ISSN: 0975-833X

Available online at http://www.journalcra.com

International Journal of Current Research
Vol. 10, Issue, 04, pp.68164-68174, April, 2018

INTERNATIONAL JOURNAL OF CURRENT RESEARCH

RESEARCH ARTICLE

CREDIT RISK MANAGEMENT PRACTICES IN THE BANKING SECTOR IN ETHIOPIA

[1]Dr. Sk. Shahida Saheb and [2,*]Dr. CH. Venkata Krishna Reddy

[1]Assistant Professor, College of Finance, Management and Development, Ethiopian Civil Services University, CMC, Addis Ababa, Ethiopia

[2]Assistant Professor, Department of Public Financial Management and Accounting, College of Finance, Management and Development, Ethiopian Civil Service University, Addis Ababa, Post Box No.5648, Ethiopia

ARTICLE INFO

Article History:

Received 25th January, 2018
Received in revised form
17th February, 2018
Accepted 11th March, 2018
Published online 30th April, 2018

Key words:

Credit Risk Exposure of Banks
Significance and scope of the Study.

ABSTRACT

The researcher starts this study to find a solution on the country's banking industry credit risk management. The researcher evaluates this banks credit risk management practice by the credit risk management principles Basel committee on bank supervision. Because if the banks can manage their credit risk the availability of finance will be better and initiate the investors to invest more. The researcher tailored the methodology well framed and persistent to the objective. Normative natured comparative study was conducted targeting two specific banks, with a mixed approach. data was planned to be from primary and secondary sources by wise use of purposive sampling. To find better practice that suit the country's economy and market the author compare two banks and identified their good practices and their gaps, and tip them with best practice of Central bank of Malaysia. The researcher learns there is even lesson to learn from one bank to other more than going outside to get best practices. And it seems NBE is playing a crucial role on providing directives and supervising their performance. The increase and volatility of NPL indicates there is lack of skill and knowledge in the banks to shape their strategy. And the increase in NPL exposes the bank to deterioration of their profit because NBE obliged them to hold provision by different percent in each classification of NPL. The banks are better to evaluate the payback culture and ability of borrowers rather than relying on collateral. The researcher recommend the banks to tailored their policy, strategy, procedure and manual according to their banks complexity.

Citation: Dr. Sk. Shahida Saheb and Dr. CH. Venkata Krishna Reddy, 2018. "Credit risk management practices in the banking sector in ethiopia", *International Journal of Current Research*, 10, (04), 68164-68174.

INTRODUCTION

Credit risk is the possibility of losing money due to the inability, unwillingness, or no timeliness of a counterparty to honor a financial obligation.. Banks are one of the many institutions that lend money for individuals and institutions to make profit. The large stake of those banks profit is from the lend money interest and related fees. But those banks face a challenge of collecting the money they lend which we call credit risk. Many banks in US like Sanderson State Bank, Haven Trust Bank, First Georgia Community Bank, and others ware collapsed or experienced financial problems due to incompetent credit risk management systems during the 2008 financial crisis. There system was characterized by high levels of insider loans, speculative lending, and high concentration of credit in certain sectors among other issues.

***Corresponding author:* Dr. CH. Venkata Krishna Reddy,**
Assistant Professor, Department of Public Financial Management and Accounting, College of Finance, Management and Development, Ethiopian Civil Service University, Addis Ababa, Post Box No.5648, Ethiopia.

Credit risk management practices and poor credit quality continue to be a dominant cause of bank failures and banking crises worldwide. "The economist" magazine wrote on September 7, 2013 edition "Low interest rates created an incentive for banks, hedge funds and other investors to hunt for riskier assets that offered higher returns. They also made it profitable for such outfits to borrow and use the extra cash to amplify their investments, on the assumption that the returns would exceed the cost of borrowing. The low volatility of the Great Moderation increased the temptation to "leverage" in this way. If short-term interest rates are low but unstable, investors will hesitate before leveraging their bets. But if rates appear stable, investors will take the risk of borrowing in the money markets to buy longer-dated, higher-yielding securities. That was indeed what happened." This was written by "The economist" after the 2008 financial crisis in US. And on the same edition "The Economist" writes failures in finance were at the heart of the crash. But bankers were not the only people to blame. Central bankers and other regulators bear responsibility too, for mishandling the crisis, for failing to keep economic imbalances in check and for failing to exercise proper oversight of financial institutions. But the regulators made mistakes long before the Lehman bankruptcy, most notably by tolerating global current-account imbalances and the housing bubbles that they helped to inflate.(The economist magazine September 7, 2013 edition)

Statement of the problem

Commercial banks in the world make most of their profit by lending money and investing on different instruments. This part of the banks activities make them vulnerable to credit risk. Credit risk is a risk which has a capacity to wipe out most of the bank capital. Now days, the world's economy becomes highly volatile. On a study conducted by Pirner, D((2003), 'Risk Management in Czech Banking, Banking) showed that from total exposure of Czech banks credit risk makes up 60 – 70 %, operational risk 20 – 30 % and market risk only about 10 %. Access to Finance Still a Problem in Ethiopia, World Bank in a study it undertook identified 10 major problems Ethiopia has been facing and at the top of these is problem of finance. Ethiopia is found at very low level of performance compared with its neighbors.

If we go through the loan portfolio of Ethiopian commercial banks we will find the problem that this study wish's to solve. As the annual report of National bank of Ethiopia shows most of the private banks loan is given to domestic trade and service and the public banks' loan is given to manufacturing. For your awareness let's take a good look on the annual report of Commercial bank of Ethiopia (CBE) & Awash international bank (AIB) on 2012/2013 or the annual report of National bank of Ethiopia on those years: National bank of Ethiopia reported the lended money in the country from is from the public bank, most (50.443%) of the lend money and advances is from CBE and from the private banks is from AIB (5.5%)(Annual report of NBE 2013/14). According to2merkato.com write by coting 'The reporter newspaper (2014)' all private banks in Ethiopia earned a combined total profit of 4.6 billion birr that AIB takes out of it 861 million birr of it and CBE earn 9.7 billion birr in the year of 2013/2014. CBE gives most of its loan for manufacturing sector but AIB gives its most loans for domestic trade and service. We all know that the manufacturing sector is more risk than domestic trade and service because of time lap and amount of money in simple scenario. So, it seems like the biggest private commercial bank is in avoiding of credit risk and holding back to give loan for financing the manufacturing which is true even for the agriculture. A case study conducted by Felix Sabeza, Jaya Shukla, Gaurav Bajpai (2015) concluded that there is a direct relationship between credit risk management and profitability of the banks. Objectives

Objectives of the study

The main objective of this study was to asses and compare credit risk management practice between Commercial bank of Ethiopia (CBE) and Awash international bank (AIB).The researcher had wanted to address the following specific objectives for the accomplishment of the general objective.

