credit risk both on ‘entire portfolio “basis and on an individual credit or transaction “basis.
- ➢ Maintaining an appropriate balance between credit risks and other risks, like market risk, operational risk etc.
- ➢ Placing equal emphasis on “banking book credit risk"(for example, loans and advances on the banks’ balance sheet/book), ``trading book risk “securities/bond) and off balance sheet risk"(derivatives, guarantees etc.)
- ➢ Impartial and value added control input from credit risk management to protect capital.
- ➢ Providing a timely response to business requirements efficiently.
- ➢ Maintaining consistent quality and efficient credit process.
- ➢ Creating and maintaining a respectable and credit risk management culture to ensure quality credit portfolio.
- ➢ Keeping consistency and transparency as watch words in credit risk management. Source :(shaker, KN, (2005) banking theory and practice, New Delhivkas publication).

2.8.6 Credit Risk Management Techniques

Risk taking is an integral part of management in enterprise. The basic techniques of an ideal credit risk management culture are:

- ✓ Certain risks are not to be taken even though there is the likelihood of major gains or profit, like speculative activities.
  - ➢ Transactions with sizeable risk contents should be transferred to professional risk institutions. For example, advances to small scale industrial unit and small borrower. Source :(shaker, ken, (2005) banking theory and practice, New Delhivkas publication).

2.9 Essentials of Effective Credit Risk Management in Banking

Basel II Accord identifies that effective credit risk management is a critical component of a bank's overall risk management strategy and is essential to the long–term success of any banking organization. Overall, the components of effective credit risk comprise.

2.9.1 Types of credit risk

Credit risk can be classified in to the following:

1. Credit default risk

The risk of loss arising from debtor being unlikely to the pay its loan obligations in full or the debtor is more than 90days past due on any material credit obligation; default risk may impact all credit sensitive ,including loans, securities and derivatives.

2. Concentration risk

The risk associated with any single exposure or group of exposures with the potential to produce large enough losses to threaten a bank core operation. It May arise in the form of single name concentration or industry concentration.

3 Country risk

The risk of loss arising from a sovereign state freezing foreign currency payments (transfer/conversion risk) or when it defaults on its obligations (sovereign risk); this type of risk is prominently associated with the countries macroeconomic performance and its political stability. Source (en.Wikipedia.org/wiki/credit risk)

2.9.2 Credit risk management

Banks are expected to provide and collect loans and advances successfully in order to earn higher profit. The economic concept of adverse selection and moral hazard provides a frame work for understanding the principles that financial institution especially banks have to follow the various techniques to reduce credit risk and to make successful loans and advances. The adverse selection in loan market occurs because bad credit risks are once which usually line up for loan. In other word, those who are most likely to produce an adverse outcome are the most likely to be selected. Borrowers with very risky investment project must have to gain if their project are successful and so they are the most easier to obtain loan clearly. However, they are the least desirable borrowers because of the greater possibility that they will be unable to payback their loans. Moral hazard exists in loan market because borrowers may have incentives to engage in activity that are undesirable from the lenders point of view. In such situations, it is more likely that the lender will be subjected to the hazard of default.

To be profitable the bank must overcome the adverse selection and moral hazard problems that make loan defaults more likely. The attempts of bank to solve problems help explain number of principles for managing credit risk.

A. Screening

Adverse selection in loan market requires that lender screen out the credit risk from the good ones so that loans are profitable to them. To accomplish effective screening, banks must collect reliable information to gather from an important principle of credit risk management.

B. Loan commitment

Banks also gather information by issuing loan commitment to provide a firm with loans up to a given amount at an interest rate that is tied to some market interest. The majority of commercial and industrial loan are made under the loan commitment arrangement. The advantage for the firm is that it has the source of credit when it needs it. The advantage for the bank is that the loan commitment promotes long term relationship, which in turn facilitates information collection. A loan commitment arrangement is powerful method for reducing the banks cost for screening and information.

C. Collateral and compensating

Collateral requirement for loans are important credit risk management tool.Collateral,which is properly promised to bank as compensation because if the borrower defaults lessens the consequence of adverse selection because it reduces the banks losses in the case of loan defaults. One particular from of collateral required when a bank commercial loan is called compensating balance.

