COMPARATIVE CREDIT RISK ANALYSES IN DASHEN BANK AND COMMERCIAL BANK OF ETHIOPIA

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ABSTRACT

This research paper titled "comparative analysis" was conducted by taking Dashen Bank (DB) and commercial Bank as case study. The main objective of the study is to evaluate and compare the Credit Risk of Dashen bank and commercial bank for the fiscal period (2015-2018/19 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. 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. Inability to create and build up quality loans and credit worthy customers leads to default risk and bankruptcy as well as hampers economic growth of a country. The study would be used variables, Capital adequacy, and non- performing loan, loan to deposit, cash to deposit and loan to asset ratios. The results showed that thus variables have significant relationship with both banks. Finally, the research offered suggestions for the improvement of efficiency in Credit Risk in selected banks.

CONTENTS

LEAST OF TABLE

ACRONYMS

BOI	Bank of Institution
BOD	Board of Director
CRAC	Credit Risk analysis Committee
CRAD	Credit Risk analysis Department
MFI	Micro Finance Instruction
PD	Probability of Default
NGO	non-governmental organization

CHAPTER ONE
1. INTRODUCTION

1.1 BACK GROUND OF THE STUDY

Any institution that conducts cash transactions or makes investments risks the loss of those funds. Development finance institutions should neither avoid risk nor ignore risk. Like others financial institutions, bank face risks that they must analysis efficiently and effectively to be successful. If the bank does not manage its risks well, it will likely fail to meet its social and financial objectives. When poorly managed risks begin to result in financial losses, donors, investors, lenders, borrowers and savers tend to lose confidence in the organization and funds begin to dry up. When funds dry up, bank is not able to meet its social objective of providing services to the poor and quickly goes out of business. Nancy et al. (2001).

Credit risk analysis is one of the key functions of the financial institutions. Those financial institutions, which analyze credit risks more consciously, protect themselves from negative events, thus obtaining comparative advantage over competitors. That is why careful credit risk analysis is important for smooth cash flow and success of overall financial performance of bank institutions. Credit risk analysis incorporates decision making process; before the credit decision is made, follow up of credit commitments including all monitoring and reporting process (Fayman and T. He 2011)

Without the provision of credit from country's financial institution especially through Bank institutions, no development of modern industrial community and fostering of investment that is achieving the target growth of economy by the state would have been impossible. As a result, most of the financial institution and bank industries are looking into managing their credit risks in different business cycle and environment that can help to alleviate crisis and major losses that could damage long term functionality of the institutions. Therefore, effective credit risk analysis is very essential to achieve this economic objective and to optimizing the performance of financial institutions. Ahmed (2002).

The development of bank institutions in Ethiopia is a recent phenomenon. The proclamation, which provides for the establishment of bank institutions, was issued in July 1931. Since then, various banks has legally been registered and started delivering financial service (Wolday, 2000). In particular, the licensing and supervisions of financial institutions in both urban and rural areas at it authorized them among other things legally accept deposits from the general public (hence diversifying sources of funds), so draw and accept drafts and to manage funds for the micro finance business (Getaneh, 2005).

So, these institutions required to design sound credit risk analysis. Bank in Ethiopia are not different from the other world micro finance institutions. Therefore they are also entitled to design sound credit risk analysis in order to achieve their desired objectives. In such away to be conduct a research title of comparative Credit Risk Analysis in Ethiopia financial institution is important for the time being. Therefor this study tries to assess Credit Risk Analysis in dashen and commercial bank of Ethiopia.

1.2. STATEMENT OF PROBLEM

Credit risk analysis is a discipline at the core of every financial institution and encompasses all the activities that affect its risk profile. It involves identification, measurement, monitoring and controlling risks to ensure that; the individuals who take or manage credit risks clearly understand it, the organization’s risk exposure is within the limits established by Board of Directors, risk taking decisions are in line with the business strategy and objectives set by BOD, the expected payoffs compensate for the risks taken, risk taking decisions are explicit and clear, sufficient capital as a buffer is available to take risk (Nagarajan 2001).

Credit risk analysis challenges are implicit in financial institutions (including bank) activities because credit risk events are typically uncertain An effective credit risk analysis process is required to helps institution’s top leadership establishes rules to prevent operating losses due to human error, employee carelessness, technological malfunction, or fraud. To illustrate, a bank finance's management may put into place internal controls and procedures as well as periodic internal audit reviews to ensure that employees comply with rules when performing duties in credit risk analysis. Nancy et al. (2001)

Most financial institutions find that loans are the largest and most obvious source of credit risk. Other sources of credit risk exist throughout the activities of a bank the credit decision is based on the financial data and judgmental valuation of the market attitude, borrower, management and shareholders. The follow-up is carried out through periodic reporting reviews of the bank institutions commitments by customer (Chua et al. 2000).