- Describe the current credit risk management practice in Commercial bank of Ethiopia (CBE) and Awash international bank (AIB).
- Evaluate the current credit risk management practice in Commercial bank of Ethiopia (CBE) and Awash international bank (AIB).
- To recommend the best practice according to internationally accepted credit risk management practices.

Research Questions

In pursuit of the specific objectives, this study was seeking to answer the following questions:

- How CBE and AIB are managing their credit risk currently?
- What extent is their management practices are efficient while compared to Basel Committee on Banking Supervision credit risk management principles?
- What are the best credit risk management practices missing in CBE and AIB?

Significance and scope of the study

It highlights the major tools or techniques that can be used by Ethiopian commercial banks to manage their credit risk. It will help Ethiopian commercial banks by providing information in credit risk management and give a chance to see their loopholes and initiate for improvement.

National bank of Ethiopia may benefit from this study to improve the current policy lived on commercial banks in the country. The study was conducted in Ethiopian context and it covers Commercial Bank of Ethiopia (CBE) and Awash international bank (AIB) for the period 2004/5-2014/15G.C. This study covers only the credit risk management practice aspects of Commercial bank of Ethiopia (CBE) and Awash international bank (AIB).

LITERATURE REVIEW

Theoretical Literature review

Credit Risk

Credit risk is defined as the probability that some of a bank's assets, especially its loans, will decline in value and possibly become worthless. Because banks hold little owner' capital relative to the aggregate value of their assets, only a small percentage of total loans need to go bad to push a bank to the brink of failure. Thus, management of credit risk is very important and central to the health of a bank and indeed the entire financial system. As banks make loans, they need to make provisions for loan losses in their books. The higher this provision becomes, relative to the size of total loans, the riskier a bank becomes. An increase in the value of the provision for loan losses relative to total loans is an indication that the bank's assets are becoming more difficult to collect (Tshore, Aboagy and Koyerhoah Coleman 2011).

Credit Risk Exposure of Banks

The current standardized approach includes two options for applying risk weights to banks. Option 1 links a bank's risk weight to the sovereign rating of the country in which the bank is incorporated, while Option 2 applies the risk weight that corresponds to a bank's credit rating. In revising the treatment of bank exposures, the Committee aims to remove both references to external credit ratings and the link to a sovereign's credit risk. The Committee seeks to develop a single approach based on two risk drivers that are relevant to banks.

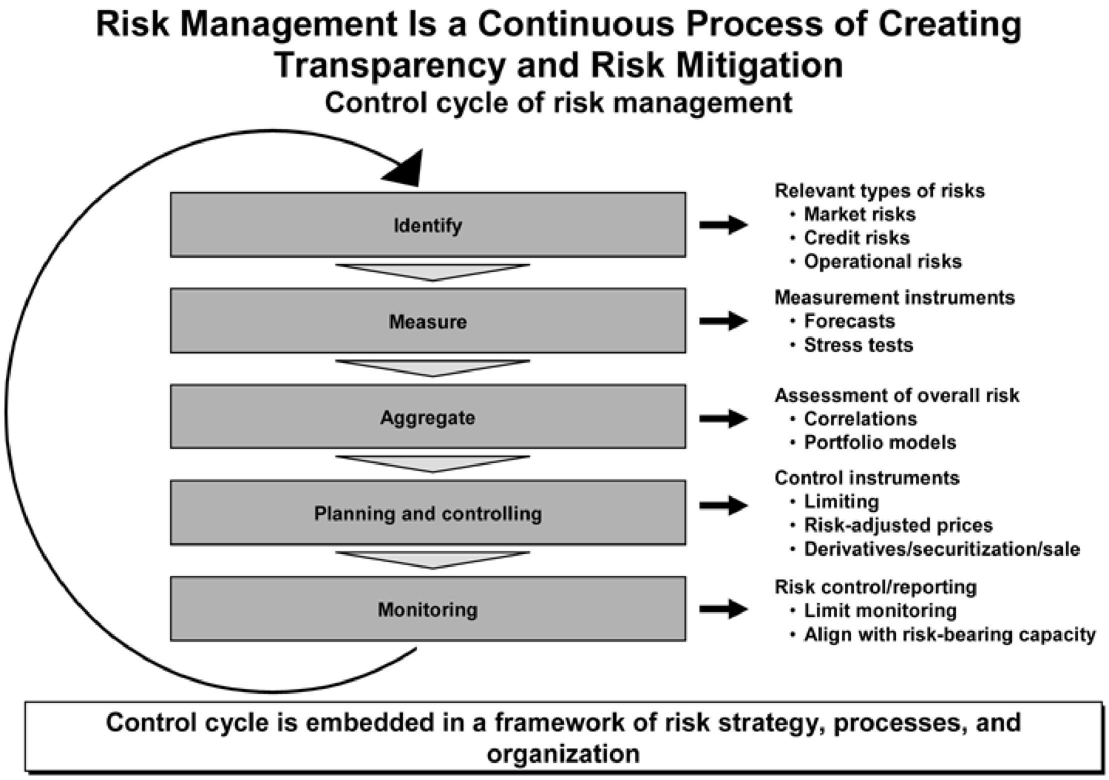
Definition of credit risk management

"Credit Risk Management" Credit Risk Management is the process of controlling the impact of credit risk-related events on the financial institution and involves the identification, understanding, and quantification of the degree of potential loss and the consequential implementation of appropriate measures to minimize the risk of loss to the financial institution (guidelines on credit risk management for institutions licensed to conduct banking business under the banking act by eastern Caribbean central bank, may, 2009).

Functions of credit risk Management

According to the credit risk management guide line developed by "Oesterreichische National bank (OeNB) in cooperation with the Financial Market Authority (FMA) (December 2004)". Risk management contains identifiaction, Measurement, Aggregation and Planning and Management of credit risk., Typically banks encounter Credit risk, Market risk and Operational risk. There are further types of risks, such as strategic risks, or reputational risks, which cannot usually be included in risk measurement for lack of consistent methods of quantification.

