



WOLKITE UNIVERSITY

FACULTY OF BUSINESS AND ECONOMICS

DEPARTMENT OF MANAGMENT

**ASSESSMENT OF CREDIT RISK MANAGEMENT SYSTEM (IN CASE
OF DASHIN BANK WOLKITE BRANCH)**

**A SENIOR ESSAY SUBMITTED TO College Of Business And Economics DEPARTMENT
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Abstract

The research was conducted on the title assessment of credit risk management system of Dashen bank in Wolkite branch. The main purpose of this study was to assess the information about credit risk management of dashen bank in Wolkite branch. To do so the research design was use descriptive method and an approach called mixed approach. The study was used both primer and secondary data. Primary data was collected by using questionnaires. And Secondary data collected from documents of the bank. The study has attempted to include sample size of 15 employees of dashen bank by using judgmental sampling methods. The collected data have been analyzed by tables and percentages. Consequently the study is tried to give conclusion and suggest possible solution for the problems.

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CHAPTER-ONE

1. Introduction

1.1 Back ground of the study

Adequately managing credit risk in financial institution is critical for the survival and growth of financial institution. In Ethiopia, in the past 20 years more than 10 private banks began and subsequently their market shares had been growing substantially. In recent years a number of private banks were established and provided various types of services. Among these credit operations are any of the most important core businesses of banks. The major principle behind credit is “Buy now – pay later”. The word credit derives from the Latin word “credit” which shows the existence of trusts between borrowers and lenders. “The principle shows that in the absence of cash on hand business entities in the economy can delay payment until funds are available, by making an agreement with the seller. Most of the time the counterparty made between buyer and seller, borrower and lender may become inefficient because of many reasons.” The existence of a problem in credit leads to the concept of “credit risk management”. On the other hand, the importance of credit to a bank can be seen by its being one of the risks a bank faces. Banks have managed four types of risk to earn profit for maximizing shareholder wealth. These risks are credit risk, interest rate risk, liquidity risk, and operational risk. All the risks mentioned above are directly or indirectly related to credit. The credit risk management process of a bank is believed to be a good indicator of the quality of the bank's portfolio. In order to reduce the rate of default, banks are obliged to establish their own credit risk management systems. Credit risk management in a financial institution started with the establishment of sound lending principles and an efficient framework for managing risk policies, industry-specific standards and guidelines, together with risk concentration limits designed under the supervision of a risk management committee. “The goal of credit risk management is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters (Basel, 1999).

Banks face a greater range of credit risk. The risk of loss of principal or loss of financial resources. Credit risk occurs when a debtor/borrower fails to fulfill his obligations to pay back the loans to the principal/lender. In banking business, it happens when “payments can either be delayed or not made at all, which can cause cash flow problems and affect a bank's liquidity. Hence credit

risk management in the bank basically involved its practices to manage/minimize the risk exposure and occurrence (Greuning and Batonovic 2003, 161).

1.2. Statement of the problem

The very nature of banking business was so sensitive because more than 85% of their liability is deposits from depository (sunder Cornett, 2005) Bank use these deposit to generated credit for their borrowers, which in fact is a revenue generating credit for most banks. This credit creation process exposed the bank to high default risk, which might lead to finance distress including bankruptcy. In today's changing financial landscape environment of intense competitive pressure, volatile economic condition, rising bankrupts and increasing level of consumer and commercial debt. An organization ability to effectively monitor and managed its credit risk can means the difference between success and failure. Effective credit Risk management attracted today more iteration than before. The more accumulation of unpaid loan that use loans losses had been produced lower return to the banks. This caused by lack of proper credit risk management.

The objective of credit risk management was in order to minimize the risk and maximize bank's risk adjusted rate of return by assuming and maintaining credit exposure within the acceptable parameters. The risk must be assessed to derive a sound investment decision and decision should be made by balancing the risks and returns. The role of credit risk management is assessing the, risk conducts monitoring and reviews of the performance of the bank. The central problem of the study would relates to credit misallocation of the banks (measurements of cost and benefit) This would have substantial adverse impact on the performance of the bank in particular (i.e.dashen bank), absence of an active risk management program, lack of effective communication of risk management effort which is an important link in the risk management process, lack of personal with required skill to knowledge and difficulty of adaptability to managed the risk (Machiraju,2008).

There should be prior concern on the side of dashen banks to give due diligence in maintain sound risk management at what interest rate and to what credit limit and the credit worthiness of the bank Most of related literatures concentrate on loan portfolio but this study tries to include the risk that come from credit misallocation of the finance institution i.e. banks. Therefore, the principal concern of this paper is to ascertain to what dashen bank could managed its credit what

tools or techniques are used and to what extent the current performance is supports to a proper credit risk management policies and strategies (Aijun, 2009).

According to different research studies on credit risk management. They give more emphasis the risks that occur by loans and advances.

(Petter S. Rose ,1999) states that risks happen banking tends to be concentrated in the loaned and the serious financial trouble usually emanates from loans and the other author that conduct the research on credit risk management is (AS chow and teguth 2008). It was observed that loan portfolio significant role of credit risk management. Some other researcher also conducted their paper on transaction (default) risk of attention to change economic or other circumstance that can leads to deterioration .But bank face credit risk on different reasons the most and an important reason that bank may face risk is un proper allocation of credit to the Asset, individual one factor for banking crises. There for an empherically derived agent for practitioner identified issues is to needed .

1.3. Research question

The study was expected to address the following research questions

1. what are the Credit risk exposure of dashen bank
2. How the bank does identify and evaluate it credit risk?
3. What are the dashen banks preventive techniques and control procedures of credit risk management?

1.4. Objective of the study

This study had address two objectives general and specific objectives.

1.4.1. General objective

The General objective of the study will to assess credit risk management system of dashen bank in Wolkite branch

1.4.2. Specific objective

The specific objective of the study will:-

1. Identify credit risk exposure that faced by dashen bank
2. To evaluate the credit risk of dashen bank
3. To examine the preventive technique for credit risk process used by dashen bank.

1.5. Significance of the study

Banks need to predict scientifically the exact level of risk they are going to assume by entering in to a contract in availing credit to the customer (paul,1991:78)

The following are the significance of the study

- It would serves as a ground stone for the coming research who want to conduct further research.
- Stake holders such as research, policy makers, professionals, and managers can used the research to guide future research, reappraise a rent banking industry practices, and provided basic guide line for banks credit risk management.
- This study would attempt to find out problems that related with credit risk management.
- TO provided relevant recommendation and conclusion by assessing a theoretical and description for better decision (method) for credit risk management practice in the organization.