The credit risk management performance is greater role for any bank. Bank sector currently face challenges of loan repayment (default) by clients. The poor loan controlling system causes serious challenges to bank institutions. Every bank try to maximize it repayment rates helps to reduce the dependence of bank on subsidies. One of the indicator effectiveness of bank is the loan repayment performance of borrower. Most of bank approves loans for productive purpose, because income increment is positively indicator to which all development activities are addressed (Daniel, 2010).

In Ethiopia, the studies by Wolday (2001), Befkadu (2007), Zigju (2008), and Michael (2006) focus on progress of bank in terms of number of clients, loan amount, and number of branches the institutions have throughout the country. Effective and sound credit risk analysis is a foundation for the safe and sound operation of a bank to improve their performance

The empirical studies that have been reviewed in the preceding section focused on the different bank issues that affect the performance of bank. In addition, most prior studies regarding credit risk analysis tried to examine the possible methods to manage credit risk including the use of credit score rating, and the impact of borrower’s financial positions on credit risk management and the impact of relation of borrower and lender on credit risk management. Therefor this study tries to asses and explores credit risk analyses and makes a comparison between dashen bank and commercial bank of Ethiopia. And finally answer the following questions in order to achieve the objective.

1.3 Objective of the study

1.3.1 General objective

The main objective of this study is to assess the comparative credit risk analysis on Dashen bank and commercial bank of Ethiopia.

1.3.2 Specific objectives

- ✓ To find out factors that affects the performance of credit risk analysis in Dashen bank and commercial bank of Ethiopia.
- ✓ To identify the credit risk analysis procedures adapted by the bank.
- ✓ To assess the performance of the bank in credit risk administration and loan documentation procedures to analysis credit risk.

1.4. Research Question

1. What is the performance of institutions that affect credit risk analysis?

2. What procedures adapted by the bank to the credit risk analysis?

3. What is the performance of the bank in credit risk administration and loan documentation?

1.5 Significance of the study

This study gives the significance for organization as well as for future researches. The importance of this study is to enhance the competitive position of in relation to credit risk in Dashen bank and commercial bank of Ethiopia by finding ways that improve the credit risk management system 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 risk 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 commercial banks. It may help to determine how to take and manage risks relating to potential market, people, regulatory, technology and operating risks. It will be enabling the governing body, specifically the managements, and the higher responsible body, risk management department of the institutions to be aware of about credit risk analysis and its effect on growth of institutions income

1.6 SCOPE OF THE STUDY

The research proposal believe that the findings of this study would be productive if will be conduct on Dashen bank and commercial bank of Ethiopia. The data will be used for this research study only starts from 2015-2018/19 (if any); because it contains more recently data about credit risk of the two banks

1.7. ORGANIZATION OF THE PAPER

The research paper had five chapters the first chapter was the introduction part, the second chapter be the review of the related literature, the third chapter was research methodology to be used, data presentation and analysis was included in the fourth chapter, and the fifth chapter gave conclusion and recommendation.

CHAPTER TWO
RELATED REVIEW LITERATURE

2.1 THEORETICAL REVIEW

According to risk management frame work in bank industry by GTZ (released in 2000) risk is an integral part of financial services. When financial institutions issue loans, there is a risk of borrower default. When MFI collect deposits and on-lend them to other clients (i.e. conduct financial intermediation), they put clients' savings at risk. According to GTZ frame work any institution that conducts cash transactions or makes investments risks the loss of those funds.

Development finance institutions should neither avoid risk nor ignore risk. Like others financial institutions, bank face risks that they must analysis efficiently and effectively to be successful. If the bank does not manage its risks well, it will likely fail to meet its social and financial objectives. As Nancy et al.(2001) noted when poorly managed risks begin to result in financial losses, donors, investors, lenders, borrowers and savers tend to lose confidence in the organization and funds begin to dry up. When funds dry up, bank is not able to meet its social objective of providing services to the poor and quickly goes out of business. Nancy et al. (2001) also noted that managing risk is a complex task for any financial organization, and increasingly important in a world where economic events and financial systems are linked.