A firm receiving a loan must keep a required minimum amount of fund in a checking account at the bank. Besides serving collateral, compensating balance helps increase the likelihood that a loan will be paid off. The do these by helping the bank monitor the borrower and consequently reduce moral hazard.

Specifically, by requiring the borrower to use a checking account at the bank, the bank can observe the firms check payment practices, which may yield a great deal of information about the borrower's financial condition compensating balances therefore make it easier for banks monitor borrowers more effectively and are other important credit risk management tool.

D. Credit rationing

The bank refuses to make loan even though borrowers are willing to pay the stated interest rate or even a higher rate. Credit rationing takes two forms. The first occurs when a lender refuses to make a loan of any amount to borrower, even if the borrower is willing to pay higher interest rate. The second occurs when a lender willing to make a loan but restricts the size of the loan to less than the borrower would like. The first you may puzzle by the first types of credit rationing. Individuals and firms with the riskiest investment project are exactly those that are willing to pay the highest interest rate. If the borrower took on a higher risk investment and succeeded, the borrower would become extremely rich. But a bank would not want to make such a loan precisely because the investment risk is high; the likely outcome is that the borrower will not succeed and the bank will not pay paid back. The bank would therefore rather not make any loans at higher interest rate; instead, it would engage in the first types of credit rationing and turn down loans.

Banks engage in the second type of credit rationing to guard against hazard. They grant loan to borrowers, but not loans as large as the borrowers want. Such credit rationing is necessary because the larger the loan, the greater the benefits from moral hazard, since

more borrowers repay their loans if the loan amount are small, banks ration credit by providing borrowers with smaller loans than they seek(Mishikhin,2002)

2.10 OBJECTIVES OF CREDIT RISK MANAGEMENT

Credit risk management is chiefly responsible for the protection of an organization lending assets it's also provide internal communication to its credit representative with policies and procedures that reduce ambiguity allow to best fulfill their duties.

2.10.1Risk Reduction

Credit risk management satisfies it primary objective of risk reduction through credit analysis and review. Credit analysis is the research and investigation required to determine the risk involved with lending to a customer. This is performed by using information from credit applications, public record and credit report, credit application provide information like the applicants name, address, age, social security number, driver license number and references. Information from public records may include judgment, lies and registration. Credit reports provide financial information from credit lines payment history legal information and credit score. Source (En.Wikipedia.org/wiki/risk reduction).

2.10.2 Internal communication

Credit risk management must provide internal communication to its credit department and representatives. This not only allow them to fulfill their obligation in risk reduction, but also allows them to operate more efficiently by providing clear instruction on how to perform or act. Through the use of credit policies and procedures, credit risk management is able to better satisfaction this objective. Those policies and procedures include information requirements for the investigation and analysis of credit. They reduce ambiguity among the organizations credit representatives. This facilitates an easier and more efficient approach to credit risk management. Source :(William, chanters (2002), Research in banking and finance).

2.10.3 Customer service

Providing good service is necessary to retain customers. The company's marketing and sales department is directly responsible for sale by attracting new. Credit risk

management, while not charged with making sales, are still indirectly responsible for them in how they treat clients (customer service). Being polite and professional are rudimentary skills. But learning to work with customers, while satisfying a risk reduction role, takes training and development. Without good customer service as basic objectives, the organization stands to lose customers. Hard credit measures such as overly conservative credit limits, payment terms and collateral requirements can cease customers away. Without customer there is no need for credit risk management, as the organization will naturally cease to exist.

2.10.4 Departmental Coordination

Another objective of credit risk management involves coordination with other department by working with the collection department. Credit risk management is better able to stay in touch with customer payment issues and possible financial problems. Coordinating with the accounting and finance department can provide information regarding cash flow requirements possible changes needed regarding financial risk. Communicating closely with sales department can reduce internal and external conflicts regarding account decisions. (Frankil, 2009.Source/www.Ebow16/9/2006).

2.11 Managing Credit Risk Using Financial Ratios

Ratio analysis is a tool used by firms to conduct a quantitative analysis of information in a company's financial statements. Ratios are calculated from current year numbers and are then compared to previous years, other companies, the industry, or even the economy to judge the performance of the company. Ratio analysis is predominantly used by proponents of fundamental analysis. There are many ratios that can be calculated from the financial statements pertaining to a company's performance, activity, financing and liquidity. Financial statements contain enough information that provides insight into the creditworthiness of a customer. Ratios that is particularly useful in evaluating the creditworthiness of a customer may include current ratio, acid test ratio, debt-equity ratio, EBIT- Total Assets ratio and return on equity ratio. Chimerine (1998)

2.11.1 Liquidity ratio

Liquidity ratio measure capability of the bank to meet its short term obligation among various liquidity measures the study use three of them.