1.6. Scope of the study

This study entitled, Assessment of credit risk management system in case of Dashen Bank in Wolkite branch.

- ❖ The study was only delimited to the credit risk management aspect of Dashen Bank in wolkite branch.

1.7. Organization of the paper

The research papers were organized in to five chapters. The first chapter provided about introduction part including bank ground of study, organization, statement of the problem, objective of the study, limitation of the study and organization of the paper. The second chapter focuses on literature review about credit risk management. Chapter three deals about methodology of the study. The fourth chapter contains data analysis interpretation and chapter five contains conclusion and recommendation.

CHAPTER – TWO

2. Review of literature

2.1. Theoretical of literature

Banks make money by providing services that their customer wants and by granting them credit. There is some risk with these services and the most significance risk is credit risk.

Credit risk is the risk of loss due to the financial weakness of the bank's customers. Generally that the customers will not be able to provide fund, to settle its transaction usually due to bankruptcy or some other anther liquidity crisis. In also defines credit risk by anther author as follows. (Poul, 1990)

It is the risk that a borrower will be unable to meet its obligation. A bank reflects and aims to profit from taking credit risk by change higher interest margins on loans to those customer that is consider present a higher risk.

2.2. The need of credit risk management

bank oil the wheels of the economy, and They play a pivotal role in mobilizing saving. In doing so, they face risk a rising from credit, traders rate, liquidity, exchange rate transaction, compliance, strategic and reputation. Banks key challenge in managing risk in understanding the interrelation of this risk factors they may be positively or negatively correlated. To be consistent with the research them the focus there is on credit risk which is the risk repayment that is the possibility that an obligor will fail to perform as agreed. Bank led to individual, corporals and government who in turn contribute to growth, employment and better socio economic conditions.(Boating,2004).

The goal of credit risk management is maximize a bank's risk adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Bank need to manage the credit risk inherent in the entire port folio as well as the risk individual credit or transaction. Bank should also consider the relationship between credit risk and other risk the effective management of credit risk is critical component of a comprehensive approach to risk managements and

essential to the long term success of any banking organization, for most banks. Loans are the largest and most obvious source of credit risk. However, other sources of credit risk exist throughout the activities of a bank including the trading book and both on and off the balance sheet. Banks, are increasingly facing credit risk (countered) party risk in various financial instruments other than loans including acceptance, interbank transaction, trade financing foreign exchange transaction, financial future, swaps, bonds equities options and in the extension of commitment and guarantees, and the settlement of transaction (Machiraju,2008).

The taking of credit risk is a principal function of banks. How a bank approaches credit risk represents one of its important policies. The willingness of banks to take credit risk has provided a major service to market economics throughout banking history. The help of banking business is assessing credit risk not necessarily taking risk but assessing them. The help of banking business is assessing credit risk not necessarily taking risk, but assessing them. The help of banking business is assessing credit risk not necessarily taking risk, but assessing them. The destination is important because the ability to assess is asking and whether the credit risk are taken or not taken is a management decision.(Ajun, 2009).

Since exposure to credit risk continues to be leading sources of problems in banks and their supervisors should be able to draw useful lessons from past experience. Banks should now have a keen awareness of a need to identify measure, monitor and control credit risk as well as to determine that they hold adequate capital against these risks and that they are adequately compensated for risk incurred.(Richard.S, 2010)

A further particular insurance of credit risk relates to the process of settling financial transaction. If one side of transaction is to settle but the other fails, a loss may be incurred that is equal to the principle amount of the transaction. Even if one party simply **that** in settling the other party may incur relating to missed investment opportunities settlement risk (i.e., the risk that completion of settlement of financial transaction will fail to take place as expected) thus includes elements of liquidity, market, operational and reputation risk as well as credit risk. The level of risk is determined by particular arrangement for settlement. Factors in such arrangement that have a bearing on credit risk include. The timing of the exchange of value payment settlement finality.(George.E.Radja,2011).

2.3. Principles of credit risk management

According to (Carol Alexander,1999)The goal of credit risk management should always be to maximize banks risk adjusted rate of return by maintain credit risk exposure within the entire portfolio as well as the risk individuals credit or transaction. Bank should also consider the relationships between credit risk and other credit risk. The effective management of credit risk is a critical component of comprehensive approach to risk management and essential to long term success of any banking business.The maser committee promotes sound for managing credit risk. In line with this objectives, the committee has out lined principles of credit risk management which are mainly applicable to the business of lending and it believes that banks, should now have a keen awareness of the need to identify, measure, monitor and control credit risk, As well as to determine that they hold adequate capital against these risk and that they are adequately compensated for risk incurred. Although specific credit risk management practices may differ among bank depending up on the natural and complexity of their credit activities, a comprehensive credit risk management program will address the following four area of credit risk management program will address the following five area of credit risk management identified by the (Carol Alexander,1999).

2.3.1. Establishing an appropriate credit risk environment

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

Principle 2: sensor management should have responsibility for implementing the credit risk strategy approved by the board of directors and for developing polices and procedure for identifying, measuring, monitoring and controlling credit risk. Such policies and procedures should address credit risk in all of the bank's activities and at both the individual credit and portfolio level.

Principle 3: banks should identify and manage credit risk inherent in all products and activities. Bank should insure the risk of products and activities new to them are subject to adequate risk management

procedures and controls before being introduced or under taken and approved the body of director or it app

Operating under a sound granting process

Principle 4: Banks must operate within sound, will defined credit granting criteria. These criteria should include a clear indication of the bank's target market and a thorough understanding of the borrower or counter party, as well as the purpose and structure of the credit and its source of repayment.

Principle 5: Banks should established over all limits at the level of individual borrowers and counter parties and groups of connected counter parties that aggregate in comparable and meaning full and manner different types of exposure, the banking and trading book and on and off balance sheet

Principle 6: Banks should rave a clearly established process in place for approving new credits as well as amendment, renewal and refinancing of existing credits.

Principle 7: All extensions of credit must be made on an army length basis. In particular, credit to related companies and individual must be authorized on the exception basis, monitored with particularly care and other appropriate steps taken to control or mitigate the risk of non-arm's length lending.

