

**ASSESSMENT OF CREDIT RISK MANAGEMENT IN NIB
INTERNATIONAL BANK OF WOLKITE BRANCH**
A RESEARCH PEPAR SUBMITTED TO DEPARTMENT OF ACCOUNTING AND
FINANCE FOR PARTIAL FULFILMENT OF BACHELOR OF ART (BA) DEGREE IN
ACCOUNTING AND FINANCE



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Declaration

I, the undersigned, declared that this senior essay paper is my original work. It has not been presented in any other university. All sources of materials used for the research paper have been dully acknowledged.

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ABSTRACT

This study was conducted to assess the credit risk management in NIB international bank (in case of Wolkite branch). To accomplish the paper both primary and secondary sources of data were used. The primary data were gathered using a questionnaire distributed to the employees of the bank and an unstructured interview was conducted with the branch manager. From a total population of 60 employees in the bank, the researcher selected 25 respondents as sample size. The researcher used personal judgmental sampling technique, because in judgmental sampling the researcher is more confidential in selecting respondents which are near to the needed accurate and sufficient information. The data gathered was analyzed and interpreted by using descriptive statistical methods like percentage, ratios, and tables. Based on the findings of the study, the bank is using credit appraisal procedures & with regard to risk management strategies the bank follows some risk management strategies like credit analysis, collateral security, feasibility study & market study. The institution with regarding the repayment the customer could enable them for more or less to repay portion their loans monthly and even if the credit is not collected with specified period, the institution must be giving them discounting and having strict follow up for those customer which do not pay on time.

List of abbreviation

CBE -Central bank of Ethiopia

NIB-Nib International Bank

CRM-Credit risk Management

EAR-Earning at Risk

FI-Financial Institution

CHAPTER ONE

INTRODUCTION

1.1. Back ground of the study

Credit risk management: credit risk is an investor`s or creditor`s risk of loss arising from borrowers who cannot make payments according to their promise. The investor`s loss may include principal as well as its interest. To reduce the lender`s credit risk, the lender may perform a credit check on the prospective borrower may require to take out appropriate insurance, such as mortgage insurance or seek security or guarantees of third parties. Credit risk management is exactly what it sounds like: monitoring of banking. The underlying principle of banking is lending and the underlying principle of lending is risk management or mitigation (Mish kin, 2004).

Charles Mensah (1999) stressed the importance of credit management as follows: Credit management process deserves special emphasis because proper credit management greatly influences the success or failure of financial institutions. This indicates that credit provision should be accompanied by appropriate and attractive credit policies and procedures that enhance performance of credit management and protects the banking industry from failure.

A bad loan often arises from different factors or combination of factors, but the most important reason is the absence of proper loan classification system. It can identify problem loans immediately and take necessary steps to minimize potential defaults and consequent losses. Poor credit risk management is the main consideration in case of bank`s unsatisfactory performance and often the reason of bankruptcy (Md. Moeid, 2014).

Banks are financial institutions that accept deposit and make loans. Commercial banks in Ethiopia extend credit or 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.

Credit management means the total process of lending starting from inquiring potential borrowers up to recovering the amount granted. In the sense of banking sector, credit

management is concerned with activities such as accepting application, loan appraisal, loan approval, monitoring, recovery of non-performing loans, etc (Shekhar, 1985). Effective management of credit risk is inextricably linked to the development of banking technology, which will enable to increase the speed of decision making and simultaneously reduce the cost of controlling credit risk. This requires a complete base of partners and contractors (Lapteva, 2009).

Credit risk is one of significant risks of banks by the nature of their activities. Through effective management of credit risk exposure banks not only support the viability and profitability of their own business but also contribute to systemic stability and to an efficient allocation of capital in the economy (Psillaki, Tsolas and Margaritis, 2010 P.873).

According to Trieschmary (1998) risk management is a managerial process that involves the executive function of planning, organizing, leading and controlling those activities in a firm that deal with specified types of risks in order to maximize the value of organization. The risk manager is charged with minimizing the adverse impact of losses on the achievement of company's goals. Risk management is the scientific approach to the problem faced by business that deals with the techniques of forecasting future so as to plan, organize, direct and control efforts to minimize the adverse effects of those potential losses. It is the reduction and prevention of the unfavorable effects of risks at a minimum.

Credit risk affects every aspect of an organization and its uncertainties result in adverse version of profit ability or losses. Credit risk is failure of borrowers with requirements agreed wrong with interest rate and at a fixed time (Teklegiorgis, 2004). Lang and Jagtiani (2010) state that loan administration is a process which is designed to avoid damages to an organization as a result of events unanticipated even though possible.

According to Asiedu-Mante (2011) loans management includes instituting proper rightful policies and measures that will make sure that proper authorities give out loans, the loans get to the right customers, and the loan is given for productive reasons which are economically viable and appropriate.

Williams (1998) defines risk as a potential variation in outcomes and exposure to a potential loss. Similarly risk is defined as uncertainty about economic losses due to the occurrence of an

event; Economic losses are caused by perils such as crimes, fire and accidents. It is the possibility of an adverse deviation from desired outcomes that is expected.

Most importantly, banks are exposed to credit risk since their principal profit making activity is making loan, to their customers. Lending represents the heart of the industry. Loans are dominant asset at banks; they generate the largest share of operating income and represent the banks greater risk exposure (MacDonald and Koch, 2006).

The very nature of the banking business is so sensitive because more than 85% of their liability is deposits mobilized from depositors (Saunders, Cornett, 2005). Banks use these deposits to generate credit for their borrowers, which in fact is a revenue generating activity for most banks. This credit creation process, if not managed properly, exposes the banks to high default risk which might led to financial distress including bankruptcy. All the same, beside other services, banks must create credit for their clients following prudent credit management procedure to make some money, grow and survive in stiff competition at the market place.

1.2. Statement of the problem

Financial institutions play a vital role in countries development through financing feasible projects. Currently, banking business is so sensitive because more of the income or revenue will be generated from credit or loan given to the customer. NIB is one of the most important financial institutions which is specialized in accepting deposits from the public and grant loans to the needy party and specialized in long-term development financing the nation's economy.