Global financial institutions have emphasized risk management as an essential element of long-term success. Rather than focusing on current or historical financial performance, management and regulators now focus on an organization's ability to identify and manage future risks as the best predictor of long-term success. Therefore, since bank institutions are part of these financial institutions, they are also be aware of about risk particularly credit risk they face and the way how to manage these risks.

On the other hand, bank institutions are established to fill the gap in the financial services sector by providing funds to the poor and lower income group and thus alleviating poverty and enhance their business activities. The bank also provides funds for start-up business or for working capital

(Woller et al., n.d). In addition, some bank also provides funds for non-business activities such as for education and emergencies purpose. In doing so agency problems like, moral hazard and adverse selection of clients exist because of information asymmetries.

2.2 Managing Risk in Financial Institutions

Risk management is a cornerstone of prudent financial institutions practice. Undoubtedly all financial institutions in the present-day volatile environment are facing a large number of risks such as credit risk, liquidity risk, foreign exchange risk, market risk and interest rate risk, among others – risks which may threaten a financial institution's survival and success.
In other words, financial institutions are business of risk (A. Kanwar 2005). For this reason, efficient risk management is absolutely required. The purpose of financial institutions is to maximize revenues and offer the most value to shareholders by offering a variety of financial services, and especially by administering risks. Recently many financial institutions have appointed senior managers to oversee a formal risk management function their objectives (Thornton 2010).

2.2.1 Credit Risk

According to a risk management frame work for bank institutions of GTZ (released in2000) credit risk is the most frequently addressed risk for bank institutions is the risk to earning or capital due to borrowers late and non-payment of loan obligation.

Credit risk encompasses both the loss of income resulting from the bank institutions inability to collect anticipated interest earning as well as the loss of principal resulting from loan defaults. Credit risk includes both transaction risk and portfolio risk.

Transaction risk: This is related to the individual borrower with which the bank is transacting. A borrower may not be trustworthy and capable of repaying loan which will result in loss of loan. All loss of loan related to delinquency of individual clients which can be because client's migration, willful defaulting, business failure etc. is called transaction risk.

Portfolio risk: Portfolio risk is related to factors, which can result in loss in a particular class or segment of portfolio. For example, the bank may lose a portfolio with a particular community, locality or a particular trade due to some external reasons. These reasons could be political, communal, failure of an industry /trade, etc.

2.3 CAUSES OF CREDIT RISK IN BANK

According to Macaver and O. Ehimare (undated) the source of credit risk can be either from borrower level or financial (lender) level.

2.3.1 CAUSES OF CREDIT RISK AT BORROWER LEVEL

The causes of loan default at the borrowers' level include the following:

Failure of investment to generate sufficient income due to improper technical advice, inadequate support services, marketing risks or natural disasters. Diversion of loan from desired objective operations to non-essential consumption which makes it difficult to meet repayment commitment on time. Existence of liabilities towards informal lenders, which may get precedence over institutional lenders, leading to delinquency and default.

Contingencies at the borrower household, such as sickness, accident or death (pure risk). Operation at very low level of subsistence, forcing additional income generated through loan-supported activities to be appropriated for basic needs. Prevalence of low real rate of interest or pegging of interest rate far below the market rate. Absence of incentives for prompt repayment, or penalties for delayed repayment.

2.3.2 CAUSES OF CREDIT RISK AT FINANCIAL INSTITUTION (LENDER) LEVEL

At the financial institution level, loan default may be due to any or a combination of the following: Defective procedures for loan appraisal, which could lead to financing of bad projects, thereby giving rise to delinquencies and defaults. Quality of loan officers, their mobility in the field, and their capacity to judge borrowers as well as the incentive package available to them affect repayment.

When loan officers are assessed more on the basis of compliance with lending targets than with recovery performance, it could lead to bad loans. When responsibility for lending and recovery are vested with separate officials in a credit agency, recovery tends to decline. Untimely loan disbursement and inappropriate repayment schedules. In addition, when the procedure for repayment is bulky, borrowers tend to default.

2.4 ANALYSIS OF CREDIT RISK

Credit risk analysis is a discipline at the core of every financial institution and encompasses all the activities that affect its risk profile.

It involves identification, measurement, monitoring and controlling risks to ensure that; the individuals who take or manage credit risks clearly understand it, the organization's risk exposure is within the limits established by Board of Directors, risk taking decisions are in line with the business strategy and objectives set by BOD, the expected payoffs compensate for the risks taken, risk taking decisions are explicit and clear, sufficient capital as a buffer is available to take risk (Nagarajan 2001).