"Credit risk management and its impact on performance, on Ethiopian commercial banks" by Girma Mekasha (2011).The researcher to conclude in the last section that banks with good credit risk management policies have a lower loan default rate and relatively higher return on asset. (GirmaMekasha 2011 Credit risk management and its impact on performance, on Ethiopian commercial banks).A study "Credit Risk Management and Profitability of Commercial Banks in Sweden "which was studied by Ara Hosna, Bakaeva Manzura And Sun Juanjuanin 2009. Their finding result shows that ―credit risk management affects profitability of those banks significantly. Ara Hosna, Bakaeva Manzura And Sun Juanjuan in 2009 Credit Risk Management and Profitability of Commercial Banks in Sweden."Assessing Credit Risk Management Practices and Performance of Commercial Banks in Rwanda" (Case Study of Banque Populaire Rwanda 2011-2013) by Felix Sabeza, Jaya Shukla, Gaurav Bajpai. By this study the researchers found that there is a direct relationship between credit risk management and profitability of commercial banks. (Felix Sabeza, Jaya Shukla, Gaurav Bajpai 2013 Assessing Credit Risk Management Practices and Performance of Commercial Banks in Rwanda (Case Study of Banque Populaire Rwanda 2011-2013))



Source: "Oesterreichische National bank (OeNB) in cooperation with the Financial Market Authority (FMA) (December 2004)"

Figure 2.1. Risk management process of transparency and mitigation.

Empirical literature review

In a study "Credit risk management and profitability of commercial banks in Ethiopia" by Tibebu Tefera (2011).The researcher examines the impact level of credit risk management towards the profitability of commercial banks in Ethiopia in general. It argues that credit risk management has significant impact on profitability of banks of Ethiopia.. The researcher purposively takes seven banks that have ten year and above life span in Ethiopia. (Tibebu Tefera 2011 Credit risk management and profitability of commercial banks in Ethiopia).

"Bank Performance and Credit Risk Management in Qatar" which was studied by Takang Felizachou & Ntui Claudine Tenguh in 2008. In their study result shows that ―There is a significant relationship between bank profitability and credit risk management (in terms of loan performance). (Takang Felizachou & Ntui Claudine Tenguh 2008 Bank Performance and Credit Risk Management in Qatar).

Research Design

The researcher used mixed approach, i.e both qualitative with quantitative approaches.

Table 4.1 Summarized Presentation Of Interview

Questions	Commercial bank of Ethiopia	Awash international bank
1.How you are managing your banks credit risk?	By National bank of Ethiopia directive and policy and the organizational structure. The banks policy and procedure has great role.	By National bank of Ethiopia directive and policy and the organizational structure.
2.Does the board of directors developed/stated strategic objective for the loan division of the bank?	BOD review and approve the strategy but the preparation is done by delegation.	Policy making starts form expert to department and branch, then approved by board of directors
3.If there is, is it consistent with the entire bank strategy and did it avoid any other objective?	From business perspective we can't say it's not consistent because there is more of government intervention and the bank is liable to work by the interest of the government.	Yes! It is consistent.
4.Who has the authority to establish credit risk management in policy or procedure your bank?	BOD	Credit risk management division under the risk and compliance directorate.
3.Does your organization have a documented credit risk management policy revision procedure?	Yes! The revision procedure is incorporated in the document itself.	Yes! In the bank policy any document is liable to revision once in five years but it may be less by the demand of the expert or the board of directors.
6.Does credit risk management division independent form the marketing and sales divisions?	Yes! It is independent.	Yes! It is independent.
7.Is their separation of duty in credit giving and evaluation bodies?	Yes! Customer relation, credit appraisal, and approving committee.	They are separate analysis start form branch.
8. What is the input of the risk management while the bank introduces new credit risk affected products?	The risk management identifies the expected risks and identifies the management tools.	How to measure the risk, how to inject in the system, experience sharing and best practice.
9.Who evaluate the appropriateness of credit rating and management of borrowers and report the results?	The credit appraisal directorate director evaluates the credit rating and then the internal auditor has the mandate to evaluate.	It can be done at the branch by loan officer or at the hade office by the analysts. There is a measurement guide line prepared and it is measured according to the guide line.
10.Who decides the time that the loan is in doubt and how?	There is a system developed according to the NBE directive.	At the end of every month the monitoring and follow division produce a report according to the National bank of Ethiopia directive.
11.Did this bank rate a credit in accordance with the level of credit risk?	No! The banks' loan is provided with the same rate unless it is special case.	Yes! The bank gives loan with a rate 9 to 17 % interest rate.
12.How do you conduct the credit rating?	The bank has a grading tool used to rate customer but the rating starts from the customer service manager.	The bank has a grading tool used to rate customer and duration of loans is used in the rating of credit. And consider market and season.
13.Do you have a credit limit?	Yes! By sector and single borrower limit which is given by NBE, and there is a limit by committee and by district.	Yes! National bank of Ethiopia provide the limits and the bank modify some as the level of risk right under the given directive.
14.Who is responsible for the revision of credit limits?	•Credit appraisal •BOD •NBE	National bank of Ethiopia and for the bank risk and compliance directorate.
15.Did the bank use sectors as a condition or use different criteria among different sectors?	Yes! The bank has priority sectors not by risk rather by objective.	Yes! It favors manufacturing, export and domestic trade and service.
16.How you deal with problem loan?	According to the policy by legal and loan recovery directorate.	According to the policy by legal and loan recovery directorate.
17.Is there any special treatment for any loan proposing party?	No! Satisfy the criteria you will get the loan but sometimes the bank favor.	No!
18.How do you measure credit risk? Is there a written system?	Yes! It is subjective and ratio based (5 ratios).	With a grading tool developed by the bank.
19.Do you conduct a stress test?	Yes! Simple stress test quarterly by taking 20% of the loan and considering if it gets NPL.	Yes! The credit risk management takes a sample of 20 big borrowers every quarter and test the stress of the bank if they default.
20.How often does your organization change its guidelines or policies to manage risks?	It may be revised by minute to revise part of it but if the comprehensive revision will be conducted according to the schedule.	As much as necessary there will be a change.
21.How does your bank effectively communicate to reduce credit risk?	If urgent 1-2 days, if not it may take a weak.	The bank has a common sharing page that every news delivered to all staff every time, this make the communication faster and facilitated.
22.How often does your organization provide credit risk management training courses?	2 times a year.	Six times a year
23.Does the bank have internal credit rating system?	Yes!	The bank has well developed excel sheet to grade its clients balance sheet.
24.What challenges you face in credit risk management?	The business concept manipulated to fit the strategy. There is no sufficient data about the recent market. And compliance with other governmental organization.	Data fallacy and the newness of the concept.
25.What are the major kinds of method or process used in credit risk management?	No! Sophisticated model but the bank use internally developed matrix.	No! sophisticated model
26.What is your opinion about its suitability for your bank?	The bank believes it is suitablefor the time.	The bank believes it is suitable for the time.
27.What is your expectation from effective credit risk management in your bank?	The bank is not exercising fully to make profit it has another objective to accomplish. But if it holds the risk low we can say it is effective.	Mitigating expected risks and put them at low level.
28.How do you develop policy?	The right is to BOD but it's delegated to directors and get prepared. After the preparation the BOD review and approve it.	The preparation starts from officers and finally approved by the board of directors. But mostly adopted and best experience.