Credit management can be seen as an essential part of lending and as such in its absence, good loans can turn bad. Thus it is expedient to note that the importance of credit management cannot be overemphasized and good credit management requires qualified personnel and the establishment of adherence to sound credit policies, procedures. If the loan is well managed; it will increase the bank's profitability and sustainability in the future. However, if failed to do so, it will be the major threat to their survival (Koch&MacDonald, 2003). This credit processes exposes the banks to high credit risk which leads to loss. With this regard the researcher initiated

to assess the credit risk of the bank (NIB) in Wolkite branch. It is assumed that business will pay both installment payment of the principal and periodic interest as per the agreed time from the revenue generated. However, banks usually require borrowers to present collaterals to be used as second way outs if business fail to settle their periodic payment.

According to Hettihewa, 1997, Credit Management is extremely important as granting credit is considered to be the equivalent of investing in a customer.

However, payment of the debt should not be postponed for too long as delayed payments and bad debts are a cost to the company. Thus, Efficiency and effectiveness in performing each steps of loan processing using various parameters has significant effect on performance of credit management.

Credit risk occurs when a debtor / borrowers fails to fulfill his obligations to pay back the loans to the loans to the principal / lender. In banking business, it happens when “payment can either be delayed or not made at all, which can cause cash flow problems and affect a bank”s liquidity” (Grevning and Bratanovic, 2009). Hence, credit risk management is a bank basically involves its practices to „manage”, or in other words to minimize the risk exposure and occurrence.

Researches were conducted in Ethiopia in the area such as that of Nigusu, (2009); Tekle, (2011); Girma, (2011); Wondimagegnehu, (2012); Solomon, (2013) and Alebachew, (2015). Some of the studies reviewed were focused on part of the credit risk management in banks like investigating factors affecting loan recovery, evaluating credit analysis practice, determinants of NPLs and its impact on performance and the credit risk management practice.

Accordingly, different organizations employ different risk management techniques, which they determine best suites them to achieve their business objectives It is customarily to observe advertises for sale of collaterals and mortgages by bank due to failure of borrowers to pay back their debt and it is customarily to come across case files against borrowers due to default. Hence the researcher sake to answers the following questions:

- ✓ What are both the inherent and prevailing risks of loan by banks in general and particular to the branch?
- ✓ What is the credit appraisal process adopted in NIB of Wolkite branch.
- ✓ What are the factors contributing for default both of the clients and banks side?

- ✓ To what extent are the strategies or measures applied by the branch effective in reducing risk of default?

1.3. Objective of the study

1.3.1 General objective of the study

The general objective of the study was to assess the credit risk management of NIB Wolkite branch.

1.3.2. Specific objectives of the study

- To identify the prevailing risks related to credit in NIB Wolkite branch.
- To assess the credit appraisal process adopted in NIB Wolkite branch.
- To investigate the factors contributing for the problems both at clients and banks side.
To assess the effectiveness of the risk management measures or strategies applied by the branch.

1.4. Significance of the study

The researcher believes that the result of this study would have many importance or significances.

First the branch will benefit from the output since it is expected to pin point the loopholes in the process of credit appraisal and management. This enables the branch to apply mechanisms for intervention in the process on the basis of the recommendation that this study forward. Besides, broadening the researcher's knowledge on the subject, it will be used as a reference by others who wish to conduct a research on the subject.

And also it will add knowledge for credit risk management officials by identifying the factors level of credit risk management have towards profit abilities of banks and it will makes them well conservative on their credit risk management mechanisms.

1.5. Scope of the study

The study was focused only on assessment of credit risk management of NIB, Wolkite branch. Due to time and resource limitation the researcher is unable to assess all the banks in Ethiopia as a whole.

1.6. Limitation of the study

The researcher faced different problems when conducting the study to collect available information and to prepare the research. Some of the problems were.

- Lack of well-organized reliable data.
- Shortage of financial resource.
- Lack of material to do research1.

1.7 Organization of the paper

This research paper was organized in five chapters. The first chapter contains about introduction part of the study. The second chapter presents about review of related literature. The third chapter deals about methodology part. The forth chapter deals on data analysis and interpretation of the data collected. And the last five chapters was showing the conclusion and recommendation for the study.

CHAPTER –TWO

REVIEW OF RELATED LITERATURE

2.1 DEFINATION OF CREDIT RISK

Banks make money by providing services that their customers want and by granting their credit .A bank reflects and aims to profit from taking credit risk by charging higher interest margins on loan to these customers that is consider present a higher risk. Credit risk is the risk of loss due to financial weakness of the bank customer. Generally, that the customer will be able to provide funds, to settle its transaction usually due to bankruptcy or some other liquidity crisis (Brigham, 2011)

As Hoff and Stiglitz in 1990 denoted, in the past decades there have been major advances in theoretical understanding of the workings of credit markets. These advances have evolved from a paradigm that emphasis the problems of imperfect information and imperfect enforcement. They pointed out that borrowers and lenders may have differential access to information concerning a Business risk, they may form different appraisal of the risk. What is clearly observed in credit market is asymmetric information where the borrower knows the expected return and risk of his/her business, where as the lender such as bank knows only the expected return and risk of the average business in the economy.

Stakeholder theory proposed that organizations are separate entities and they are connected with many parties while achieving their targets (T. Donaldson & Preston, 1995). Moreover, they explained that it is management's duty to make sensible decisions and put their best efforts in attaining the benefits that satisfy all stakeholders. In addition, Wang and Dewhirst (1992) that highlighted board of directors should not ignore their responsibilities towards protecting interests of stakeholders.

Credit risk is the risk to earning or capital that an obligation may fail to meet the forms of any contract with the bank. It usually associates with the loan and investment, but it can be also a risk in connection with the derivatives foreign exchange and other extensions of the bank credit it. Although bank hales for many reasons the single most important reasons bad loans. They make loan that or bad at the time go has of the time the loans were made the decisions seemed correct. However, unforeseen change in economic condition and other factors such as have results in credit problem.

The process of credit management begins with accurately assessing the credit-worthiness of the customer base and his/her business viability. This is particularly important if the company chooses to extend some type of credit line or revolving credit to certain customers. Hence, proper credit management is setting specific criteria that a customer must meet before receiving the proposed credit arrangement. As part of the evaluation process, credit management also calls for determining the total credit line that will be extended to a given customer (James, 2005).