2.11.2 Loan to deposit ratio (LDR)

Indicates percentage of total deposit locked into non liquidity asset and it calculated by

$$LDR = \frac{Loan}{Deposit}$$

2.11.3 Cash to deposit ratio (CDR)

Indicates the higher or less liquidity of the banks from the deposit amount and it is calculated by

$$CDR = \frac{Cash}{Deposit}$$

2.11.4 Loan to asset ratio (LAR)

It is used to total loans outstanding as percentage of total asset and it is calculated as

$$LAR = \frac{Loan}{Asset}$$

2.11.5 Capital adequacy ratio

Capital adequacy ratio is measure of an institution capacity to absorb losses and still have adequate fund to maintain regular financial service.

2.11.6 Non-performing loan to total loan ratio (NPTL).

This is one of the most important criteria to evaluate the quality of loans or asset of any commercial banks.

Non-performing loans to total loan ratio (NPTL) measure the percentage of gross which are doubtful in banks port flow the lower ratio of nonperforming loans to total loan ratio. (NPTL)the better the percentage.

2.12 EMPIRICAL LITERATURE

Niinima¨ki (2004) in his paper entitled “The effects of competition on banks’ risk taking” found that the magnitude of risk taking depends on the structure and side of the market in which competition takes place. He also concluded that if the bank is a monopoly or banks are competing only in the loan market, deposit insurance has no effect on risk taking.

Bank in this situation tend to take risks, although extreme risk taking is avoided. Introducing deposit insurance increases risk taking if banks are competing for deposits. In this case, deposit rates become excessively high, thereby forcing banks to take extreme risks. Kealhofer, 2003).

The measures, however, focus on risk-return trade-off, i.e. measuring the risk inherent in each activity or product and charge it accordingly for the capital required to support it. This does not solve the issue of recovering loan able amount. Consideration that form the basis for sound CRM system include: policy and strategies (guidelines) that clearly outline the scope and allocation of a bank credit facilities and the manner in which a credit portfolio is managed, i.e. how loans are originated, appraised, supervised and collected (Basel, 2003).

2.13 Summary of Review Literature and Literature Gap

The literature review that are discussed so far showed that, banks credit risk are determined by macroeconomic, and bank specific factors. The empirical evidence shows that, favorable macroeconomic conditions, such as sustained economic growth, low unemployment and interest rates, tend to be associated with a better quality of bank loans. The studies in general show that the association between real GDP growth, inflation, real interest rate, unemployment rate, financial sector development, and competition. On the other hand, bank specific factors like, bank size, financial performance, operational efficiency, rapid loan growth, ownership type, income diversification, risk assessment, capital adequacy, loan to deposit ratio and monitoring are found to be having significance on the occurrence of credit risk of commercial banks.

In the context of Ethiopia, the related study conducted by Tsegaye & Nigatu, (2016) investigated the Macroeconomic and bank specific credit risk factors that affect credit risk of Ethiopian commercial banks during the period from 2003 to 2009 by ignorance of all industry factors such as financial sector development, competition, government regulation and the likes. Furthermore, Tilahun & Rafisa (2014) and Atakelt & Veni

(2015) conducted their studies on determinants of credit risk only by considering bank specific factors that are associated with credit risk with the reference of Ethiopian Banks. Considering the various risk faced by bank, the National Bank Of Ethiopia (NBE). This chapter provides so many evidences which identify the major determinants of bank loans particularly Credit risk. In case, some studies are conducted on particular country and the others on panel of countries. Hence many researchers have conducted a lot of study on determinants credit risk due to its significance for the bank's failure. the study tried to analyze and compare the financial statements of dashen bank and Nib international bank.