The achieve the objective of this study cross sectional collection of data for intensive analysis, longitudinal collection of data of intensive character because the researcher was conducting comparative case study which has more of normative comparison character. Document analysis looks like it gives the empirical data and previous interventions impact and interview can suite for the need of resent practice information. The interview shall contain semi-structured questions because the researcher doesn't want to escape a chance to know more by following fully structured questions or losing its scope by using unstructured questions and for the document analysis the researcher will go through risk management manual, annual report and if available other documents.

Sample Design

This comparative study will be conducted between two banks namely Commercial bank of Ethiopia and Awash international bank. The researcher find out these banks have their own risk management departments. Although these departments are separate from the other departments. So the population of the study will be the members of Commercial bank of Ethiopia's and Awash international bank risk management department staffs. The researcher had chosen its respondents by considering the experience of those officers in the department. The directors or chief officers were the first targets of the researcher. The target of the study was more of professional nature so the researcher was better to use non-probability sampling. Purposive sampling was preferable for such experience and knowledge requiring respondents' identification. This purposive sampling is done by following parallel sampling design. The researcher had planned to conduct interview for a qualitative data so, there was no need of determining the sample size. As mentioned above the researcher had planned to conduct comparative study. This type of studies requires deep investigation and professional respondents. The target of the researcher had been determined by the availability of the required information.

Source of Data

The researcher used both primary and secondary data for a better analysis of the previous and the present for its comparison. The primary data would get by the interview conducted on purposely selected peoples and the secondary data had been gathered form reports and manuals working in both banks.

Data presentation and analysis

The result of interview presentation

The researcher interviewed four peoples working in both banks, two from each. From AIB the researcher interviewed the hade of credit risk management division and one senior credit And they have 14 and 12 years' experience as well. And from the Commercial bank of Ethiopia the researcher interviewed one senior risk management officer and one senior officer and associate division hade of credit appraisal division. In the following table the researcher analyzed and summaries the response of the interviewee for a clear understanding and comparison of the readers. The banks respond to the researcher well. And the researcher observes there are differences and similarities among them. As well the banks seem implementing the NBE directive. Most of their similarity comes from the directives given by the NBE. It was seen there is difference on the communication, AIB has well organized communication infrastructure and CBE do not. Separation of duty seems a problem in AIB and good in CBE. On rating loans according to their risk level AIB take the upper hand. And for credit rating AIB has no sophisticated model and CBE get internally developed matrix.

Current credit risk management practice in Commercial bank of Ethiopia (CBE)

Commercial bank of Ethiopia is now managing its credit risk by two big systems: loan policy and procedures and organizational structure. This specific bank carries a big burden of being part of the banking industry and financing the economic development. Commercial bank of Ethiopia has a share of 53% loan and advances given by the banking industry in Ethiopia on the year 2014. This bank takes only 34.2% of the capital in the industry on the same year. Now a days the banks in Ethiopia become around 17, but it seems commercial bank of Ethiopia is growing faster and becoming bigger and bigger. This bank manages to get the biggest share of profit in the industry. Commercial bank of Ethiopia is giving a lot of its capital to loan and advance but stile managing it. One of the tools used by this bank is organizational structure. The bank put the credit management and credit appraisal and portfolio management under different vice presidents. And the customer handling and the credit appraisal is done in different directorates and the loan approving is done by a committee. If we see the NPL (Non-performing Loans) of this bank with the willingness of the bank the researcher was able to collect five years data with break down by sector. This helps the researcher to identify the weak spot of this bank.

It seems commercial bank of Ethiopia is facing the greatest non-performing loan on the manufacturing sector loan. And the construction and building sector has less and constant non-performing loan. The other loans seem well managed. To consider the size difference between the sectors the researcher goes through the loan portfolio of the bank. Then why the NPL of manufacturing sector loan elevate on the year 2015?. The portfolio shows there is a constant growth on the manufacturing sector loan provided by Commercial bank of Ethiopia. And the loan given to the building and construction is low. So, it seems the NPL is depending on the size of the loan provided. But the fast increase of the NPL on the year 2015 by the manufacturing seems there is something wrong with the credit risk management. Or there is something wrong with the economy and the bank is not good on considering the economic condition of the country. The increase on manufacturing sector seems it is form the increase in the outstanding as even it shows a bit elevated in the year 2015. The building and construction seems totally out lying on the year 2013 but the bank manages to control it and decrease the NPL by the subsequent years. Surprisingly the personal & emergency staff loan & mortgage loan is lifted from its constant flow by 12%. It's by different percentage but the manufacturing sector is increasing form the smooth flow. Other sectors in the portfolio seem well managed.

Current credit risk management practice in Awash international bank (AIB)

Awash international bank is a big and proud privately owned bank in the banking industry of Ethiopia. This bank makes 63% of its income from interest in the year 2013/14.

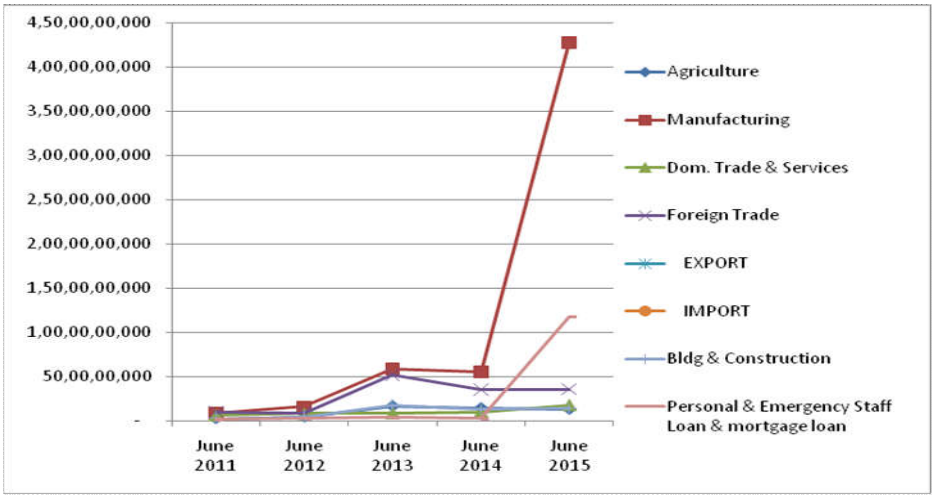


Figure 4.1 non-performing loan of commercial bank of ethiopia by sector for 5 sequential years (in birr)