Credit is primary cause of bank failure and it is the most visible risk facing bank managers. Interest rate risk is the risk that at earning favorable this risk arises from different in timing of rate change and the timing of cash flow change in the shape of yield curve (yield curve risk). And from the option value embedded in the bank (product operation) is sense the market value of banks assets increase in the interest rate.

2.2 Credit risk management

Credit risk management is a risk where by borrower has failed to make payments or reimburse a loan when it is due. The risk is a result of lender that has ailed to pay the interest, principle which distracts the cash inflow. Proper risk management will mean that the company will determine appropriate written of cash between return and risk (Teklegiorgis, 2004).

To solve the problem. help to examine a number of principles for managing credit risk screening and establishment of long term customer relationship loan commitment, compensating balance requirements and credit rationing (Mishkin, 2004).

2.3 Bank credit management basic concepts

Credit management ties at health of commercial banking credit become the business of banking, and the primary basis on which a banks quality and performance are judged (Muller, 1998).

2.4 Credit policies, directives, procedures & process

2.4.1 Credit policies

Credit policy provides the frame work for the entire credit management process. Written credit policies are the corner stone of sound credit management. The set objective standards and parameters to guide bank offices who guaranty loans and manage the loan portfolio. They also provide the board of direct as, regulations and internal and external auditors with a basis for evaluating a bank's credit management performance. When credit policies are carefully by all organizational levels, they enable bank management to maintain proper credit standards, avoid excessive risks and evaluate business opportunities properly (Horne, 1995).

2.4.2 Credit directives

The address policy issues in response to change in markets and economic conditions, banks often disseminate especially designated credit policy directives. The directives typically provide general parameters for the type of credit that bank will offer and the type of customer, and markets it will serve, as dictate by current Strategic decisions. They will also regulate loan concentration levels in particular market sector or industries the lending division often insures or modifies directives but challis are issued by the credit policies division under the responsibility of senior credit policy committee or senior loan committee. Directives and policy manual constitute the sum total of credit policy of a bank at one time officers must familiarizes themselves and comply with these document SimilarlyCompton (1985) s.

Compliances control both during the process of loan approval and after disbursement control functions are carried out by internal and external auditors, independent loan review function directors, committees, and regulators may police and directives to one of staff-group and assign the task of monitoring the application of these lending policies as well as the quality of the bank's portfolio to their group (Mish kin, 2004).

2.4.3 Credit procedures

The lending procedures also usually comply in the credit policy manual may cover the submission and procedures to minimizing credit files and exchanging credit information with banks and supplies. Procedures may also cover the aspects of lending that are govern by

regulation or law, other items often include certain to credit review, and inspection, outstanding debts, doubtful assets and recovery process. Operational procedures the process for carting out the lending the credit department. The procedures includes maintaining and generating liability record to support periodic reveals for credit renewal, generating loan compliance check lists, and per paring reports on account profit ability and market exposure (Muller, 1998).

2.4.4 Credit process

In a well-run bank, a close linkage is maintaining by policy process and audit process is the line driven operational arm of lending and lending strategy. It is immediate concern of line supervisors and loan officers banks vary in how the initiate business process and approve credits and keep abreast of them offer they are booked, but the ingredients is similar each bank has its own personality based on tradition, management style and market trust. Each decides how beat to structure its resources and talent, they process designs with identifying the lending markets often referred as target markets and proceed through a series of stages to loan repayment Tomothy (1995).

2.5 Problem loans and work outs

Problem loans commonly arise from customer cash crises. Although some countries affected with serve lack of financial discipline have a class of delinquent borrowers known as will full defaulters who are able, but unwilling to repay. A cash crisis is sometimes abrupt, but it usually develops gradually, a size develops internal and external signs of the impending crisis emerge, often loan officers are the bonks first lines of the defense against credit losses, they must be available on the health of the customers' business without constant updates of information, problem indicators may be over looked. Every warning system for detected potential problems is difficult to design and the human element is often a major important to early identification. Loan offices in charge of managing on account have been known to delay reporting danger signals because they were reluctant to expose themselves to possible incites for having involved in problem situation Lawrence (1997).

2.6 Review of lending function and operation

A when carrying out its duties on behalf of both depositors and those holders do and of directors must ensure that a bank's lending function fulfills there fundamental objectives

- Loans should be planted on a found and collectible basis
- Funds should be invested profitably for the benefit of their holders and the protection of depositors.
- The legitimate credit needs of economic agents and or there holders should be fortified.

The purpose of review of lending operations is to evaluate whether the process meets these criteria. In other words, it is crucial to assess if lending is well organized policies well reflected in internal procedures and manuals, stuffing adequate and diligent in following established policy and quid lines and the information normally available to participants in the lending process timely, accurate and complete.

Lending process review

The integrity and credibility of leading process depend on objective credit dictions that ensure an acceptable risk level in relation to the expected return. A review of the lending process should include analysis of credit manual and other written guidelines applied by various departments of bank and of the capacity and actual performance if all departments involved in the credit function. It should also cover the organization, appraisal approval, disbursement, monitoring, and collection and handling procedures for the various credit function provided by the bank. Especially the review should comprise the following.

- A detailed credit analysis and approval process in chiding samples of loan application forms, internet credit summary forms, internal credit manuals, and loan files.
- Criteria for approving loans, lending limits at various well of the banks management and for making arrangements for lending through the branch network;
- Collateral policy for all types of loans and actual methods and practices concerning revaluation of collateral and files related to collateral.
- Administration and monitoring procedures, including responsibilities, compliance and controls.
- A process for handling exceptions (James, 2005).

2.7 Credit Analysis

Once a customer request a loan bank officers analyze all available information to determine whether the loan meets the banks risk return objectives.

Credit analysis essentially default risk analysis, in which a loan officer attempts to evaluate a borrower's ability and willingness to repay.

Traditionally, key risk factors have been classified according the five C's of credit. Banks in order to achieve their profit objectives, they make successful loan that are paid bank almost in full and so subject the institution to little credit risks. In order to overcome the problems of credit risk, banks need to evaluate the credit worthiness of individual of business concern base on relevant factors indicating ability and willingness to pay obligations. There is no magical formula that will assist banks in assessing the probability that a given customer will not pay.

In general terms, credit analysis of banks often use classic 5CS of credit to focus their analysis on the key dimension of an applicant's credit worthiness. These dimensions are.