The acceptance and management of credit risk is inherent to the business of bank as financial intermediaries (Nusselder 2003). Risk management as commonly perceived does not mean minimizing risk; rather the goal of risk management is to optimize risk-reward trade -off.

Despite the fact that banks are in the business of taking risk, it should be recognized that an institution need not engage in business in a manner that unnecessarily imposes risk upon it: nor it should absorb risk that can be transferred to other participants. Rather it should accept those risks that are uniquely part of the array of bank's services (Nusselder 2003)..

The board is responsible for ensuring that a formal risk assessment is undertaken at least annually for the purposes of making its public statement on risk analysis, including internal control. The board should acknowledge, in this statement, its responsibility for the risk management process and for reviewing its effectiveness.

Management is accountable to the board for designing, implementing and monitoring the process of risk management, and integrating it into the day-to-day activities of the institutions (Thornton 20

2.4.1 THE GOAL OF CREDIT RISK MANAGEMENT

The goal of credit risk management, as presented by the Basel (2000) is to maximize a financial institution's risk adjusted rate of return by maintaining credit risk exposure within acceptable parameters.

Consistent with principles of managing portfolio, it is requested that both the credit risk arising from individual creditors or transactions and the risk of the entire portfolio should be managed, and the relationship between credit risk and others must be considered as well

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2.5 METHODS TO MITIGATE CREDIT RISK

According to Zoltan et al. (undated) the following are some of the methods that lenders can mitigate credit risk. Pavla Vodova (undated) also noted the following as a means of credit risk mitigation mechanisms.

Risk-based pricing: Lenders generally charge a higher interest rate to borrowers who are more likely to default, a practice called risk-based pricing. Lenders consider factors relating to the loan, such as loan purpose, credit rating, and loan-to-value ratio and estimates the effect on yield.

Covenants: Lenders may write stipulations on the borrower, called covenants, into loan agreements:

Periodically report its financial condition. Refrain from borrowing further or other specific, voluntary actions that negatively affect the company's financial position. Repay the loan in full, at the lender's request, in certain events such as changes in the borrower's debt-to-equity ratio or interest coverage ratio.

Tightening: Lenders can reduce credit risk by reducing the amount of credit extended, either in total or to certain borrowers. For example, a distributor selling its products to a troubled retailer may attempt to lessen credit risk by reducing payment terms from net 30 to net 15.

Diversification: Lenders to a small number of borrowers (or kinds of borrower) face a high degree of unsystematic credit risk, called concentration risk. Lenders reduce this risk by diversifying the borrower pool.

2.6 Collateral as a Means of Credit Risk Mitigation in Bank

Collateral is a risk reduction tool, which, like many other such tools, mitigates risk by reducing credit exposure. The effect of collateralization is to substitute the credit risk of the issuer of the collateral for that of the counterparty to the transaction. Collateral reduces credit risk but gives rise to other forms of risk including legal, operational and concentration risk.

In lending agreements, collateral is a borrower's pledge of specific property to a lender, to secure repayment of a loan (E. Condolff 2006). Anderson (2010) also noted that the collateral serves as protection for a lender against a borrower's default - that is, any borrower failing to pay the principal and interest under the terms of a loan obligation.

If a borrower does default on a loan (due to insolvency or other event), that borrower forfeits (gives up) the property pledged as collateral - and the lender then becomes the owner of the collateral.

Collateral, especially within banks may traditionally refer to secured lending (also known as asset-based lending). More recently, complex collateralization arrangements are used to secure trade transactions.

2.6.1 Valuation of Collateral

The valuation of the collateral provided by the credit applicant is an essential element in the credit approval process and thus has an impact on the overall assessment of the credit risk involved in a possible exposure. The main feature of a collateralized credit is not only the borrower's personal credit standing, which basically determines the probability of default (PD), but the collateral which the lender can realize in case the customer defaults and which thus determines the MFIs loss.

2.7 Components of Credit Risk analysis

According to the risk management guidelines for commercial banks & other financial institutions in Pakistan, A risk management work for microfinance institutions (GTZ,1999and,2000) ,Nancy et al. and Bruett (2001) ,principles for the management of credit risk Basel committee(2000), Credit Institutions Regulatory Document Impairment Provisions for Credit Exposures(Irish financial service authority 2005),guide lines on credit risk management for financial institutions prepared by eastern Caribbean central bank(released in 2009) ,appraisal guide for microfinance institutions(Isern et al. 2008)in their writing stated that typical credit risk management framework in a financial institution may be broadly categorized into following main components.