2.13 Conceptual Framework of the Study

According to (Svinicki, 2010) conceptual framework is defined as an interconnected set of ideas (Theories) about how a particular phenomenon functions or is related to its parts. In this study on The basis of theoretical, empirical literatures, and the hypotheses that developed from the literature part and the regression model of the study, the following conceptual frame work was developed

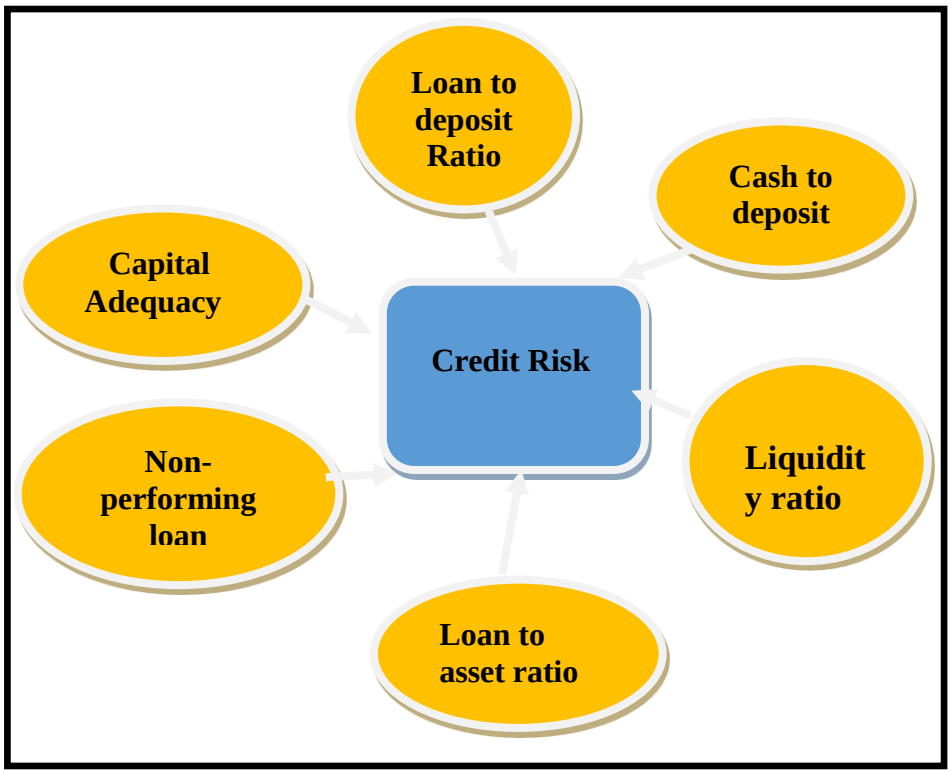


Figure 1. Conceptual Framework of the model of the study

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter over view the methodology the study adopted in the research. It includes the research design used to assess about the research and detail methodology showing the logical framework that discuses research designed, research method was presented. To achieve the objective of this research the appropriate method was adopted and method that was used to collect the data and the method employed to run the data analysis and interpretation was discussed under this chapter.

3.2 Research approach

The research problem and objective along with the philosophy of the different research approaches, the quantitative nature of the data collected, and quantitative research approach was found to be appropriate for this study. This study was used quantitative research approach to examine a stated objective because quantitative research is a systematic and scientific investigation of quantitative properties and phenomena and their relationships (Abbey, 2009).

3.3 Research Design

The formidable problem that follows the task of defining the research problem is preparation of the design of the research project popularly known as research design. To achieve stated objective of study, the research used descriptive research methods. Descriptive research designs focus on describing station at set of circumstance by observing to give scientific description. The researcher also relayed on descriptive method, because of this method is more suitable to describe measure, compare and classify the Credit Risk of Dashen bank and Nib international banks.

3.4 Study Design

The research problem having been formulated in clear cut terms, the research required study design. This study design facilitates research to be as efficient as possible yielding maximum information and reduced the effort, cost and time. The researcher selected the descriptive research design to conduct the study. The descriptive research design includes survey and fact finding enquires of deferent kinds and the major purpose of this method is description of the state of affairs as it exists at present.