Character: - is the applicant willingness as to mat credit obligation. Without character and integrity no person can be trusted. Character includes integrity of purpose, reputation for honesty, promptness in paying debt and fulfilling contracts, high standards of business ethics and the like. The risk associated with these factors is moral risk.

Capacity: - refers to the applicant's ability to meet credit obligation out of operating cash flows. Capacity involves business ability reputation of product, to undress of business practically as evidenced by profit making records.

The index of measuring capacity is detailed comparative operating statements. By which the rate of return to invested capital over period of time is discussed. Capacity involves both the borrower's legal standard and management's expertise in maintaining operations to the firm or individual can repay its debt obligation. A business must have identifiable cash flow or alternative source of cash to repay debt. An individual must be able to generate income.

Capital: - is the applicant's net worth or financial reserve. It is the financial strength of the applicant as reflected by its owner ship position. Analysis of applicant's debt relative to equity and its profitability ratios are frequently used to access its capital.

Collateral: - the amount of asset the applicant available for use in securing the credit. The larger the available assets, the greater the chance that a bank will cover its funds if the applicant defaulted. A review of applicants assets can be used as evaluate its collateral.

Conditions: - refers to the current economic and business climate as well as any unique circumstances affecting either party to the credit transaction.

First two C.S character and capacity because they represent the most basic requirements for extending credit to applicants consideration of the last three C.S capital, collateral and conditions are in making the final credit decision, which is affected by credit analysts experience and judgment Lawrence (1997).

2.8 Lending procedures and policy

Loan evaluation: - loans are initiated with an applicant and an interview with a loan officer, who is count given. Credit period is a means by which a firm may be able to affect product demand, hoping to increase demand by extending the credit period. Discount given involves an attempt to speed up the payment of receivable. To be sure, the discount is not regarded as a means of cutting price and by previous loans and other services naturally expected to have their loans approved more readily than applications stranger does. Presumably, a continued close relationship, with a customer gives the bank information about the borrower that is not easily available to others. The cost of obtaining and verifying such information makes it impractical for title known firms to make public levity offerings and make it economical to maintaining ongoing relationship with banks.

No matter how conscientious the loan evaluation process is there is always the possibility that an expected development the illness of a key person an earth quake and unfavorable legislation will undermine the financial viability of a company or-house hold when substantial sums are involves the bank may try to identify the most important risk and take measures to protect its loan. It may insist an adequate insurance against mutual disasters and on the development of strategic plan to response to changes in customer tests to congressional.

Legislation to competition from other companies. If the business depends on a single supplier, purchaser or product sometimes given a more congenial title such as “relationship manager”. The loan officer responsibility is acquiring information about the customer, the purpose of the loan and the likely hood of its repayment. Those who have a long standing relationship with the bank involving deposit extending credit to more risky class whose credit worthiness is not known exactly. This policy increase profit by increasing the level of loans extended to the customers but incurs higher risks of bad debt, loss and faces the problem of liquidity. Tight credit worthiness. This policy is very selective in extending credit and results a low profit but it has minimum costs

and enhance of bad debt losses. Thus managers should develop credit policies, which make tradeoff between risk and return.

2.9 Credit of standard

Credit standard is a minimum criterion for extension of credit to customer. It enables the credit management to accept the desirable clients and the undesirable once. Setting credit standards implicitly require as a management of credit quality, which are defined interims of the probability of borrower default. The probability of a given borrower to pay the loan is by a subjective judgment. However, a system of credit standard enhances the ability of the credit manager to make the correct decision if use fairly and consistently.

2.10 Credit term

Credit term involved both the length of the credit period and the bank may encourage it to diversity. If the company business is vulnerable to technology change the bank may insist that more effort be spend on research more development.

2.11 Collection policy

The firm's collection policy is the set of procedures for collecting accounting receivable when they are due the effectiveness of this policy can be partly evaluated by looking at the level of bad debt expenses. This level depends not only on collection policy but also on the policy on which the extension credit policy is based. A number of collection techniques are employed as an account becomes more personal and more intense the popular technique are.

Letter: after on account receivables become overdue a certain number of days neither are the firm normally sends a polite letter remaining the customer of its obligation. If the accounting is not paid within a certain period after the latter has been sent, a second more reminding letter is sent. This letter may be followed by yet another letter, if necessary. Collection letters are the first step in the collection process for over the accounts.

Telephone calls: - If letters provide unsuccessful a telephone call may be made to the customer to personally request immediate payment. Such a call is typically directed to the customers accounting payment department where the responding employees act on instructions of his or her

loss. If the customer has a reasonable excuse, arrangement may be made to extend the payment period. A call from the seller's attorney may be used if all other discussions seem to fail.

Personal visit: - this technique is much more common of the customer credit level, but it may also be effectively employed by industrial suppliers. Sending a local sales person or a collection perform to confront the customer can be a very effective collection procedure. Payment may be made on the spot.

Collection Agencies: - a firm can turn non- collectible accounting over to a collection agency or an attorney for collection. The fees for these services are typically quite high the firm may receive less than 50 cents on the dollar from account collection in this way.

Legal: action: - legal action is the most stringent step in the collection use of collection process. It is an alternative to the use of collection agency. Not only is direct legal action expensive, but it may force the debtor into bankruptcy. There by reducing the profitability of future business without quarantining the ultimate receipt of the overdue amount (Lawrence, 1997).

2.12 Policy guideline

The fundamental credit risk management policies that are recommended for adoption by all banks in Bangladesh. The guidelines contained herein outline general principles that are designed to govern the implementation of more detailed lending procedures and risk grading system within individual Banks.

2.13 Lending guidelines

All banks should have established credit polices ("lending guidelines") that clearly outline the senior management view of business development priorities and the terms and conditions that should be adhere to in order for loan to be approved.

2.14 Evaluating the credit worthiness of the applicants

2.14.1 Five C's of credit to focus on the key dimensions of an applicant's credit worthiness

- **Character:** - a moral obligation to pay debts or the borrowers honestly and trust worthiness. Past payment history of the applicant would be used to evaluate its character.