2.3.2. Mentioning an appropriate credit administration measurement and monitoring process

Principle 8: Banks should have in place a system for the ongoing administration of their various credit bearing portfolios.

Principle 9: Banks should have in place a system for monitoring the condition of individual credit including determining the adequacy of provision and sources.

Principle 10: Bank is encouraged to develop and utilize an internal risk rating system in managing credit risk. The rating system should be consistent with the natures, size and complexity of a bank's activities.

Principle11: Banks must have information systems and analytical techniques that enable management to measure the credit risk inherent in all on and off balance sheet activator. The management information system should provide adequate information on the composition of the credit portfolio, including identification of any concentration of risk.

Principle12: Banks must have in place a system for monitoring the overall composition and quality of the credit portfolio.

Principle 13: Banks should take in to consideration potential future changes in economic condition when assessing individuals credit and their credit portfolio and should assess their credit risk exposure under stressful condition.

2.3.3. Ensuring adequate controls over credit risk

Principle14: Banks must establish a system of independent, ongoing assessment of the bank's credit risk management process and the result of such reviews should be communicated directly to the board of director and senior management.

Principle15: Banks must ensure that the credit granting function is being properly managed and that the credit exposures are within levels consistent with prudential standards and internal limits. Banks should establish and enforce internal controls and other practices to ensure that exceptions to the policies, procedures and limits are reported in timely manner to the appropriate level of management for action.

Principle16: Banks must have a system in place for early remedial action on deteriorating credit.

2. 3.5.The role of supervisor

Principle 17: supervisor should require that banks have an effective system in place to identify measure, monitor and control credit risk as part of an overall approach to risk management supervisors should conduct an independent evaluation of a banks strategies, procedures and practices related to the granting of credit and the ongoing management of the portfolio.

Supervisor should consider setting prudential limits to restrict bank exposure to single borrowers or groups of connected counter parties.

2.4 Credit risk management approach

Banks manage their credit risk based on three approaches. There are minimizing risk, price risk and diversity of risk approach. All approach requires an ability to assess credit risks. The difference between the three approaches is the way assessment of risk is used by the banks (Herrick, 1990:135).

2.4.1 Minimal risk approach

The minimal risk approach to credit risk management attempts to separate loans, securities and other assets in to two groups includes credit in which there is no reasonable doubt that the asset will be redeemed at face value, or in the case of equity investment, no reasonable doubt that the environment will provide a significant return over a period of years. The other group include all assessments of credit risk where it appears that a credit not provide a good return. Many young banker of the time told themselves that they would do that whatever was needed to prevent the experience from happening again. Done about past loan many of them were either on the workout basis or on salvageable. But new loans and some renewed loan were the type of business over which a banker had some One preventive measure was to look carefully at quality the loan application. Little could be discretion. Banker did not feel confident about drawing fine lines of various degree of risk and credit worthier loan which were not likely to be repaid beyond reasonable doubt simple were not made.

The minimal risk approach relies on the classic three C's of credit character, capital and capacity. The risk approach to credit risk requires that bankers act as a helpful friend, a consultant and an advisor who user firm persuasion when necessary. This informal relationship adds a subtle, but strong, pressure to the management of any organization to keep it affairs in good shape.

Moreover, if a banker approach credit risk from the minimal risk from occurring. There is no place in his thinking for lasses and he makes extra ordinary efforts to full this outlook .with this credit risk approach and with dedication to his customers, there is often a feeling of person's failure if loss accurse. This psychological incentive to prevent losses provides an important part of attitudes of bankers with a strategy that strives to minimize risk. The effect of the minimal risk

approach is that it tends to keep activities restricted to areas that are already well known to a bank new areas of banking involve greater uncertainties than areas that are part of daily banking activity. A step outside this circle of knowledge and friends reduces the value of years of banking acquaintance in other established areas of business or government. Although the minimal risk approach has important limitations built in to its philosophy, many banks have been very successful for many years following this policy of credit risk. (Herrick,1990:135).

2.4.2 Price for risk approach

Risk pricing recently has developed as an alternative approach to credit risk. The interest charged for a loan of greater risk. In recent years, this approach also has retired on the basic method of credit analysis noted with the minimal risk approach but carries the conclusion much further.

The risk pricing approach looks at all degrees of risk as a normal part of the banking business. In effect, it views the assets of the bank loans, securities, and investment in various shades of white and grey and accepts all of them as legitimate worthwhile assets. Assets of greater credit risk involves greater risk of loss but these of greater credit risk involves greater risk of loss but these assets are expected to be priced to earn enough more interest income to offset their credit risk, a profit for the bank. Assets of little credit risk involve low risk of loss.

These assets are expected to earn lower interest rates and also earn profit for a bank. If risk pricing is done properly, assets of all types of credit risk should show approximately the same profit to a bank. The risk pricing approach reflects two trends in during the past decade.

First, has been a growing assurance among many banks that they possess the technical capabilities of assessing risk to greater extent than did an earlier generation of bankers. New techniques have been applied to banking that did not exist a generation ago. Computers have enabled banks to handle much greater quantities of information operations research and system research have opened new ways generation of analyzing information. Operations research and system research have opened new ways generation of analyzing information.

A new generation of thinking has raised which believer that it can make more accurate conclusion based on fractural experience that on the rule-of- thumb guides and the personal judgment of credit officer's loans officers and security trader.

Many banker have been emboldened developed their confidence developed their confidence above "motivating" people. All of these approaches to knowledge rest on supreme confidences that are highly refined ways of conducing operation that will bring superior results. The second trend underlies the growth of risk pricing is the recent emphasis for the banks to show strong earnings gains.

Risk pricing opens the door to major expansion is banking. Business a large proportion of a business that world is turned dawn on the basis of the minimal risk approach choices bankable business. To work successfully over a long period, the risk price, approach requires three conditions. The first requirement is need for a larger number of assets in the bank asset portfolio. The basis of risk pricing is that a banker does not know which loan security or investment will require emergencies efforts reduced terms of fail, but he should have goad idea of likelihood that these difficulties could occur in large part folio.

The second requirement is that the bank needs a staff will considerers analytical skills. The process of assessing various degrees of risks is not a task that a one or two main credit department can easily handle. The development or risk pricing format for a bank involves major statistical operation. Moreover, the risk pricing format for one bank would not necessarily be appropriate for another bank.