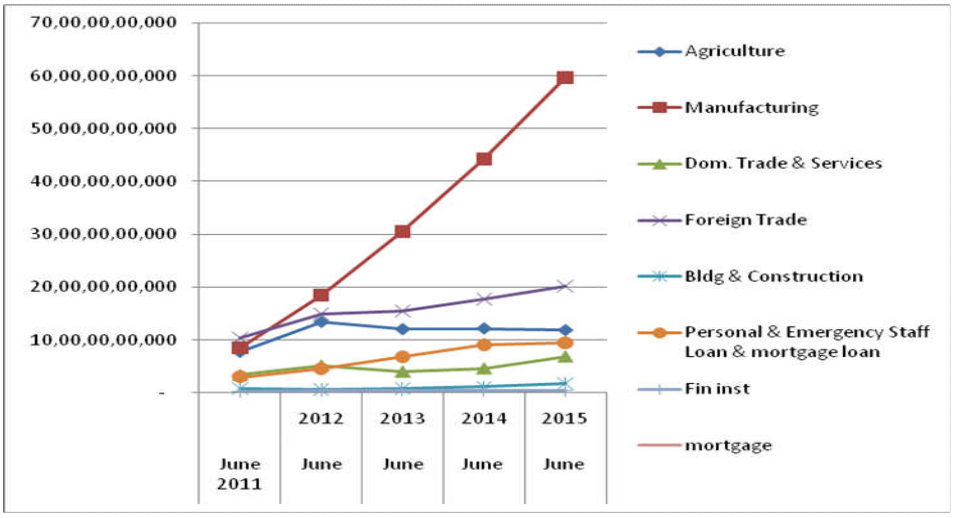
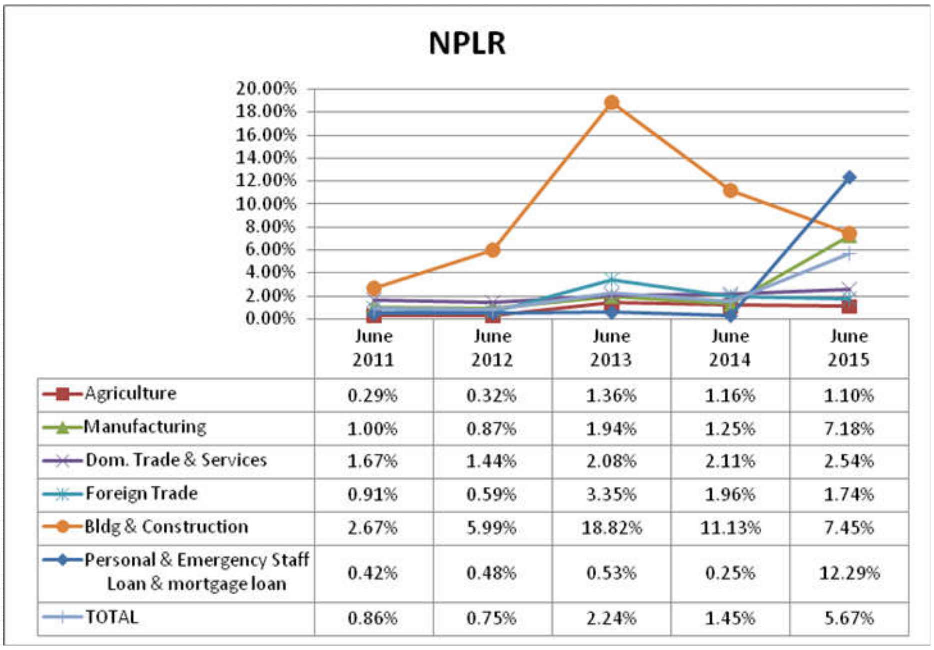


Figure 4.2 Total loan outstanding of commercial bank of ethiopia for five sequential years (in birr)



	June 2011	June 2012	June 2013	June 2014	June 2015
Agriculture	0.29%	0.32%	1.36%	1.16%	1.10%
Manufacturing	1.00%	0.87%	1.94%	1.25%	7.18%
Dom. Trade & Services	1.67%	1.44%	2.08%	2.11%	2.54%
Foreign Trade	0.91%	0.59%	3.35%	1.96%	1.74%
Bldg & Construction	2.67%	5.99%	18.82%	11.13%	7.45%
Personal & Emergency Staff Loan & mortgage loan	0.42%	0.48%	0.53%	0.25%	12.29%
TOTAL	0.86%	0.75%	2.24%	1.45%	5.67%

Figure 4.3 Non-performing loan ratio of commercial bank of Ethiopia

This banks credit risk management is done by the tool of National bank of Ethiopia (SB-43) and by the policy of the bank. And that the structure of the bank delegates the responsibility of the management to all parties and individuals who are part of loan giving process. The following graph shows non-performing loan of Awash international bank.

Widely spreader graph shows big volatility. As the graph shows there is problem on four sectors. Export, domestic trade and service, agriculture and building and construction are all volatile. The bank seems not able to manage the export sector. Or there was a big economical change on the year 2014 that affect the export sector and not detected by the bank at the time. for a wash international bank!

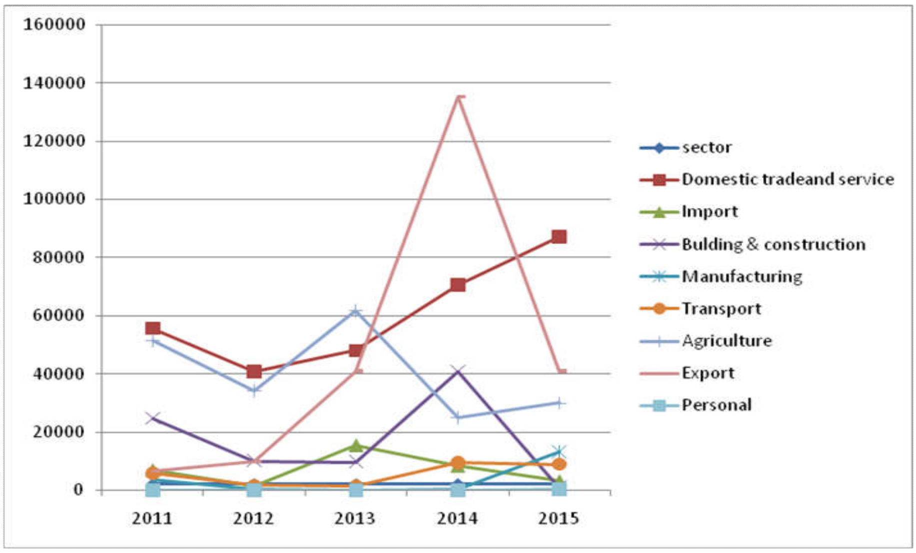


Figure 4.4. Non-performing loan of awash international bank for five sequential years (in thousends of birr)