- **Capital:** - the borrower's wealth position, measured by financial soundness and market standing. Capital helps cushion losses and reduces the likelihood of bankruptcy. Capital reflects the financial strength of the applicant.
- **Capacity:** - is merely another term for earning power and it shows the applicant's ability to repay the requested credit.
- **Condition:** - the economic environment or industry-specific supply, production, and distribution factors influence the firm's operations. Repayment of source of cash often varies with the business cycle or consumer demand. The condition refers to the current economic and business climate affecting the credit transaction.
- **Collateral:** - the amount of assets the applicant has available for use in serving the credit. The larger the amount of available assets, the greater the chance that a firm will recover its funds. Receivable and inventory are preferred because of their liquidity. Plant, equipment, and real estate are also valuable. Virtually any asset or the general capacity to generate cash flow can be used as collateral.

2.15 Five C's of bad debt (credit)

1. Carelessness

Involve poor underwriting, typically evidenced by inadequate loan documentation, lack of current financial information in the credit files, and a lack of protective covenants in the loan agreement.

2. Complacency: - refers to the tendency to assume that because things were good in the past they will be good in the future.

3. Communication breakdown: - loan problems often arise when a bank's objectives and policies are not clearly communicated. Management should articulate and enforce loan policies, and loan officers should make management aware of specific problems with existing loans as soon as they appear.

4. Contingency: - refers to lenders' tendency to play down or ignore circumstances in which a loan might default. The focus is on trying to make a deal work rather than identifying downside risk.

5. Competition: - involves following competitors behavior rather than maintaining the bank's own credit standards. Just because the bank down the street is doing something does not mean it's good.

2.16 Source of information about the loan applicant

1. Financial statement: - it is one of the most desirable sources of information for credit analysis. Frequently, there is a correlation between a company's refusal to provide a statement and its weak financial position.

2. Credit rating and reports: - are available from various mercantile agencies. It gives the credit analyst an indication of the estimated size a net worth and a credit appraisal for the companies of a particular size ranging from high to limited.

3. Banking checking: - by calling or writing a bank in which the credit applicant has an account firm's bank is able to obtain information on the average cash balance carried, loan accommodations, experience and financial information.

4. The company's own experience: - a study of the promptness of past payment, including any seasonal patterns, is very useful. Frequently the credit department will make a written assessment of the quality of the management of a company to whom credit may be extended. These assessments are very important for they pertain to the first of the famous Five C's of credit (Muller 1998).

2.17 Disbursement of loan

The formal credit decision can be made individually or by committee depending on a bank's organizational structure. This structure varies with bank size, number of employees and type of loan handled. The bank's board of directors normally has the final say on which loans are approved. Typically each lending officer has independent authority to approve loans to up to some fixed dollar amount. Larger loans are reviewed by committee made up of the bank's senior loan officer. This committee reviews each step of the credit analysis as presented by loan officer and supporting analysts and makes a collective decision.

Once a loan has been approved by the general manager or branch manager according to the amount of the loan based up on the loaners request but disbursement of loan determined by the

purpose of the loans. A loan officer notifies the borrower and prepared a loan agreement. This agreement formalizes the purpose of loan, the forms, and repayment, schedule, collateral required, and loan covenants. It also states what conditions may include late principal and interest payments the sale of substantial assets, a declaration of bankruptcy and breaking any respective loan covenants. The officer then checks that all documentation is present and in order. The borrower signs the agreement along with other guarantors, turn over collaterals if necessary and receives the loan proceed.

- **Documentation:** - a critical feature of executing any loan involves perfecting the banks security interest in collateral. A security interest is the legal claim on property that secures payment of a debt or performance of an obligation. When the bank's claim is superior to that of other creditor and the borrower. Its security interest is said to be perfected.
- **Loan covenants:**-once a bank lends fund to a customer, the bank and borrower effectively became partner. The bank wants the customer to repay the debt service and purchase other bank services. The customer looks to the bank to provide useful accounting, financial and tax advice. Both the bank and borrower should recognize this partnership when negotiating credit terms; still it's important that each party protect its interest. For this reason the bank includes covenants in the loan agreement as per the agreement made between the loaner of the bank, disbursement will be affected. For the sake of loan withdrawal request for disbursement is made with the confirmation of officer's inspection report. The request for disbursement again signed by both parties and the loan with register in the name of the loaner and the interest calculation is implemented and may be calculated within a day, month or a year basis (Timothy w-Koch 1998).

2.18 Reducing credit risk

Bank use wide varies or the techniques to reduce credit risk some of the techniques are:-

A. Collateral: reduce the risk to the lender and treat of loss of the collateral provides on incentive for borrowers to repay their loan.

B. Diversity: The loan portfolios diversification means making loan to parties of borrowers whose cash flows are not perfectly positively correlated and avoiding a due.

C. Documentation: It refers to the entire document needed to legally enforce a loan contract and to protect bank interest. Documents typically include promissory note, guarantee, financial statement and so on.

D. Limit: The amount of credit extended to any single borrower or group of borrowers with the related cash flow patterns in order to avoid undue loan concentration.

E. Monitoring: The behavior of the borrower after the loan is made to ensure compliance with the loan agreement (James, 2005).

2.19 Review of Empirical Evidence

Different researchers were conducted on this area of studies in different banks. Girma (2011) points out in his study on credit risk management and its impact on performance in Ethiopian commercial banks that the default ratio of any bank in Ethiopia depends on the credit risk management quality of the institution.

Solomon (2013) studied credit risk management practices of Nib International Bank of Ethiopia and in his assessment the researcher found that factors leading to wrong decision making and an increase in NPL level of the bank are concentration of credit in few sectors and borrowers, collateral as number one technique of credit risk management, absence of a credit risk model for the credit portfolio, lesser attention for MIS and advisory services to customers and absence of proper follow-up.

Kwaku, (2015) studied assessing credit risk management practices in the Banking Industry of Ghana: Processes and Challenges and obtained the following findings. Some of the key findings from the study revealed that the bank has documented policy guidelines on credit risk management with a senior manager having oversight responsibility for implementation. However, the study showed that there were some implementation challenges of the credit risk policies which have resulted in a low quality of loan portfolio of the bank. It is being submitted that the bank's risk policies should be reviewed frequently.

Chen and Shuping, (2012) conducted a Research on the Credit Management of Commercial Banks of Lianyungang City for the small scale and medium enterprises (SMEs). Investigators have found out that the risk management plan and operation method that really suit for credit demand for the SMEs is still not mature and it caused that the bad debts and dead loan were overstocked in Lianyungang commercial bank, thus it seriously impact on the capital operation of commercial banks, and then it has caused some adverse impact to the development of local economy. Therefore, it is necessary for commercial banks in Lianyungang city to supervise and manage the whole process of credit of the small and medium-sized enterprises.