A risk pricing formal provides specific guidelines shown the way particular bank will price a loan, security, or investment and reflects the franchise of a particular bank, its personnel and its ongoing business relationship with customer.

The third requirement is that a bank need to possess an out sanding forecasting capability. Risk pricing is concerned about the future and must make much more complete and accurate assumptions concerning the future conditions of credit markets, business activities and attitudes of debtors.(Herrick,1990:135)

2.4.3 Diversity of Risk Approach

Credit risk management often diversifies a portfolio of loans, securities and investments as a simple yet effective way of keeping problems of credit risk under control. However, the approach is sometimes mistakenly used to justify taking greater individual credit risk or a higher risk price premium than otherwise would be justified, which is mistaken.

In fact, diversity can only partially control risk and it is not an approach to risk that can stand independently of other approaches. For example, if the credit department of a bank is covered by other departments or is not well managed, and loan quality assets are acquired without eliminating their risk. It would mean that the bank would hold a wide variety of low quality assets. Diversity permits the more fundamental approaches to credit risk minimal and risk pricing to be fulfilled in true colors. It reduces the likelihood that random or accidental occurrence will have an appreciable effect on one of these fundamental policies. A major practical problem in diversifying credit risk is deterring what constitute diversity. There are literally thousands of ways of classifying assets and a case could be made that many of the categories represent diversity on logical ground. Yet to be effective, risk diversity requires relevant categories and the determination of the relevant categories is not an easy matter. (Herrick, 1990:135)

2.5 Credit risk management cost

According to (Pony von Vestal, 2014), the starting point for efficient credit control is recognition of the cost of credit and its potential effects on profit and liquidity. Techniques for managing operating credit risk build on the basic principles of risk management that are already deeply ingrained in banking to consider. They are:-

1. **Exposure reduction:** this exposure could be eliminated by requiring the customer to provide collateral or guarantees. Banks have their own specialist lenders and credit risk assessors who have the skills and experience to assess risk reduction. Although exposure reduction techniques are generally not expensive for banks to implement, they result in higher customer cost.
2. **Risk control:-** programs to control risk on the other hand can involve a change in operations and are often expensive to implement. This is designed to monitor the actual level of risk or if it changes and to refer to transactions to the proper credit authority for approval before the exposure is made.

3. Loss funding – provision must also be made for any losses that do occur: Although banks ensure loans by deducting a provision from earnings to create a reserve, must do or use this mechanism to ensure against losses from operating services. Ideally, reserves should be built and capital allocated to operating services in proportion to the risk they incur.

To determine the level of credit risk to be funded, the following have to be considered: how much risk remains after implementing exposure reduction and risk control procedures, the operation dependability of the efforts and an analysis of the likelihood of loss from the remaining exposure. (Pony von vestal, 2014).

Prior to issuing a loan, a lender reduces credit risk through control that reduce the potential for delinquency or loss commonly known as preventive steps before issuing a loan and includes: loan term, loan amount requesting the client's repayment capacity, legibility, criteria for a loan request, repayment frequencies, collateral, ability and willingness of borrowers to repay a loan and check credit history with suppliers and other credit organization.

Once the loan is issued a lender's risk management expands control that reduce actual losses, commonly known as controls after extending loans. It includes the following factors

- Periodically analyzing the portfolio quality with intent to modify procedures and policies before the loan quality deteriorates.
- Lender staff and clients must understand that late payments are not acceptable and clients should be penalizing for the late.
- There should be effective follow up procedure
- The consequence of loans default must be successfully unappealing to clients

All credit departments should have credit management manual in order to standardize procedures. The manual should be regularly updated to account for changes in procedure and circumstances. The manual contains:- statements of credit policy, Methods of payment for various accounts, specimen of management information forms and reports and the time table for completion and procedures for account collection, credit sanction, legal action, disputed, bad debts, credit limits etc.

2.6. Credit risk management function

credit risk managements is the core to achieve the desired objective credit risk management contains three basic functions and these are: credit analysis and appraisal, credit monitoring and review and work out procedure. (Basel committee, 1999).

2.6.1. Credit analysis and appraisal

According to (Lapteva.M.N,2009) having compiled a basic file of information and investigated revenues suggested by inconsistencies, derogatory comments, and favorable opinions, the analysis assess the willingness and ability of the applicant to repay. Each of these describes an area of the person or firm's credit worthiness. In addition to the bank have traditionally focus on the principle of five "C"s to estimate borrowers credit worthiness, these five "C"s are:

1. **Character:** - The quality of desiring to repay debates when due is tanked above all other considerations of course, honesty is a necessity, but character implies integrity and empathy for the lender position as well. An established credit record (substantial) borrowing and voluntary repayment) is one of the best evidences of business or individual willingness to repay, Also character is implied by the applicants' position of trust accepted and full filled in business and social organization follows that of top management, its facilities for keeping records, the reutilization of office function and relation with employees.
2. **Capacity:-** Capacity is the ability to repay debuts as schedules for households, the employees of the working member provides most of the income which is spent for consumer expendable and debt repayment consumer capacity is a reflection of safety margin between income and committed out flows and the stability of each. The analysis must consider the effect of unusual events of such as prolonged illness or un employment on the economic sales income expenditure patterns, and debt commitments, However, the complexities of business operation are substantially greater than that of household, requiring analysis highly trained in corporate finance and knowledge about the accounting marketing and financial peculiarities of the firm and its industry

3. Capital:- This faces of the applicant refers to his or her finance strength, that is the ability to raise funds from the liquidation of assets or other business, As last resort the borrower's capital may repay the debt, but such actions generally means the termination of the borrower's capital may repay the debt, but such actions generally means the termination of the borrower's business and, of course, the relationship with the leading institution.
4. Conditions:- Borrowers may be subject to unfavorable economic conditions beyond their control. Repayment depends not only up on character capacity and collateral. But those factors over which the borrowers exercise little or no control. The long. Run and short run business cycle affects nearly all persons and individuals, but certain industrials are especially prone to oscillate between prospect and depression. Credit analysis monitor industrial externs, looking for early signs of weariness which load to unemployment, say declines and operating losses. Income, even strong, honest character may subvert the loan relationship in order to pressure their economic position one factor for banking crises.