Board and senior Management's Oversight Organizational structure Systems and procedures for identification, acceptance, measurement, monitoring and control risks.

2.8 Board and Senior Management's Oversight

It is the overall responsibility of Board to approve institution's credit risk strategy and significant policies relating to credit risk and its management which should be based on the institution's overall business strategy. To keep it current, the overall strategy has to be reviewed by the board, preferably annually.

The responsibilities of the Board with regard to credit risk management shall include:

Explain institution's overall risk tolerance in relation to credit risk.

Ensure that institution's overall credit risk exposure is maintained at prudent levels and consistent with the available capital.

Ensure that top management as well as individuals responsible for credit risk management possess sound expertise and knowledge to accomplish the risk management function.

Ensure that the institution implements sound fundamental principles that facilitate the identification, measurement, monitoring and control of credit risk.

Ensure that appropriate plans and procedures for credit risk management is in place.

2.8.1 The Responsibilities Senior management

The senior management of the institutions should develop and establish credit policies and credit administration procedures as a part of overall credit risk management framework and get those approved from board. Such policies and procedures shall provide guidance to the staff on various types of lending including corporate, SME, consumer, agriculture, etc.

At minimum the policy should include

Detailed and formalized credit evaluation/ appraisal process, Credit approval authority at various hierarchy levels including authority for approving exceptions, Risk identification, measurement, monitoring and control, Risk acceptance criteria Credit origination and credit administration and loan documentation procedures, Roles and responsibilities of units/staff involved in origination and management of credit, Guidelines on management of problem loans.

2.8.2 ORGANIZATIONAL STRUCTURE.

To maintain bank overall credit risk exposure within the parameters set by the board of directors, the importance of a sound credit risk management structure is required.

While the bank may choose different structures, it is important that such structure should be commensurate with institution's size, complexity and diversification of its activities.

It must facilitate effective credit risk management oversight and proper execution of credit risk management and control processes.

Each bank depending upon its size, should constitute a Credit Risk analysis Committee (CRAC), ideally comprising of head of credit risk management Department, credit department and treasury. This committee reporting to institutor's risk management committee should be empowered to oversee credit risk taking activities and overall credit risk management function.

The CRAC should be mainly responsible for:

The implementation of the credit risk policy / strategy approved by the Board. Monitor credit risk and ensure compliance with limits approved by the Board. Recommend to the Board, for its approval, clear policies on standards for presentation of credit proposals, financial covenants, rating standards and benchmarks. Decide delegation of credit approving powers, prudential limits on large credit exposures, standards for loan collateral, portfolio management, loan review mechanism, risk concentrations, risk monitoring and evaluation, pricing of loans, provisioning, regulatory/legal compliance, etc. Further, to maintain credit discipline and to enunciate credit risk management and control process there should be a separate function independent of loan origination function.

Credit policy formulation, credit limit setting, monitoring of credit exceptions / exposures and review /monitoring of documentation are functions that should be performed independently of the loan origination function. To do so the bank should institute a Credit Risk Analysis Department (CRAD).

Typical functions of CRAD include:

To follow a holistic approach in management of risks inherent in bank portfolio and ensure the risks remain within the boundaries established by the Board or Credit Risk Analysis Committee. The department also ensures that business lines comply with risk parameters and prudential limits established by the Board or CRAC.

c) Establish systems and procedures relating to risk identification, Management Information System, monitoring of loan / investment portfolio quality and early warning. The department would work out remedial measure when deficiencies/problems are identified.

The Department should undertake portfolio evaluations and conduct comprehensive studies on the environment to test the resilience of the loan portfolio.

2.8.3 SYSTEMS AND PROCEDURES FOR IDENTIFICATION, MONITORING AND CONTROL RISKS.

Bank institutions must operate within a sound and well-defined criterion for new credits as well as the expansion of existing credits. Credits should be extended within the target markets and lending strategy of the institution. Before allowing a credit facility, the bank must make an assessment of risk profile of the customer/transaction.

This may include

- Credit assessment of the borrower's industry, and macro-economic factors.
- The purpose of credit and source of repayment.
- The track record / repayment history of borrower.
- Assess/evaluate the repayment capacity of the borrower.
- The Proposed terms and conditions and covenants.
- Adequacy and enforceability of collaterals.