Ahmed, Takeda and Shawn (1998) in their study found that loan loss provision has a significant positive influence on non-performing loans. Therefore, an increase in loan loss provision indicates an increase in credit risk and deterioration in the quality of loans consequently affecting bank performance adversely.

David, (1997) Bank Risk Management: Theory .This paper is conducted to discuss why risk management is needed. It outlines some of the theoretical underpinnings of contemporary bank risk management, with an emphasis on market and credit risk. This paper merely focuses on theory it doesn't get in to the practical aspects of the title.

According to Basel committee (1999) on the management of credit risk, the following was observed: Many credit problems reveal basic weaknesses in the credit granting and monitoring processes. While shortcomings in underwriting and management of market-related credit exposures represent important sources of losses at banks, many credit problems would have been avoided or mitigated by a strong internal credit process. They noted too that many banks find carrying out a thorough credit assessment (or basic due diligence) a substantial challenge. For traditional bank lending, competitive pressures and the growth of loan syndication techniques create time constraints that interfere with basic due diligence. Globalization of credit markets increases the need for financial information based on sound accounting standards and timely macroeconomic and flow of funds data. When this information is not available or reliable, banks may dispense with financial and economic analysis and support credit decisions with simple indicators of credit quality, especially if they perceive a need to gain a competitive foothold in a rapidly growing

foreign market. Finally, banks may need new types of information, such as risk measurements, and more frequent financial information, to assess relatively newer counterparties, such as institutional investors and highly leveraged institutions.

The study of NBE (2009) identified and ranked three important types of risks in which Credit risk was ranked firstly and then followed by operational and liquidity risk

Richard E. et al., (2008) conduct research on the credit risk management system of Tanzanian commercial banks and found that checklist with the help of 5C (character, capacity, condition, credit history, and collaterals) was used to assess borrowers creditworthiness. Researcher also found that the quantitative credit scoring model was not used as a result of poor record keeping and lack of effective data base system in different sectors with in the country. Researcher further noted the difficulty of using modern credit risk management model due to lack of information and other financial infrastructure in under developed country.

Wondimagegnehu, (2012) conducted a study with a purpose of identifying the determinants of non-performing loans the case of Ethiopian banks. The study covered the period between 2005 up to 2010. The researcher identified deposit loans and total asset variables as affecting NPL of Ethiopian banks. Accordingly, the researcher found that there were no statistically significant relationship between all independent variables and NPL.

2.20 Summary and Knowledge Gap

As it has been stated above in the literature, several studies have suggested their findings with regards to credit risk management practices in the banks. Among others Solomon, (2013) found that collateral as a number one techniques of credit risk management and lesser attention to MIS and advisory service to customers. The researcher collected primary data through questionnaires and interview to evaluate the banks credit risk management and practices as a tool. The questionnaires are developed only for staffs of the bank not included borrowers. In addition, Alebachew (2015) in his study he assess the credit risk management policies and practices in Nib international bank S.C. the study found that poor credit policy. The researcher collected primary data through

questionnaires and interview to evaluate the banks credit risk management policies and practices. The same as the previous study in the same topic the researcher questionnaires prepared only for staffs.

Therefore this study aim to fill the previous studies gap on research made on Nib international bank S.C. by applying different techniques of risk management tools like risk identification, risk understanding, risk evaluation, monitoring and controlling. According to the researcher those tools are major tools for assessing credit risk management. The interaction of our country's economy to the globe is increasing time to time NBE (2010) the evaluation of the bank risk management practices is very essential.

CHAPTER THREE

METHODOLOGY

3.1 Design of the study

A descriptive study design was considered the most suitable approach in view of the nature of the problem being investigated. Data could be collected and analyzed on the basis of research design because it provides the structure for such an assessment, Bryman and Bell (2013).

This research is a descriptive research; the research uses questionnaire and interview as data collection tool. This was exactly used to collect useful information for assessment of credit management process at NIB. Descriptive research involves gathering data that describe events and then organizes, tabulates, depicts and describes the data collection (Glass & Hopkins, 2000).

3.2 Sample size and sampling techniques

The total numbers of employees within the organization are 60 and the researcher selected 25 employees. The researcher used judgmental sampling technique, because in judgmental sampling the researcher is more confidential in selecting respondents which are near to the needed accurate and sufficient information.

3.3 Data sources and collection

The study was conducted by using both primary and secondary data sources. The primary data was collected by using structured and unstructured interview from the branch manager. The open ended and close ended questionnaire was also prepared to collect relevant information from employees of the branch bank and staff members. The reliable secondary data was collected

from reports of the organizations, written materials, different library sources and documents of the organizations which are published.

3.4 Methods of data analysis

The data collected was expressed or analyzed by using statistical tools such as percentages, ratios and tables. In addition, the researcher has used both qualitative and quantitative data analysis techniques and expressions.

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION & INTERPRETATION

This chapter is concerned with the presentation, analysis, and interpretation of the data gathered via primary sources both questionnaires and interviews and secondary sources collected from the bank's annual reports, manuals and data bases. The sample size was 25. The sampling method the researcher used was judgmental sampling method

4.1 General question

Table 4.1 Credit appraisal procedures.

Item	Response	Number of the respondents	Percentage (%)
Does the bank have credit appraisal procedures?	Yes	25	100%
	Total	25	100%
If your answer is Yes to question number 1 are they strictly followed by credit officers?		25	100%
	Total	25	100%

Source: questionnaire, 2020

From the above table 4.1; one can understand that majority of the respondents which accounts 25 or 100% answer the given question by saying yes. Generally, based on the above table or response of the respondents, the researcher conclude that the bank have credit appraisal procedures and due to having of good credit appraisal procedures the company or the organization should properly facilitate the credit activities.

As indicated in the above Table 4.1, all the yes respondents or 100% of the respondents have agreed that the credit appraisals are strictly followed by credit officers. According to the response of respondents, the researcher concludes that the bank give high emphasis with regard to credit control. And also the researcher summarizes or concludes that from the data above; most of the credit appraisal procedures are strictly followed by credit officers of the branch bank.