Would over, credit risk has proved to be the most critical of all risk, faced by a banking institution. A study of bank failure in new emplaned found that of the 62 bank in existence before 1984, which failed from 1989 to 1992 in 58 cases it was observed that loans and advance were not being record in time. The effect of poor risk management can clearly be seen in the problems that have arises from the un regulated sub-prime mortgage lending market in the USA were the loans had been securitized in to ever more complex securities. Which was the housing price stabilized and stopped increasing led to a huge increasing in defaults of the underlying sub-prime mortgage. This, in turn lead to massive losses in the sacristies, which had been sold. The reason mentored above indicated an increased need to manage risk and in particular credit risk and default predication.

Generally banks face credit, market, liquidity, operational compliance (legal) regulatory and reputational risk, across county experience evident that credit activates are the main determine factors for the well being of the financial sectors especially in inter mediation activities such as banking service.

5. Collateral:- is an asset normally moveable property pleaded against the performance of an obligation. Bank can sell the collateral if the borrower defaults, while collators reduce banks risk it enhances the cost in terms of documentation and monitoring the collateral. The factor

determines suitability of the collateral is standardization, durability, identification, marketability and stability of value, standardization helps in identifying the nature of asset that is being used as collateral. Durable asset make better collateral. Identification is possible if the collateral has defined characteristics like a building or serial number (motor vehicle) marketable collateral alone is of value to the bank if it has to sell it. Marketability sale with little or no loss from current of loan

2.6.2. Work out procedure

Work out procedure is important aspect of credit risk management. If timely action is not taken to address the problem loans, opportunities to collect poor quality asset will soon vanish, work out procedure involves loan following process. Identification of the problems loans, reviewing loan history and documentation and meet the customer and openly discuss the problem.

The first element of workout procedures is to ensure collection. In the absence of ensuring collecting within short period of time, arranging new agreements for the borrower if it helps to get out of problem is another alternative. The arrangement may be in terms of extending the loan period for injecting additional capital if the problem is working capital shortage. The last step in work out procedure is to collect the loan through litigation if possible. (Basel committee, 1999).

2.6.3. Loan monitoring and review

Proper credit risk management involves due credit analysis, having proposition approved, can disbursed and ultimately follow up the loan in order to have the extended credit rapid back good credit could become problem loans unless continuous follow up is made which enables to detect signs that reveal difficulties. The objective of credit monitoring and review among other included ensuring the loan are directed to the intended purpose, ensuring the loan convenient are compiled with following loan and identifying emerging problem.

Attention should be given to the following while conducting monitoring and review of credit. Check an early working signal: check the end use of the loan fund, assess all conditions of the borrowers, assess financial need of the borrower and state finding and interpret them improvements, deterioration and changes. (Basel committee, 1999).

2.7. Empirical review

The assessment of credit risk management system is defined by different researchers in different place and time and those try to assess the credit risk management system by their own effort.

From those researchers some are:-

According to Shimeles Bogale (2012) during this study, to examine how to assess credit risk management system in Hawassa university and also try to examine how the bank know borrowers and to estimate its credit worthiness of the lender. The past researcher uses both primary and secondary source of data but it collects the primary data through interview and in addition to this the approach is mixed. When those researchers collect the data thorough interview by using personal interview of selected division head of the bank/management of the bank officer. And it takes descriptive data analysis method is employed to assess the credit risk management system and it reaches at their finding by using all above listed information.

According Hilina Getahun (2015) who study to examine how to assess credit risk management system in Arbaminch University and also try to examine how the bank know borrowers and estimate its credit worthiness of the lender. Its source of data, approach and data analysis method almost the same as Shimelis Bogale that study in Hawassa university.

According to Birhanu Getaneh (2017) during this study, try to examine credit risk management system of dashen bank in Bahir dar university and its effective management of credit risk is critical component of a comprehensive approach to risk management and essential to the long term success of dashen bank. The researcher use primary source of data and collected through closed questionnaires and unstructured personal interview. And uses descriptive method of data analysis to transform of raw data in to form and would made easy to understand to the reader and enterprise.

Knowledge gap

Our study will have interested to overcome some problems that hinder the assessment of credit risk management system in dashen bank. The past researcher collects data through personal interview of selected division of the bank. But this not preferable because personal interview is not economical /expensive, and the interview is focus only selected division of the bank, so this

is not preferable b/c other employees are not participate in the interview as a result this not fair in order to assess the credit risk. And the communication way is one to one and it is difficult to ask each individual by oral and the respondents not answer the questions by their own freedom. Generally by considering the above past researcher's druses /gap and to fill up the druses the researcher collect the data through questionnaires in order to limit the cost and to give the chance not only selected division of the bank /management of the officer but also to addressed the questionnaires to existing employees according to sampling techniques. and in questionnaires the questions are no pressure on the side of employee and the respondent is answer freely the question and communication way is one to many and It is appropriate if the question is addressed in the form of questionnaires rather than personal interview.

Chapter Three

3. Research methodology

3.1. Research Design

The study was focused on the Assessment of credit risk management system in case of dashen bank in Wolkite branch. Hence in order to do this research, the researchers was used the most appropriate design to study, which is descriptive method. Because descriptive method largely describe or justify the information that express the raw data and convert in to form that obtain from respondents and describe this raw data using tabulation, charts, and percentage in communicable and understandable way for the reader. And an approach called quantitative and qualitative (mixed) approach. It was clarify the research method, it quietly able to provide adequate for reader.

3.2. Source of data and method of data collection

In The study both quantitative and qualitative approach was used to attain the objective of the study. And the primary data was collected through questionnaires. Questionnaires with standard set of questions addressed to managers of the bank and employees. The questionnaires include both open ended and close ended questions.

The secondary data was collected from manual report and publication also used as back up means of collecting secondary information.

3.3. Sample and sampling techniques

The sample was selected by using non probability sampling specifically, Judgmental sampling technique. There are four reasons for selecting judgmental sampling methods. The first reason is the researcher needs to deal only the target group who are expertise or judgment on the study and the type of sampling has its own advantage. Secondly Judgmental sampling is use under the non probability sampling to collect data from the employee of the bank in line of the research

question. The third one is the rationale behind employing this judgmental sample type is to identified the employee that have been specialized knowledge of credit risk management system and to share their understandings about the study. And the last reason is the researcher believed that employees are representative of interest are appropriate.