2.8.4 CREDIT ADMINISTRATION.

Ongoing administration of the credit portfolio is an essential part of the credit process. Credit administration function is basically a back office activity that support and control extension and maintenance of credit.

A typical credit administration unit performs the following functions:

Documentation. It is the responsibility of credit administration to ensure completeness of documentation (loan agreements, guarantees, transfer of title of collaterals etc.) in accordance with approved terms and conditions. Outstanding documents should be tracked and followed up to ensure execution and receipt.

Credit Disbursement. The credit administration function should ensure that the loan application has proper approval before entering facility limits into computer systems. Disbursement should be effected only after completion of covenants, and receipt of collateral holdings. In case of exceptions necessary approval should be obtained from competent authorities.

Credit monitoring. After the loan is approved and draw down allowed, the loan should be continuously watched over.

These include keeping track of borrowers' compliance with credit terms, identifying early signs of irregularity, conducting periodic valuation of collateral and monitoring timely repayments.

Loan Repayment. The obligors should be communicated ahead of time as and when the principal/mark up installment becomes due. Any exceptions such as non-payment or late payment should be tagged and communicated to the management. Proper records and updates should also be made after receipt.

Maintenance of Credit Files. Institutions should devise procedural guidelines and standards for maintenance of credit files. The credit files not only include all correspondence with the borrower but should also contain sufficient information necessary to assess financial health of the borrower and its repayment performance.

It need not mention that information should be filed in organized way so that external / internal auditors or SBP inspector could review it easily.

Collateral and Security Documents. Institutions should ensure that all security documents are kept in a fireproof safe under dual control. Registers for documents should be maintained to keep track of their movement.

Procedures should also be established to track and review relevant insurance coverage for certain facilities/collateral. Physical checks on security documents should be conducted on a regular basis.

2.8.5 CREDIT RISK MONITORING & CONTROL

Credit risk monitoring refers to incessant monitoring of individual credits inclusive of Off-Balance sheet exposures to obligors as well as overall credit portfolio of the bank. Banks need to articulate a system that enables them to monitor quality of the credit portfolio on day-to-day basis and take remedial measures as and when any deterioration occurs. Such a system would enable a institutions to ascertain whether loans are being serviced as per facility terms, the adequacy of provisions, the overall risk profile is within limits established by management and compliance of regulatory limits. Establishing an efficient and effective credit monitoring system would help senior management to monitor the overall quality of the total credit portfolio and its trends. Consequently the management could fine tune or reassess its credit strategy policy accordingly before encountering any major setback.

The banks Credit policy should explicitly provide procedural guideline relating to credit risk monitoring.

2.8.6 CREDIT ANALYSIS

Credit analysis is geared toward one decision; does the bank grant the loan? The purpose of credit analysis is to generate profitable loan that do not expose the lender to excessive amount of risk. The reason for the acceptance or reject decision should be clearly documented and the decision should be in accordance with the bank stated loan policy.

The banks' loan policies include the desired portfolio of loan by category and include minimum credit standard such as collateral requirements and minimum ratios. Other provisions include lending limits for certain loan officers positions, standards for grading loan, requirements for monitoring existing loan ,polices on inside loan and the documentation required to evaluate a loan applications.

2.9 BANK INSTITUTIONS IN ETHIOPIA

It is believed that the provision of bank credit to poor households would increase their assets and income. As a result, bank credit is considered as one of the methods of alleviating poverty. Since in the mid- 1980s, many non-governmental organizations (NGO) in Ethiopia have started providing micro- credit to poor households for income generating activities (Michael 2006). Moreover, the development bank of Ethiopia, in collaboration with the ministry of trade, has launched a micro enterprise lending program (Kereta 2007). Since 1994, recognizing the importance of microfinance facility, the present government issued a proclamation that laid down the framework for licensing and supervision of the business of bank institutions (BIs) in July 1931, through Proc. No. 40/1996. The objectives of the proclamation were:-

To provide a legal framework that brings monetary and financial policies and. To provide a legal framework for the promotion of banks. The proclamation allows banks to undertake both financial and non-financial activities.

The licensing and supervision of banks enhanced the status of banks as it authorized them to, among many other things, legally accept deposits from general public (hence diversify their sources of fund), draw and accept deposits, and manage funds for bank businesses. According to the association of Ethiopian bank report currently there are 18 bank operating throughout the country licensed under the national bank of Ethiopia

2.10. EMPIRICAL REVIEW

Paul et al. (2001) in their study of viewing bank as a social risk management instrument examined that there should be efficient and equitable risk management for bank institutions through bank insurance since bank insurances has positive impact on effective credit risk analysis.