Table 4.2 the special circumstances that such criteria or procedures are relaxed.

Item	Response	Number of Respondents	Percentage (%)
<ul style="list-style-type: none"> • For instance, • In accepting loan applicant • In collateral estimation • follow up and loan approving amount 	Yes	20	80%
	No	5	20%
	Total	25	100%

Source: questionnaire, 2020

From the above table 4.2; 20 or 80% of the respondents have answered for the given question by saying yes, but the remaining 5 or 20% of the respondents filled the question by saying no. this shows that majority of the respondents agree that there are circumstances that loosen criteria and procedure of credit.

- The respondent 20 or 80% who said yes were also of the asked to mention some of the special circumstance in which credit criteria would be relaxed. Accordingly, as responded the following are cases in which the credit criteria's are relaxed.
- Borrowers having sufficient mortgage.
- Borrowers have enough collateral.
- Borrower's willingness.
- It is revision able to some extent
- When customer request is frequently lodged, and technological etc.

Generally, the researcher understands from this point that there are special circumstances in which credit criteria are relaxed.

Table 4.3 External factors that most contributed for loan defaults NIB, Wolkite branch.

Item	Response	Number of respondents	Percentage (%)
Are there external factors that most contributed for loan defaults NIB, Wolkite branch?	Yes	22	88%
	No	3	12%
	Total	25	100%

Source: questionnaire, 2020

From the above table 4.3; 22 or 88% of respondents have replied for the given question by saying yes, the remaining 3 or 12% of the respondents has replied for the questions by saying no. this implies that there are external factors that contribute for the loan defaults.

- Respondents who said yes were also asked to mention some of the external factor that most contributed for loan default Nib International Bank Wolkite branch .Accordingly as respondent responded the following are case in which external factor for loan default is

- Non productivity of customers.
- Customers lack capacity to pay loan.
- Environmental situation.
- Lack of comfortable work area and other
- Market fluctuation

Table 4.4 Credit monitoring.

Item	Response	Number of respondents	Percentage (%)
Does the credit monitoring determine loan default?	Yes	18	72%
	No	7	28%
	Total	25	100%

Source: questionnaire, 2020

As indicated in the above table 4.4, the majority of the respondents 18 or 72% of respondents or employees have responded for the above question by saying yes, the remaining 7 or 28% of the

respondents have replayed for the questions by saying no. based on the response of respondents, the researcher concludes that the credit monitoring determine loan defaults.

As it is indicated in the above question about 28 or 62% of the respondents have given their agreement with regard to credit monitoring for determining loan default and they have forwarded the ways such as; follow up each customer’s monthly repayment, special mentioned and appropriate credit monitoring is playing a great role to determine loan default, because by arrange different planning system and control how to consume the money and refund it.

Table 4.5 Agreement regarding the repayment

Item	Response	Number of respondents	Percentage (%)
Does the loan repayment are in the due date?	Yes	25	100%
	Total	25	100%

Source: questionnaire, 2020

According to above table 4.5; information, the customers are pay the loan in the due date.

Table 4.6 Collect its credit with in specified period.

Item	Response	Number of respondents	Percentage (%)
Does the institution collect its credit given to customer with in specified period?	Yes	10	40%
	No	15	60%
	Total	25	100%

Source: questionnaire, 2020

As shows above table 4.6, 10 or 40% of the respondents are response that the institutions collects its credits on the specified period of time and 15 or 60% of the respondents are witnessed that the institution does not collect its credit on specified time. From this we can understand that the institution given priority for lending than collect. Therefore it may be lead to risk of uncollectibility of receivables of the institution because of the repayment does not made on specified time by customers.

- Respondents were also asked whether they have any additional comment or any suggestion regarding the credit risk management of NIB, Wolkite branch.

Accordingly the majority of the respondents or employees of the Nib international bank (NIB) Wolkite branch were filled similar answers by saying before taking the legal action on the

borrowers, the authorized body must treat the counter parties to pay regularly to minimize the banks adjusted credit risk and credit risk management is used to manage the customers or creditors on how to use the loan, how to re-fund, how to increase their profit through the credit.

Table 4.7. presence of loan and saving services

6	For what income level of people loan and saving services are given?		
	Items	No. of Respondents	Percentage
	Low income earning	12	48%
	Medium income earning	9	36%
	Large income earning	4	16%
	Total	25	100

Table 4.3 shows 12(48%) of respondents low income earning get loan. This implies low income people get loan and saving service. 9(36%) respondent's medium earning income

People .this implies some amount not large as low income people. But 4(16%)of respondents high income earning people.

Table 4.8 what type of loan you have been taken from this bank?

Item	Number	Percentage
Short term	14	56%
Medium term	8	32%
Long term	3	12%

Total	25	100%
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Source.questionnaire 2020

Table item depicted that taken short term loan 14(56%) this implies maturity value is less than one year. Under medium term 8 (32%) customer uses this loan term and for long term 3(12%) loan the risk of that loan are higher than another.

Table4.9 Does the bank visits your business site after loan granting?

Does the bank visit your business after loan granting	Response	No. Response	Percentage
	Yes	20	80%
	No	5	20%
	Total	25	100%

As show above table 4.9 20 or 80%the respondent are response that the bank visits your business after loan granting and 5or 20% of the respondents are witnessed that the banks visit your business after loan granting.

Table 4.10 loan client relation with the bank?

Variable	No respondent	Percentage
Excellent	9	36%
Very good	7	28%
Good	5	20%
Fair	3	12%
Poor	1	4%
Total	25	100%

Source .questionnaire 2020

This result indicates that as loans and advances is the main product of the banking business, the client relation to the bank has to be improved to the excellent and very good level through improving the current credit issuing procedures.

Interview conducted with the branch manager

In addition to distributed questionnaires to employees, the researcher has prepared a face to face interview with the general manager of the bank and the manager has given the proper answer for the interview questions. The first interview questions were focused on:

- What risk management strategies do you follow?

For the first question the general manager of NIB has responded by mentioning some of the examples like:

- Credit analysis.
 - Collateral security.
 - Feasibility study.
 - Market study and others.
 - Follow up
-
- Another question forwarded to manager of the banks were: - how do you evaluate their effectiveness of credit risk management applied?