So the above four elements are the major reasons for researchers selecting judgmental sampling techniques than other sampling techniques.

The researcher selected judgmentally 15 respondents or employees from the total population of 33. Its advantage the researcher takes 15 employees from the total population in order to save time, cost and to conducted the sample. And in addition to these the researcher select judgmentally by considering persons who senior bank professions, branch managers, customer service agent, accountants, loan section heads & loan/credit analysis officers are more knowledgeable and represent the whole population and to answer the question in clearly manner than the total population and to get clear information about credit risk management system of dashen bank in wolkite branch.

3.4. Data analysis and presentation

The relevant information that was collected from primary and secondary source of data was depend on descriptive analyses. The reason for researchers use descriptive analyses used to transformation of raw data in to a form and it was easy for the reader to understand.

Descriptive analyses was largely described or justified the information that expressed the raw data that obtain from respondents and describe this raw data using tabulation, charts, and percentage in communicable and understandable way for the reader.

Chapter Four

4. Data Analysis and Interpretation

A structured questionnaire was developed to know the attitude of respondents towards the credit risk management of dashen bank. In this section, the data collected through questionnaires will be presented and analyzed using statistical tables. The questionnaire had been distributed to 15 sampled employees and management members of the bank. The selection of respondents was made in a way to represent both the management and employees working in different operations of the bank. 15 questionnaires had been returned for use in the study. The responses will be analyzed here under:

4.1. Respondents Background

All respondents who participated in this study were management and employees' from different operations of the dashen bank. Presented here is general background information about the respondents. Respondents were studied for their gender, age, highest level of education, and position in the bank. The tables that follow present the results for each of these variables.

Table 4.1 Personal information, Educational, and Position of respondents

Respondent	Frequency	Percentage
Gender		
Male	13	86.6
Female	2	13.33
Total	15	100%
Age		

21-25	5	33.33
26 to 30	8	53.33
Above 30	2	13.33
Total	15	100%
Educational status		
College diploma	0	0
First degree	13	86.66
Second degree and above	2	13.33
Total	15	100%
Position		
Ass.manager	1	6.66
Auditors	1	6.66
Maker and checker	7	46.66
Accountant	2	13.33
customer service agent	3	20
branch manager	1	6.66
TOTAL	15	100%

Sour
ce: by
survey

questionnaire 2025

A. Gender Respondents

The above table 1 shows the respondents' gender in this study. It shows that 12 or 80 %) of the bank respondents were male while the remaining 3 or (20%) were female.

B. Age of the Respondents

The Above table 1 , indicates, the majority of the respondents 2 or (13.33%) were aged above 30 year, 8 or (53.33%) of respondents were within the age range of "26-30" years and 5 or (33.33%)

of the respondents were aged between “21-25” years old, so that most respondents are aged above 26 to 30 year, this indicates that the respondents have better Experience and the other respondents who are aged 21 to 25 shows as; there is better service in the bank.

C. Educational Status of the Respondents

Regarding to the educational background, above table 1 shows that the highest frequency, 13 or (86.33) of respondents possessed first degree and there is no diploma holders, in the bank and 2 or (13.33%) of the respondents’ having educational qualification of second degree and above. This implies that, the bank has got better educated employees.

D. Positions of the Respondents

The above table 1 shows that the majority of the respondents 7 or (46.66%) serving the bank as checker and maker 3 or (20%) of respondents serving the bank as customer service agent and 2 or (13.33%) of the respondents working as an accountant, the remaining Assistant manager, auditors, branch manager have 1 or (6.66%) respectively. This indicates the respondents in the study have good knowledge and information about the credit risk management of the bank

Credit facility of dashen bank.

Table 4.2 What is credit facility of dashen bank?

Credit facility	Frequency	Percentage
Transport loan (trans loan)	10	66.7
Personal loan (pears loan)	14	93.33
Agricultural loan (agree loan)	3	20

Domestic teach and service (DTS)	5	33.33
construction	8	53.33
Working capital fund (wcf)	8	53.33

Source: by survey questionnaire 2025

From above tables 93.33% or most of the respondents agreed that, dashen bank that gives credit facilities to the personal loan. This implies that, the bank that gives credit facilities in a good way to personal loan because the credit risk of personal loan is less when compare to other facilities in addition to this the the above table indicates that creditors pay their loan on time.

Table 4.3 .which credit facilities of the bank have more risk from alternatives of above?

Credit facility	Frequency	Percentage
Transport loan (trans loan)	10	66.7
Personal loan (pears loan)	14	93.33
Agricultural loan (agree loan)	3	20
Domestic teach and service (DTS)	5	33.33

construction	8	53..33
Working capital fund (wcf)	8	53.33

Source: by survey questionnaire 2025

From above tables respondents agreed that agricultural loan has more risk than another because of economic volatility and different natural disasters according to Ethiopian condition most of agrarian peoples faced to drought because of seasonal fluctuation of rainfall. So those and another conditions are hindered the agricultural loan to become more credit risk faced, and creditors not pay the loan on on time as a result the bank does not provide credit facility to agricultural loan because credit risk of agricultural loan is high when compare with others.

4.2 Credit risk management of the Bank

Analysis of the credit worthiness of the Debtors

A question had been asked so as to find out the attitude of management and employees towards the bank's ability to collect enough information about the debtors. Summary of the responses are summarized in the table below:

Table 4.4 Does the bank collect enough information about creditor before providing loan?

Responses	Frequency	Percent
Yes	15	100
No	0	0
Total	15	100

Source: by survey questionnaire 2025

As displayed in the above table, 15 or 100% of the respondents were agreed that the bank carefully collects enough information about the debtors before approving the loan application. So

that it helps how much dose the bank should borrow to its customers and to know the profit of the bank before owe.

Determinants of credit worthiness of the debtors

A question had been asked so as to find out the attitude of management and employees towards the bank. This question determined how the bank consider credit applicant during providing loan?

Table 4.5 What factor do you consider in selecting credit applicant?