Laurentis and Mattei (2009) conducted research on Lessors' recovery risk management capability and found that the development of modern reliable systems of risk management can enhance even more those management capabilities. This means that credit institutions should invest significant resources in projects aimed at correctly implementing rating systems and credit risk models, and highlights once more the importance of these tools well beyond the scope of regulatory compliance. The research method used is that mixed research method.

Chua et al. (2000) conduct research on bank, risk management, and poverty indicated that the relationship between risks to the client and risks to the loan portfolio has been largely important to the bank industry. This is because a more explicit recognition of this relationship in the design of products and services can reduce both the risk of borrowing for clients and the risk of lending for banks. Products, services, and delivery mechanisms that are designed to improve the capacity of clients to deal with risk in their lives (reduce their vulnerability) and to reduce the risk of taking a loan can lead to better repayment, fewer dropouts, and, accordingly, lower operating costs.

Nawai and Shariff (2010) in their study found that close and informal relationship between bank and borrowers help in monitoring and early detection of problems that may arise in non-repayment of loans that finally lead to credit risk. In addition, cooperation and coordination among various agencies that provide additional support to borrowers may help them success in credit risk management in their business that quantitative research method.

Samuel (2006) tries to touch the issue of credit risk analysis in some bank institutions in Ethiopia but they did not assess exhaustively the performance of bank institutions in credit risk analysis.

The empirical studies that have been reviewed in the preceding section focused on the different bank institutions issues that affect the performance of bank institutions. In addition, most prior studies regarding credit risk analysis tried to examine the possible methods to manage credit risk including the use of credit score rating, and the impact of borrower's financial positions on credit risk analysis.

2.11. SUMMARY AND KNOWLEDGE GAP

The previous study try to asses investigate relationship between risks to the client and risks to the loan portfolio has been largely important to the bank industry Chua et al. (2000) in addition most prior studies regarding to credit risk analyses tried to assess and explore the possible method to manage credit risk including the use of credit score rating and the impact of borrower's financial positions on credit risk management. Aalthough there have been a number of studies on credit risk analysis and related issues both in developed and developing countries, Ethiopia in particular, there are limited studies that exhaustively examine the credit risk analysis practice of bank institutions especially in comparison manner. As a result, this study will be designed to fill the aforesaid gaps and tries to asses and explores credit risk analyses and makes a comparison between dashen bank and commercial bank of Ethiopia.

CHAPTER THREE
3. RESEARCH METHODOLOGY

3.1. RESEARCH DESIGN

The research design is arrangement of condition for collection and analysis of data in manner that aims to combine relevance to the research purpose with economy in procedure (Claire Selltiz 1962). The selection of the one over the other design for the conducting of the study is based on research problem (issue or concern that needs to be addressed) so, for the purposes this study descriptive research design would be used.

3.2 RESEARCH APPROACH

Research approach was a plan and procedure that consists of the steps of broad assumptions to detailed method of data collection, analysis and interpretation. As noted in Creswell (2003), in an investigative study there are three familiar types of research approaches to business and social research namely, quantitative, qualitative and mixed methods approach. Thus, to generate necessary information and come up with more rich and comprehensive data, quantitative approaches would be employed.

3.3 SOURCE OF DATA AND COLLECTION METHODS

To execute the study secondary source of data would be used. Such source of data would be obtained from published and non-published materials from Dashen bank and commercial bank of Ethiopia. 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 commercial bank of Ethiopia. In order to avoid the risk of distortion in the quality of data, the data would 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 commercial bank of Ethiopia.

3.4 DATA ANALYSIS METHOD

To achieve the objectives of the study, panel data of Dashen bank and commercial bank of Ethiopia for five years (2015 - 2019) 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 Commercial Bank (CB). 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 2015-2019 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 4.1 Capital adequacy ratio of the DB and CB

Dashen Bank				**Commercial Bank**			
Year	**Total capital**	**Total asset**	**%CAR**	**Year**	**Total Capital**	**Total Asset**	**%CAR**
2015	1396.40	14659.79	9.5%	2015	1308	10116	13%
2016	1827.89	17520.04	10.4%	2016	1610	11937	13.48%
2017	2045.70	19747.17	10.3%	2017	2011	14859	13.5%
2018	2597.62	21962.20	12%	2018	2525	19948.6087	12.6%

2019	2923.89	24763.88	12%			2019	3090	23869.61	13%

Source- own computation from annual report of both banks (2015-2019)

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%. This indicates that the company is permitted to go for debt and also shows the company good position. 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 more commercial 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. Above shows the non-performing loan ratio of each bank of the Bank is below the requirement set by the commercial Bank of Ethiopia which is below 5%.