The manager response with regard to loan granting for risk management purpose they usually secure collateral for the amount of loan granted for example if a borrower request a loan amounting one million birr the bank secure a collateral, but more than one million birr of collateral the type of collateral might be building, machinery, vehicle and etc. so the creditor without default pays its loan, and by using repayment report.

Generally, the banks have their own risk management strategies and evaluating their effectiveness by using different mechanisms.

- Does your organization provides or gives credit service to clients who need credit service?

The branch manager has answered by that the organization is engaged in providing credit service to clients who seek credit services and who fulfill and submit all the requirements to be financed by the bank.

And another question with the branch manager was: - how many borrowers do you have in your branch bank? The branch manager gave the response by saying there are 200 borrowers in bank.

✓ Does the bank consider the 5 cs at the time of extending loan to its customer?

As response of the manager showed that the bank considers the 5cs like

- ❖ Character
- ❖ Capital
- ❖ Capacity
- ❖ Condition
- ❖ collateral

When loans are extended to customer of bank.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusions

The researcher analyzed the necessary data which are relevant to credit risk management and reached the following conclusions.

- ❖ The bank is granting loans or credit mainly on collateral basis.
- ❖ Most of the loans provided are on short term repayment schedule (Mostly for the purpose of working capital). This is may be due to the limitation of capital base of the bank. However, it is currently causing burden of installment repayment and most of loan clients preferred to be improved as most of the time faces difficulty to manage it accordingly. It is one of the causes for loan client termination.
- ❖ . The credit analysis and procedures which is being followed by the bank is lengthy and reluctant to approve adequate amount per the requisition and intended purpose of the business, requiring improvement so as to speed up and satisfy the delivery of loan to its clients and become acceptable in the eyes of potential customers.
- ❖ The default problem in the bank is due to market problem, environmental problem, loan diversion, and policy problem like the credit policy of the bank related to loan duration and amount. These all leads to credit risk that has bad consequences on the Bank's financial stability, clients' business performance, and economy.
- ❖ The collection techniques so far adopted by the bank is appropriate and convenient to most loan clients to manage it. Consistent to the convenience of the collection techniques, the repayment behavior of most loan client is improved to the required level revealing one step forward in the culture of meeting obligation and trustworthiness. Most of loan

clients now a day are considering loan repayment per the contract agreement as ethical and obligation.

5.2 Recommendation

Based or depending on the conclusions of the study, the researcher forwarded the following recommendations:

- ❖ The bank should provide continuous training for the borrowers as well as for employees authorized or responsible to manage the credit or loan.
- ❖ And also the other recommendations are given in order to improve credit risk management of the branch lack screening borrowers and processing information since that lead the bank to conceive asymmetry of information about the borrowers and improper use of its policy, risk management mechanisms and the bank should visit and check whether all.
- ❖ The authorized body of the bank for credit service should properly follow the borrowers for the repayment of their obligations.
- ❖ There is no interest disparity on all types of loan. The importance of interest rate disparity is that when there is high risk in the business of the borrower, the probability of repayment is low. Due to this the interest rate should be higher in order to cover bad debt loss of one riskier borrower. But when there is low risk in the business of borrower the probability of repayment is high. So the interest rate should be low to encourage and attract borrowers of safe business. For these reason, it should be suggested that the bank should charge interest to borrowers depending on the risk associated with each loan portfolio indifferent sectors.
- ❖ Even if the credit is not collected with specific period, the institution must be ready to make change like.
 - ❖ Appreciating customers, which pay on time, by giving them a discount and having strict follow up for those customers which do not pay on time at the same time and should train and create awareness on its customer about the time value of money.

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APPENDIX
WOLKITE UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE

Dear respondents, this questionnaire is prepared for employees of NIB in Wolkite branch. We am third year accounting and finance student in Wolkite University.

The main purpose of this questionnaire is to collect primary data on the topic entitled as “assessment of credit risk management in NIB in the case of Wolkite branch. The information you provide is very important or highly valuable to accomplish the objective of the study. Your responses will be kept confidentially and will be used for academic purpose only.

Thank you in advance for your cooperation!

General instruction:

- You are not required to write your name.
- Give your response in the provided by circling or put a tick () mark and write your answers to the open-ended questions on the space provided.

PART TWO: General question

1. Does the bank have credit appraisal procedures?

Yes No

2. If your answer is "Yes" to question number 1 are they strictly followed by credit officers?

Yes No

3. Is there any special circumstance that such criteria or procedures are relaxed?

Yes No

4. If your answer is "Yes" in above question, would you please mention some of such special circumstances?

5. Is there external factors that most contributed for loan defaults NIB, in Wolkite branch?

Yes No

6. If your answer is 'Yes' in above question would you please mention some of the factors?

7. Does the credit monitoring determine loan default?

Yes No

8. If your answer is yes, please mention how?

9. What are the loan repayment periods for the clients?

Monthly Yearly Quarterly

10. Does the institution collect its credit given to the customer with in specified time period?

Yes No

11. If your answer is no, why

SSspecify_____

12. Is there any problem in credit risk management in the institution?

Yes

No

13. If your answer is yes,

specify _____

14. Does the customer have habit of loan of customer repayment?

Yes

No

15 Is the loan processing time short and convenient for you?

Yes

No

16 If your answer to Q no.15 is "No", where do think the problem

a) At branch level

b) At head office level

17 When you approach the branch do you get relevant information to your request/ need?

Yes

No

If your answer to Q no.17 is no, please specify the problems you faced

18 Do you think to extend your relation further with the bank?

Yes

No

it dependent

19 If your answer to Qno.18 is "No", please explain the reason

20 Does the bank visit your business sites after loan granting?

Yes b) No

21 You became unable to pay your periodic loan repayment, what is/are the major reason/s/ for failure?

- **Market problem**
- **Environmental problem**
- **Contingencies problem such as death, sickness, etc**
- **Usage of the loan for other purposes like consumption**
- **Policy problem like credit policy of the bank**
- **Lack of appropriate management**

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15. Do you have any additional comment or any suggestion regarding the credit risk management of NIB, Wolkite branch?

Interview with branch manager

1. What type of risk management strategy do you follow?

2. How do you evaluate their effectiveness of credit risk management applied?

3. Does your organization provide credit service of clients who need credits?

4. How many creditors do you have in your branch?

5. Does consider the "5" c" s at the time of giving loan to your customer