3.5 Source of data and collection methods

Given the research design, secondary data would be used to meet the objectives of the study. According to Stewart and Kaman's (1993) cited in Li Yuri (2007), secondary data would have its own advantages. Compared to primary data, secondary data gives higher quality data, the feasibility to conduct longitudinal studies and the permanence of data. That is, secondary data generally provide a source of data that is both permanent and available in a form that can be checked relatively easily by others and increases the dependability of the data, hence ensure data quality. As a result, the data for the banks' credit risk management indicator variables were obtain from audited financial statements of the Dashen bank and Nib international bank of Ethiopia. In order to avoid the risk of distortion in the quality of data, the data will be the audited financial statements particularly balance sheet and income statement. Therefore, in order to get sufficient and relevant information for the study the researchers are used secondary data.

The secondary data would be collected from home office of Dashen bank and Nib international bank of Ethiopia.

3.6 comparative analysis

The population of the study was Dashen bank and Nib international bank of Ethiopia registered by National Bank of Ethiopia (NBE). Currently, as per NBE (2011/12-/14/15) annual report the major financial institutions operating in Ethiopia.

3.7 Data analysis method

To achieve the objectives of the study, panel data of Dashen bank and Nib international bank of Ethiopia for five years (2010/11 to 2014/15) were used. This is because of that panel data has the advantage of giving more informative data as it consists of both the

cross-sectional information, which captures individual variability, and the time-series information, that captures dynamic natures of the data. And hence it ensures more variability, more degrees of freedom, more efficiency, and less co linearity among variables (Gujarati, 2004). In the analysis of the descriptive statistics, the mean, standard deviation, maximum and minimum value would be used to analyses the trends of the data. Then after the data is edit, it can be analyzed and evaluated and judged in relation to assumed variables. Next, appropriate interpreting conclusions and recommendations forwarded using statistical tools such as table and percentage.

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION

4.1 Data Analysis, presentation and Interpretation

Based on the intended objectives of this study, this chapter is devoted to analysis and interpretation of different ratios which were computed based on the audited financial statement of Dashen Bank (DB) and Nib International Bank (NIB). In this chapter the credit risk analysis and interpretation supported by financial ratios has been discussed. And these financial ratios are Cash to deposit, Loan to deposit, Capital Adequacy, Liquidity and Loan to Asset ratio. For this purpose, the balance sheet, Income statement, Cash flow statement and change in stockholder's equity statement for the records 2011-2015 has been used.

4.2 Capital adequacy ratio

Capital adequacy ratio is a measure of an institution's capacity to absorb losses and still have adequate fund to maintain regular financial services. The rule is that capital should be commensurate with the volume and risk involved in business and adequate to absorb losses related to defaults in loan portfolio.

Dashen bank capital structure is achieved when capital adequacy ratio of the bank is higher than 8% which is a supervisory authority issued for commercial banks.

Table 4.2.1 Capital adequacy ratio of the Dashen bank

Year	Total capital	Total asset	%CAR
2011	1396.40	14659.79	9.5%
2012	1827.89	17520.04	10.4%
2013	2045.70	19747.17	10.3%
2014	2597.62	21962.20	12%
2015	2923.89	24763.88	12%

Source: Secondary data (dashen bank, 2011-2015)

The capital adequacy ratio of the bank compared with the supervisory authority required minimum level i.e. 8%. From the above table we can understand that the capital adequacy ratio of the bank is greater than the supervisory authority requirement

of 8%. Then the capital adequacy of dashen bank the minimum is 9.5%. This indicates that the company is permitted to go for debt and also shows the company good position.

Table 4.2.2 Capital adequacy ratio of the NIB bank.

Year	Total capital	Total asset	%CAR
2011	1308	10116	13%
2012	1610	11937	13.48%
2013	2011	14859	13.5%
2014	2525	19948.6087	12.6%
2015	3090	23869.61	13%

Source: Secondary data (Nib bank, 2011-2015)

Then the capital adequacy of nib international bank the minimum is 12.6% This indicates that the company is permitted to go for debt and also shows the company good position. Also comparing with Dashen bank the capital adequacy ratio is less than Nib international bank of Ethiopia.

4.3 Non- performing Loans to Total Loan Ratio (NPTL)

This is one of the most important criteria to assess the quality of loans or asset of any bank. Non- performing Loans to Total Loan Ratio (NPTL) measures the percentage of gross loan which are doubtful in banks' portfolio. The lower the ratio of Non-performing loans to total loan ratio (NPTL), the better is the performance.