Responses	Frequency	Percent
Profitability of the business	6	40
Liquidity ratio	0	0
strength of collateral	8	53.33
some other factors	1	6.66
Total	15	100

Source: by survey questionnaire 2025

As the above table portrayed majorities of the respondents, 8 or (53.33%) had strongly responded that the bank believes in strength of collateral and collects enough information about the collateral submitted by the debtors. Whereas the others 6 or (40%) of the respondents replied that the bank belies and collects enough information about the profitability of the business of the debtors, and liquidity ratios of the debtors are no respondent. While the remaining 1 (6.66%) or of the respondents believes that the bank collects enough information about the history of the debtors in repaying their debts owed.

Methods of identifying credit risk

One question was forwarded to the respondents as to whether the bank uses different methods of identifying the credit risk. Summary of the respondents is presented hereunder:

Table 4.6. Methods of identifying credit risk.

Responses	Frequency	Percent
Yes	15	100
No	0	0
Total	15	100

Source: by survey questionnaire 2025.

As the above table shows that all, 15 or 100% of the respondents had strongly agreed that the bank employs different methods to identify the credit risk. Those are by studying customer background or by knowing your customer the bank considers the investment sector/area of the debtors and the current economic condition of the country as the major methods to identify the credit risk.

Table 4.7 what does the measurement of the bank use for Customer to give them credit?

Responses	Frequency	Percent
Collateral	0	0
Condition		0
Character	0	0
Capacity.	0	0
All 5c are used as a measurement	15	100%
Total	15	100

Source: by survey questionnaire 2025

According to the respondent for the above question is dashen bank use all 5cs as the measurement to be give the credit to the customer. This implies the bank have strong measurement to be give the credit as respondents response.

Table 4.8 What are the risks that faced by Dashen bank?

Response	Frequency	Percent
Credit risk	2	13.33
Financial risk	4	26.66
Liquidity risk	7	46.66
Business risk	2	13.33
Total	15	100

Source: by survey questionnaire 2025

From the above table most of respondents were agreed that 46.66 % of risk is comes from Liquidity risk and 26.66 % of risk comes from financial risk & respondents agreed another 13.33% of respondents argued that risk is comes from business risks and credit risk respectively; fro this the researcher concludes the bank should be try to minimize risk that comes from credit.

Preventive mechanisms of credit risk

The other question forwarded to the respondents was as to whether the bank uses different mechanisms of credit risk. The respondents reply is presented here under:

Table 4.9 Preventive mechanisms of credit risk.

Responses	Frequency	Percent
Yes	13	86.6
No	2	13.33

Total	15	100
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Source: by survey questionnaire 2025

The above table revealed that, 86.6% of the respondents had strongly agreed that the bank uses different mechanisms to avoid credit risk but 13.33% of the employee oppose. The analysis of credit worthiness of the debtors and continuous follow ups helps the bank to avoid or minimize the potential credit risk associated with such outstanding loans. so the bank should do some activist or promotion in order to aware the rest 13.33% who oppose. to protect credit risk before occurrence dashen bank takes different mechanisms like analyzing the market condition, credit type, current economic and political conditions in to considerations.

Table 4.10 Do you think majority of customers repay their debt on time?

Responses	Frequency	Percent
Yes	13	86.6
No	2	13.33
Total	15	100

Source: by survey questionnaire 2025

From above table 86.6 % of respondents agree the customers repay their debt on time but the rest 2or (13.33%) of respondents agree that most of customers are not repay their debt on time because of bankruptcy.

11. What is the reason for late repayment?

Another question had been asked so as to find out the attitude of management and employees towards the reasons for late payment of the debtors. A summary of the respondents is presented here under:

Table 4.11 Reasons for late repayments

Responses	Frequency	Percent
Bankruptcy	8	53.33
Lack of knowledge	4	26.7
Unwillingness	3	20
Total	15	100

Source: by survey questionnaire 2025

As the above table 11, shows that the majority, 8 or 53.33% of the respondents had responded that bankruptcy are the major reason for late repayments by the debtors. While the remaining 3 or (20%) of the respondents believe that the reason for late repayments is unwillingness of the debtors to repay back the amount owed and 4 or (26.7%) had responded the reason is lack of knowledge.

12. What measure do you take to enforce early payment?

According to most respondent early payment is forbidden in the contract. The bank provides the debtors a discount to encourage them to repay back the amount owed within the discount period, and by giving enough time to repay their debt. However, if they fail to repay back within the discount period, Dashen bank uses different mechanisms to enforce late repayments. The bank employs a strict follow ups on the business of the debtors so as to repay back on the due date. and also most of the respondent suggests to reduce credit risk is ‘business consultation’ as a means to reduce credit risks.

Table 4.12. Do you think that dashen bank properly handle credit risk?

Responses	Frequency	Percent
Yes	14	93.33
No	1	6.6
Total	15	100

Source: by survey questionnaire 2025

From above table 93.33 % or most of respondents agree the bank properly handle the credit risk properly, because most of the time the bank take appropriate measurement on 5Cs and by knowing the customer of the bank. But the rest 1or (6.6%) of respondents opposed that, the bank does not properly handle credit risk.

14. How does the bank follow up creditors whether they are running the business or not?

According to the respondent's information the bank follow up the creditors whether they are running the business or not by: Firstly creditors communicate or make relationship with the manager of the bank, secondly by observing day to day working area of the creditors in order to check the work is performed properly.

Chapter Five

5. Conclusion and Recommendations

5.1 Conclusion

Research studies on the credit risk management of dashen bank remained less area of empirical research. Thus, this study has examined the credit risk management system of Dashen bank. The primary sources of data were used. Primary data was collected from questioners.

Regarding the attitude of management and employees towards the bank's ability to collect enough information about the debtors, all 15 or 100% of the respondents were agreed that the bank carefully collects enough information about the debtors before approving the loan application.

Respondents' views towards the determinants of the credit worthiness of the debtors usually considered by the bank area, 8 (53.33%) of the respondents had strongly responded that the bank believes in strength of collateral and collects enough information about the collateral submitted by the debtors. Whereas the others 40%, and 6.6% of the respondents replied that the bank believes and collects enough information about the profitability of the business of the debtors, and some other factor respectively. While the remaining respondents does not believes that the bank collects enough information by liquidity ratio in repaying their debts owed. As respondent implies most of the time the bank face credit risk and bankruptcy is the reason to be late repayment and also the bank use all the 5c mechanism as a measurement to give credit to the customers.

The respondents view as to whether the bank uses different methods of identifying the credit risk is; all, 100% of the respondents had strongly agreed that the bank employs different methods to identify the credit risk. The bank considers the investment sector/area of the debtors and the current economic condition of the country as the major methods to identify the credit risk.