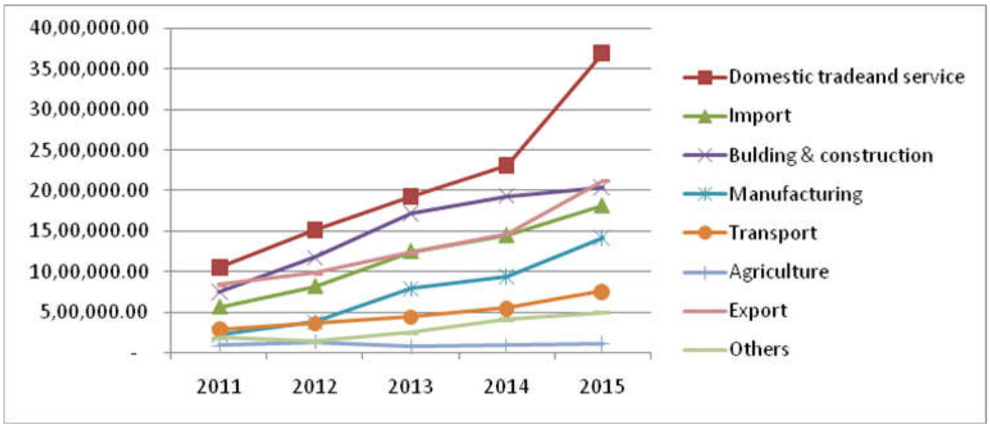
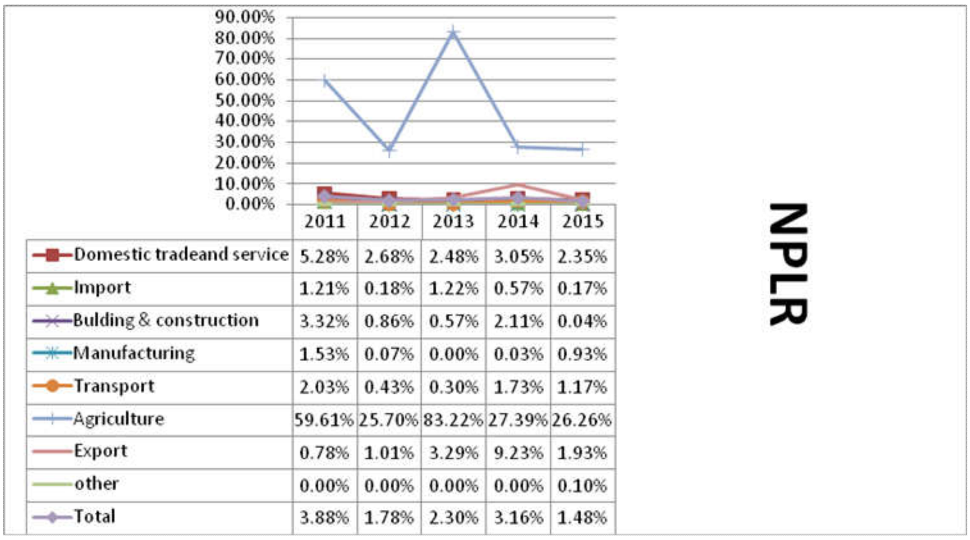


Figure 4.5 Loan outstanding of awash international bank for five sequential years (in thaousends of birr)



	2011	2012	2013	2014	2015
Domestic tradeand service	5.28%	2.68%	2.48%	3.05%	2.35%
Import	1.21%	0.18%	1.22%	0.57%	0.17%
Bulding & construction	3.32%	0.86%	0.57%	2.11%	0.04%
Manufacturing	1.53%	0.07%	0.00%	0.03%	0.93%
Transport	2.03%	0.43%	0.30%	1.73%	1.17%
Agriculture	59.61%	25.70%	83.22%	27.39%	26.26%
Export	0.78%	1.01%	3.29%	9.23%	1.93%
other	0.00%	0.00%	0.00%	0.00%	0.10%
Total	3.88%	1.78%	2.30%	3.16%	1.48%

Figure 4.6 The ratio of npl's from the total loan of awash international bank (nplr).

Table 4.2 Evaluating commercial bank of ethiopia and awash international bank by basel committee credit risk management principles

COMMERCIAL BANK OF ETHIIOPIA	AWASH INTERNATIONAL BANK
✓Did board of directors approve & revise the credit risk strategy?	
Yes!	Yes!
✓Does the strategy reflect the bank's tolerance for risk & expected profitability?	
?	?
✓Who is responsible for identifying, monitoring & control of credit risk?	
The bank has risk management division as a director level.	The bank establishes special division specifically for credit risk management under the director of risk management.
✓Does your bank identify credit risk in new products?	
The risk identification start from the one who propose the product and the directorate identify the remaining risks and ways to deal with them.	Products mostly adopted from other banks best experience and the strategies are adopted the same way.
✓Does board of directors approve new products?	
Mostly done by senior management	Yes!
✓If they did, are they aware of the level of credit risk?	
Yes!	Yes!
✓Do you have well defined credit granting criteria?	
Yes! Mostly the bank's concern is on the loan worthiness is on the borrower's personality.	Yes!
✓Is there a credit limit at the level of individual borrower?	
Yes! The bank implements the directive of the national bank of Ethiopia.	Yes! The bank implements the directive of the national bank of Ethiopia.
✓Do you have a clearly established process for approving, amending, renewal and refinancing of existing credit?	
Yes!	Yes!
✓Did the directors, senior management or other influential parties can override the established credit granting and monitoring process of the bank?	
No! But it is influenced by government's strategy.	No!
✓Is there a classification among the loan approving party?	
Yes! By three levels, there are three credit approving committees.	Yes! The bank has two committees and loans up to 2 million birr are approved by the branch.
✓Do you have in place a system for the ongoing administration of their various credit risk bearing portfolios?	
?	?
✓Do you have in place a system for monitoring the condition of individual credits, including determining the adequacy of provision and reserves?	
Yes! Every individual loan has credit manager for follow up and monitoring and the status will be determined by using the directive provided by National bank of Ethiopia by these managers.	Yes! The follow up is done by the branch and oversee is done by credit monitoring and follow up division, and the status will be determined by this division according to the directive of the National bank of Ethiopia.
✓Do you have internal risk rating system in managing?	
Yes	Yes
✓If you have, is it consistent with the nature, size and complexity of a bank's activity?	
No!	No!
✓Do you have information system and analytical techniques that enable the management to measure the credit risk inherent in all on- and off ✓balance sheet activities?	
The bank has an excel sheet which is well developed to grade the borrowers. It gives the approving committee the qualitative evaluation and quantitative coded and rated.	The bank has an excel sheet which is well developed to help the decision makers to get the eagle view about the borrowers.
✓If there is a system, is able to provide adequate information on the composition of the credit portfolio, including identification of any concentrations ✓of risk?	
It seems.	It lacks evaluating details.
✓Do you have a system in place for monitoring the overall composition and quality of the credit portfolios?	
Yes! There is directorate to evaluate the portfolio.	But the credit risk management division goes through the portfolio to see the degree of risk.
✓ Do you consider the future economic conditions when assessing individual credits and their portfolios and assess credit risk exposure under ✓stressful conditions?	
The bank follows the strategy of government and it helps the bank to find bigger market but not seems helping for the credit risk exposure.	The bank schedule its cash flow by seasons, try to avoid stressful conditions but stile it doesn't seems it's working.
✓Do you establish independent credit risk management division?	
No!	Yes!
✓If you have established the credit risk management division, is it responsible to board of directors and senior management?	
	No! It is administratively responsible to the president and accountable to board of director.
✓Is your credit granting function properly managed and that credit exposures are within levels consistent with prudential standards and internal limits?	
Yes!	Yes! With a little doubt.
✓Does your bank establish and enforce internal controls and other practice to ensure that expectations to policies, procedures and limits are reported ✓ in a timely manner to appropriate level of management for action?	
Yes! By the internal auditor, every case has its own time table and responsible officer.	It doesn't seem.
✓Do you have a system in place for early remedial action on deteriorating credits, managing problem credits and similar workout situations?	
Yes! The bank conducts stress test.	Yes! The bank conducts stress test.