Table, 4.3.1 bellow shows the non-performing loan ratio of each bank of the Bank is below the requirement set by the National Bank of Ethiopia which is below 5%.

Table 4. 3.1 Non-performing loan ratio of Dashen bank

Year	Non-performing loan	Total loan	%NPLR
2011	123.66	6217.54	1.9%
2012	174.44	8123.81	2.1%
2013	199.07	8862.32	2.2%
2014	197.74	9429.63	2%

2015	193.91	11526.99	1.6%

Source: Secondary data (Dashen bank, 2011-2015)

As it can be seen from table, performing loan dashen bank the maximum is 2.2% in general the amount of non- performing loan is small in size confirming the collection rate is at its required level.

Table 4.3.2 Non-performing Loan Ratio of NIB bank

Year	**Non-performing loan**	**Total loan**	**%NPLR**
2011	144.914	3986.464	3.63%
2012	148.892	5504.61	2.7%
2013	178	7710	2.3%
2014	208.26	9176.36	2.26%
2015	217.06	12482.04	1.7%

Source: Secondary data (Nib bank, 2011-2015)

As it can be seen from table, performing loan nib international bank the maximum is 3.63% in general the amount of non- performing loan is small in size confirming the collection rate is at its required level. The lower the ratio of Non-performing loans to total loan ratio (NPTL), the better is the performance. Also comparing with Dashen bank the performing loan ratio is better than Nib international bank of Ethiopia.

4.4 LIQUIDITY RATIO

Liquidity ratio measure capability of the bank to meet its short term obligation. among various liquidity measure the study use three of them.

4.5 Loan to Deposit Ratio (LDR)

Indicate percentage of total deposit locked into non-liquid asset and it is calculated by

LDR =Loan

Deposit

Table 4.5.1 Loan to deposit ratio of dashen bank

Year	Total loan	Total deposit	%LDR
2011	6217.54	11841.24	52.5%
2012	8123.81	14065.60	57.7%
2013	8862.32	15851.26	55.9%
2014	9429.63	17681.34	53.3%
2015	11526.99	19814.11	58.1%

Source: Secondary data (Dashen bank, 2011-2015)

The loan deposit ratio of loan nib international bank the maximum is 58.1% Higher value of this ratio indicate bank take more financial stress by making excessive Loan and lower loan deposit ratio always favorable, so the bank gets less ratio time to time which is less favorable comparing with Nib international bank the maximum is 67.3%.

Table 4.5.2 Loan to deposit ratio of NIB Bank

Year	Total loan	Total deposit	%LDR
2011	3986.464	7744	51.4%
2012	5504.61	9204	59.8%
2013	7710	12545	61.4%
2014	9176.36	15040	61%
2015	12482.04	18520.42	67.3%

Source: Secondary data (Nib bank, 2011-2015)

From the above table, the loan deposit ratio of loan nib international bank the maximum is 58.1%. loan to deposit ratio of Nib international bank of Nib international bank the maximum is 67.3% is favorable with comparing with Dashen bank of Ethiopia in 2014/15 excessive loan recorded and also in average loan to deposit ratio is increasing from year to year.

4.6 Cash Deposit ratio (CDR)

Indicate the higher or less liquidity of the bank from the deposit amount and it is calculated by CRD = Cash / Deposit

Table 4.6.1 Cash to deposit ratio of Dashen bank

Year	Total cash	Total deposit	%CDR
2011	1062.52	11841.24	9%
2012	1286.65	14065.60	9.1%
2013	1307.78	15851.26	8.25%
2014	1755.99	17681.34	10%
2015	1795.66	19814.11	9.06%

Source: Secondary data (Dashen bank, 2011-2015)

As it can be seen from table, Cash to deposit ratio of dashen bank the maximum is 10% in general the amount of Cash to deposit ratio is small in size confirming the collection rate is at its required level. This show the liquids of the bank is bad position, which have a negative effect on the financial performance the bank.

Table 4.6.2 Cash to deposit ratio of NIB Bank

Year	Total cash	Total deposit	%CDR
2011	593.322	7744	8%
2012	494	9204	5.36%
2013	634	12545	5%
2014	684.91	15040	4.5%

2015	989.28	18520.42	5.3%

Source: Secondary data (Nib bank, 2011-2015)

As it can be seen from table, Cash to deposit ratio of dashen bank the maximum is 8% in general the amount of Cash to deposit ratio is small in size confirming the collection rate is at its required level. From the above table cash to deposit ratio of Nib international bank of Ethiopia decreasing to year to year comparing with Dashen bank.