Almost, 86.6% of the respondents had strongly agreed that the bank uses different mechanisms to avoid credit risk. The analysis of credit worthiness of the debtors and continuous follow ups

helps the bank to avoid or minimize the potential credit risk associated with such outstanding loans.

The majority, 53.33% of the respondents had responded that bankruptcy is the major reason for late repayments by the debtors and 26.7% of the respondents believe that the reason for late repayments is lack of knowledge. While, the remaining 20% is unwillingness of the debtors to repay back the amount owed.

Usually dashen bank uses different mechanisms to enforce late repayments of outstanding loans. The bank provides the debtors a discount to encourage them to repay back the amount owed within the discount period. However, if they fail to repay back within the discount period, the bank employs a strict follow ups on the business of the debtors so as to repay back on the due date.

5.2 Recommendations

Based on the findings, the researcher would like to forward the following recommendations:

- ❖ The bank should carefully consider all the strength of collateral, profitability of the business and the history of the debtor before approving the loan application so as to decrease or avoid the credit risk associated with the outstanding loans.
- ❖ Based on the unanimous agreement among all respondents regarding the bank's thorough approach to collecting information about debtors before loan approval, it is recommended that the bank continue to enhance its data collection and analysis processes. This could involve investing in advanced analytical tools and technologies to further streamline the evaluation of debtor profiles, ensuring that the bank maintains its high standards of due diligence. Additionally, regular training sessions for staff on best practices in information gathering and assessment can help sustain this positive attitude and reinforce the importance of informed decision-making in lending practices.
- ❖ To further strengthen its efforts in mitigating credit risk, the bank should continue to refine and expand its mechanisms for assessing debtor creditworthiness. This can be achieved by integrating advanced predictive analytics and machine learning models that analyze historical data and identify potential risk factors more accurately. Additionally,

implementing a proactive communication strategy for continuous follow-ups with borrowers can enhance relationship management and facilitate timely interventions when early signs of repayment issues arise. By fostering a culture of vigilance and responsiveness, the bank can not only minimize potential credit risks but also improve overall customer satisfaction and loyalty.

- ❖ To address the issue of late repayments effectively, the bank should implement a comprehensive financial education program aimed at improving borrowers' understanding of credit management and repayment obligations. This program could include workshops, online resources, and personalized financial counseling to equip debtors with the knowledge and skills necessary to manage their finances more effectively, thereby reducing the likelihood of bankruptcy and late payments. Additionally, the bank should consider developing tailored repayment plans that accommodate borrowers' financial situations, fostering a sense of partnership and commitment to repayment. By addressing both the lack of knowledge and the willingness to repay, the bank can enhance its overall credit performance and support its customers in achieving financial stability.
- ❖ To enhance its effectiveness in managing late repayments, Dashen Bank should consider implementing a tiered incentive program that not only offers discounts for early repayment but also introduces graduated penalties for late payments. This approach could motivate debtors to prioritize repayment by clearly communicating the financial benefits of paying on time while also establishing a structured follow-up system that includes personalized reminders and support. Additionally, the bank could offer flexible repayment options or restructuring plans for borrowers facing genuine financial difficulties, fostering goodwill and encouraging long-term customer loyalty. By balancing incentives with supportive measures, Dashen Bank can improve repayment rates while maintaining positive relationships with its clients.
- ❖ The bank should enhance its preventive mechanisms of credit risk and continuous follow ups of the debtors.
- ❖ The bank should provide more discounts so as to encourage early repayment of outstanding loans. In addition to this the bank should be given enough time to initiate customers to repay their debt

- ❖ The researcher recommends that the bank to be focuses on the business consultation to reduce credit risk.

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Appendix

Wolkite University

Faculty of business and economics

Department of Management

Questioner will be completed on employee of dashen bank in branch

The purpose of this questioner is to collect data for the assessment of credit risk management, for the partial fulfillment of bachelor degree of art in Management. Please take your time to complete the questionnaire & return it as soon as possible. Any of the information you provide below will not be used for any other purpose it's only academic purpose. Please put a check mark (✓) in the boxes of your choose. Try to answer all the questions.

Thank you in advance

Directions:

You are not supposed to write your name.

Your response will be confidential; it will be used only for academic purpose.

Please put "X" mark on the space

You can select more than one alternative

Part 1

Personal Information

Sex: Male Female

Age: 21-25 26-30 >30

Educational Background: Diploma Degree Masters& above other

1. In what position are you working in the department

Ass, manger maker and checker customer service agent

Branch manager auditor accountant

Part 2

Related question

2. What is credit facility of Dashen bank?

PERS (personal loan) AGRE(agricultural loan)

Transport loan (trans) DTS(domestic teach and service loan) construction
working capital fund(cwf)

3. Does the bank collect enough information about creditor before providing the loan?

Yes No

4. What factor do you consider in selecting credit applicant?

Profitability of the business strength of collateral

Liquidity ratio some other factor

5. IS there any method to identify credit risk?

Yes No

6. What does the measurements of the bank use for customers to give them credit?

Collateral character
Condition capacity capital all 5C

7. What are the risks that faced by Dashen bank?

Financial risk business risk
Liquidity risk credit risk
If others please specify

8. Do you think that the bank use any protective mechanism before occurrence of credit risk

Yes No

9. If you say yes for question number 10 what are the mechanism used to protect credit risk

Collateral and Security **Credit Risk Assessment and Analysis**
Diversification **Credit Insurance**
Loan Covenants

10. Do you think majority of customer repay their debt on time?

Yes No

11. If you say NO for question number 12 what is the reason for late payment?

Bankruptcy unwillingness
Lack of knowledge use for other objective

12. What measure do you take to enforce early payment?

Incentives for Early Payment

Clear Payment Terms

Automated Payment Reminders

Penalties for Late Payment

13. Do you think that Dashen bank properly handle credit risk?

Yes No

14. How does the bank follow up creditors whether they are running the business or not?

Regular Financial Reporting

Site Visits and Inspections

Monitoring Bank Accounts

Covenants and Compliance

15. Please give, if any suggestion you have to reduce credit risk exposure?

Strengthen Credit Assessment Processes

Diversify Credit Portfolio

Implement Strong Credit Policies

Collateral and Security