Table 4. 2. Non-performing loan ratio of DB and CB

Dashen Bank

Year	Non-performing loan	Total loan	%NPLR
2015	123.66	6217.54	1.9%
2016	174.44	8123.81	2.1%
2017	199.07	8862.32	2.2%
2018	197.74	9429.63	2%
2019	193.91	11526.99	1.6%

Commercial Bank

Year	Non-performing loan	Total loan	%NPLR
2015	144.914	3986.464	3.63%
2016	148.892	5504.61	2.7%
2017	178	7710	2.3%
2018	208.26	9176.36	2.26%
2019	217.06	12482.04	1.7%

Secondary Source- own computation from annual report of both banks (2015-2019)

As shows the performance of loan as compared to the total loan granted in the both banks. As it can be seen from table, in general the amount of non- performing loan is small in size confirming the collection rate is at its required level.

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

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

Table 4.3. Loan to deposit ratio of DB and CB

Dashen Bank

Year	Total loan	Total deposit	%LDR
2015	6217.54	11841.24	52.5%
2016	8123.81	14065.60	57.7%
2017	8862.32	15851.26	55.9%
2018	9429.63	17681.34	53.3%
2019	11526.99	19814.11	58.1%

Commercial Bank

Year	Total loan	Total deposit	%LDR
2015	3986.464	7744	51.4%
2016	5504.61	9204	59.8%
2017	7710	12545	61.4%
2018	9176.36	15040	61%
2019	12482.04	18520.42	67.3%

Secondary Source- own computation from annual report of both banks (2015-2019)

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 get less ratio time to time which is less favorable comparing with commercial bank. From the above table loan to deposit ratio of commercial bank of Ethiopia is favorable with comparing with Dashen bank of Ethiopia in 2019 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

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

Table 4.4. Cash to deposit ratio of DB and CB

Dashen Bank				Commercial Bank			
Year	**Total cash**	**Total deposit**	**%CDR**	**Year**	**Total cash**	**Total deposit**	**%CDR**
2015	1062.52	11841.24	9%	2015	593.322	7744	8%
2016	1286.65	14065.60	9.1%	2016	494	9204	5.36%
2017	1307.78	15851.26	8.25%	2017	634	12545	5%
2018	1755.99	17681.34	10%	2018	684.91	15040	4.5%
2019	1795.66	19814.11	9.06%	2019	989.28	18520.42	5.3%

Secondary Source- own computation from annual report of both banks (2015-2019)

This show the liquids of the bank is bad position, which have a negative effect on the financial performance the bank. From the above table cash to deposit ratio of commercial 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 4.5. Loan to asset ratio of DB and CB

Dashen Bank **Commercial Bank**

Year	Total capital	Total asset	%CAR		Year	Total Capital	Total Asset	%CAR
2015	6217.54	14659.79	42.4%		2015	3986.464	10116	39.4%
2016	8123.81	17520.04	46.3%		2016	5504.61	11937	46.1%
2017	8862.32	19747.17	45%		2017	7710	14859	52%
2018	9429.63	21962.20	43%		2018	9176.36	19948.6087	46%
2019	11526.99	24763.88	46.5%		2019	12482.04	23869.61	52.2%

Source- own computation from annual report of both banks (2015-2019)

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. 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.

CHAPTER FIVE
5. 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 Management, 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 (2015-2019).

In the five years dashen bank and commercial 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 commercial 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 commercial 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 commercial bank of Ethiopia. Like in profitable and risk and solvency measure commercial 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 8% 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

- Banks should have to hire the one who has high experience and qualification on credit risk .
- Banks board of directors are responsible for each and every activities of the bank, so they need to conduct continues training for their employees particularly for credit risk management department managers and employees as well.
- Policy maker of banks (in our country commercial bank of Ethiopia) need to set policy , and guidelines which force banks to think over their credit policy ,risk management policy , and other related things .
- Since there was no formal research conducted on such area other researcher of the country needs to conduct different and important so that contribute their responsibility and should have to made changes on the attitude of the community and the responsible body.

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