4.7 Loan to Asset Ratio (LAR)

It is used to total loans outstanding as a percentage of total assets, and it is calculated as

$$LAR = \frac{loan}{Asset}$$

Table 4.7.1 Loan to asset ratio of Dashen bank

Year	Total loan	Total asset	%LAR
2011	6217.54	14659.79	42.4%
2012	8123.81	17520.04	46.3%
2013	8862.32	19747.17	45%
2014	9429.63	21962.20	43%
2015	11526.99	24763.88	46.5%

Source: Secondary data (dashen bank, 2011-2015)

As it can be seen from table, Cash to deposit ratio of dashen bank the maximum is 46.5% in general the amount of Cash to deposit ratio is small in size confirming the collection rate is at its required level. This show that the amount of loan from the given asset is less which is favorable to the bank and it has less risk. So the financial performance of the bank is better.

Table 4.7.2 Loan to asset ratio of NIB Bank

Year	Total loan	Total asset	%LAR
2011	3986.464	10116	39.4%
2012	5504.61	11937	46.1%
2013	7710	14859	52%

2014	9176.36	19948.6087	46%
2015	12482.04	23869.61	52.2%

Source: Secondary data (Nib bank, 2011-2015)

As it can be seen from table, Loan to asset ratio of dashen bank the maximum is 52.2% in general the amount of Loan to asset ratio is small in size confirming the collection rate is at its required level. From the above table the amount of asset from the given loan is greater in this case the bank can be favorable and profitable from the above table the amount of loan is decreasing and the amount of loan is increasing for both bank from year to year. From the above table Loan to asset ratio of Nib international bank of Ethiopia decreasing to year to year comparing with Dashen bank.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

This chapter is focus in summarizing the major finding obtained from the analysis part. Then based on the findings conclusions and recommendation were drawn.

5.1 CONCLUSION

With respect to the title comparative analysis of Credit Risk, the two financial statements of the bank have been analyzed. These are balance sheet and income statement. The analysis highly depends on secondary data which is gathered from accounting department involving the audited financial statement of the year (2011-2015).

In the five years dashen bank and Nib international bank performed in a good manner and then show improvement from year to years in their performance independently. Throughout all five years, based on findings both have sustainable growth. Their total deposit paid up capital loan and advance increase from year to year.

Having Nib international bank to be less profitable compared to dashen bank, what expect rule of finance the higher the expected return the higher the risk, the profitability and risk and solvency perfectly in this risk return profile and allow to conclude that NIB is less profitable also less risky.

The analysis of liquidities measure indicate dashen bank is less liquid in all liquidity than measurement more occur shows that while loan to deposit ratio of dashen bank decrease this decreasing trend is due to increase in its deposits base which can be considered a positive, and good sign for dashen bank. However, dashen bank was exposed to higher than Nib international bank of Ethiopia. Like in profitable and risk and solvency measure NIB is found to be less efficient interims of asset utilization but in regarding of income expanse the bank should good increment time to time.

The capital adequacy ratio of both banks is more than the minimum requirement of supervisory authority that is Capital structure/Leverage as measured by debt to asset ratio had statistically significant negative relationship with profitability, which was in line with

prior expectation. This result also supports the prefers using internal finance before raising debt or equity.

5.2 Recommendation

Based on the findings of the study the following possible recommendations were forwarded:

- Ethiopian commercial banks should be considering the performance of the real economy when extending loans.
- The government should be reducing the strains to the general economy in order to facilitate economic growth but also to enhance the minimization of Cr
- The government as well as other stakeholders in the economy should acknowledge the threat that Credit risk pose not only to the banking sector but also to the general economy.
- The government must take into account that Cr can contribute to the collapse of the banking sector and to the entire economy.
- Furthermore, the government should implement policies that take into account of Cr.
- The result of this study more specifically indicates that the government should come up with strategies aimed at reducing the impact of inflation rate, growth domestic products in commercial banks of Ethiopia.
- Thus, the future researcher should incorporate external factors such as regulatory environment (loan loss provisions), money supply, unemployment rate and corporate governance.

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