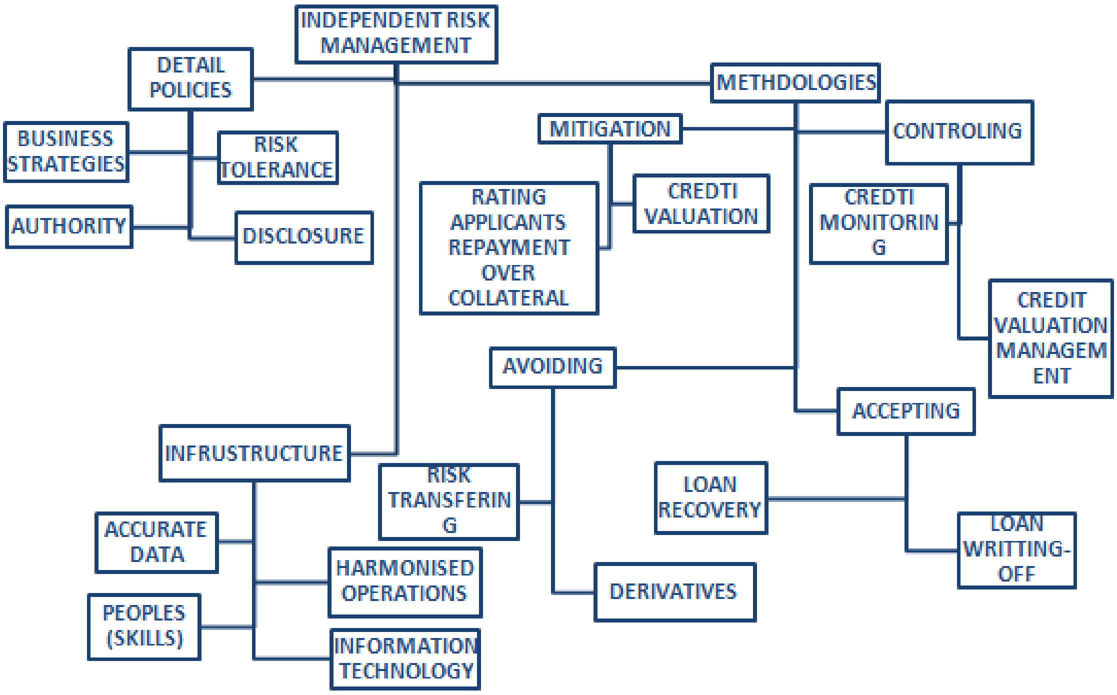


Figure 5.1. Credit risk management framework

The domestic trade and service sector is contributing a great share for NPL portfolio. And as we can see on the following graph the bank is giving more loans for this sector. Even while comparing the NPL graph the bank seems giving more loans for the sectors which have significant share in the NPL portfolio.

The following graph shows loan outstanding of Awash international bank.

This looks good the loan giving capacity of Awash international bank is increasing. But the danger is while you give loan for sectors that cause trouble. The bank is giving loan more and more to the sectors which cause more NPL to the bank. Awash international bank is not considering what is happening with the agriculture sector. The bank is giving fewer amounts to the sector but stile not managing it well. The amount given to the sector is increasing but the bank seems missing how this sector operates to manage the NPL in this sector.

Evaluating Commercial bank of Ethiopia and Awash international bank by Basel committee credit risk management principles

The researcher develop the following questions to evaluate both the banks by the principles provide by Basel committee on credit risk management. The researcher be leave answering the following questions can help to evaluate the current position of the two banks according to the principles. The developed 25 questions are from the given 17 principles of Basel committee on bank supervision. From the time the researcher spend in both banks by enter view and by document review the researcher was not able to find about risk tolerance. Both the banks claim they have tool to evaluate borrowers but the researcher is not satisfied with the adiquasy of the information it provide. At the same time the banks claim the follow the economic condition but the quantitative part of this study do not support that.

The NBE obliged the banks to istablish independent credit risk a management division in all banks of Ethiopia but the researcher was not find one in CBE.

Best practice for management of credit risk

The bank the researcher wanted to use as a benchmarking is the central bank of Malaysia (BANK NEGARA MALAYSIA).The Bank has further strengthened its financial stability framework and governance arrangements in the management of financial stability over the 10-year period. The regulation and supervision of financial institutions during this decade has become more risk-focused and pre-emptive to reflect the nature, size and complexity of different institutions. This has been accompanied by a significantly more pronounced focus for the effective oversight of financial institutions by boards and senior management.

The management of system-wide risks to financial stability has also been strengthened, with improved data and information, enhanced tools and methodologies, closer inter-agency and regional cooperation, and expanded financial stability powers. The following ten besat practices can be break in to four and can be part of the sound practices of credit risk management by Basel committee on bank supervision which is shown in the literature. According to bank of Negara Malaysia best practice guideline for managing credit risk is as follows (BANK NEGARA MALAYSIA (September, 2001)):

- The BOD is expected to adopt a supervisory role and be responsible for ensuring that adequate risk management processes are in place.
- The credit approving function should be performed by full time executive personnel or committee comprising of such. The BOD need to have veto power to reject or to modify loans.
- Banking institutions are required to set up a committee to specifically assist the BOD in overseeing the credit risk management process.

- Banking institutions are required to have a product evaluation program, which requires all new credit products to be signed off by all relevant departments affected by the product and approved by the committee or BOD.
- Banking institutions are requires to develop appropriate credit grading systems.
- Banking institutions are required to ensure that personnel involved in credit appraisal, credit approval and credit review are subject to common training programs, pass a common test and receive certification from accredited bodies or individual acknowledged by the BOD before being eligible to approve a credit proposal.
- Banking institutions are required to have an independent credit review department/ unit.
- Banking institutions are required to conduct stress analysis at least once every six months.
- Banking institutions are required to set an internal limit on single customer exposure.
- Banks are required to assess credit based primarily on repayment capacity rather than on collateral, which should be secondary.

From the above mentions best practices the Commercial bank of Ethiopia implement most of it and Awash international bank implement some of it. CBE's BOD delegate the responsibility of insuring that adequate risk management process to the process council. For AIB this responsibility is filled by the BOD. For credit approving function both banks have full time executive personnel or committee comprising of such. The BOD need to have veto power to reject or to modify loans. Banking institutions are required to set up a committee to specifically assist the BOD in overseeing the credit risk management process which CBE has neither AIB.

Banking institutions are required to have a product evaluation program, which requires all new credit products to be signed off by all relevant departments affected by the product and approved by the committee or BOD. Both banks implement it partially: AIB approve new products by BOD but not sure by all relevant departments; CBE present new products after it is approved by the process council, which is composition of relevant department's heads. As shown in the best practice banking institutions are requires to develop appropriate credit grading systems and both banks did. Both banks work on training officers and skill improvement which is not enough.
The separation of duty in CBE can be mentioned as the banking institutions are needed to have an independent credit review department/ unit but seems not for AIB. Thanks for the NBE it obliged the banks to do a stress test. The same is true for single borrower limit is set by NBE.

Conclusion and Recommendation

Conclusion

From the collected data, from the interview, document review and from process tracing the researcher finds the following gaps from each bank: Not properly framed policies, procedures and manuals, governments strategy was influencing on the business strategy of CBE, in the process there was redundancy of responsibility more in AIB, un monitored or too liquid policy and procedure exposed the banks for insider trading, and slow communication of changes in policy, procedure and manuals seems too risky.

These are not the only problems; the banks have a problem of predicting the economy and understand how the market operates. The skill gap shown in both banks on predicting the economy and limited understanding the market expose them to unseen risks. And from the evaluation the researcher conducted with the help of the principles provided by Basel committee on bank supervision the researcher understand the above mentioned problems are contradictions with the principles and further more the researcher observe less effective strategy on understanding the market and economy.

Recommendation

The banking sector is more sensitive area and the area do not tolerate big mistakes and require tid control and close supervision. Banking is interesting because you are talking about high profit but risky. To control the risk in this industry we need to have well-crafted policy, procedure and manuals, just tailored to your bank by well-educated and experienced people. Hear the tip on developing your credit risk management:

Prepare your frame work with the following benchmarks

- Policies: well-structured and tailored for your bank.
- Methodologies: these could be suitable for the market that you operate in.
- Infrastructure: NBE needs to prepare the macro infrastructure. And for the banks, you need to prepare the best infrastructure according to the complexity of your bank.

The researcher thought it seems if you implement the above recommendation that you can solve most of the problems. Job redundancy was seen in AIB and structure problem was seen it needs to be improved by taking the experience of CBE and fit it with the banks strategy. The process council used in CBE shares the burden of BOD and can lead the other banks to better performance. CBE is recommended to learn the infrastructure developed and used by AIB on its communication. Policy, procedure and manual changes need to be watched because they expose the banks to insider trading so; if you got the process council let them do it. The researcher recommend, if you have limited and controlled over riding rating results. The researcher wants to compliment AIB for the preparing credit application form in Amharic which CBE doesn't have.

For the supervisors which are the BOD in both banks the researcher wishes to highlight the following: Supervisors should be cautious against over-reliance on internal tools for credit risk management and regulatory capital. Where appropriate simple measures, could be evaluated, in combination with sophisticated modeling to provide a more complete picture. With the current low interest rate environment possibly generating a "search for yield" through a variety of mechanisms, supervisors should be cognizant of the growth of such risk taking behaviors and the resulting need for firms to have appropriate risk management processes. Supervisors should be aware of the growing need for high-quality liquid collateral, and if any issues arise in this regard they should respond appropriately. The Parent Committees should consider taking appropriate steps to monitor and evaluate the availability of such collateral. About the NPL these banks are having, each non-performing loan in the financial sector is viewed as an obverse mirror image of an ailing unprofitable enterprise.

From this point of view, the eradication of non-performing loans is a necessary condition to improve the economic status. If the non-performing loans are kept existing and continuously rolled over, the resources are locked up in unprofitable sectors; thus, hindering the economic growth and impairing the economic efficiency. Not only locking the resource that the bank lends to its customers. *The money you hold as provision is in lock, no profits on the NPL and on its provision.*

REFERENCES

AraHosna, BakaevaManzura And Sun Juanjuan in 2009. Credit Risk Management and Profitability of Commercial Banks in Sweden

Awash international bank 2011,2012,2013,2014 and 2015. Annual report of Awash international bank

Basel Committee on Bank supervision December, 2000 Sound practice for backstage counterparty credit risk models

Basel committee on bank supervision September, 2000 Principles of the management of credit risk

Central bank of Malaysia September, 2001 guide lines on Best practice for the management of credit risk

Commercial bank of Ethiopia (2011,2012,2013,2014 and 2015) Annual report

Commercial bank of Ethiopia 2015 profile 2014/15

Eastern Caribbean central bank May, 2009 Guidelines on credit risk management for institutions licensed to conduct banking business under the banking act

Felix Sabeza, Jaya Shukla, GauravBajpai2008 Assessing Credit Risk Management Practices and Performance of Commercial Banks in Rwanda (Case Study of BanquePopulaire Rwanda 2011-2013)

GirmaMekasha2011Credit risk management and its impact on performance, on Ethiopian commercial banks

IMF 2013 The growth comeback in developing economies: a new hope or back to the future.

National bank of Ethiopia 2014 annual report 2013/2014

National bank of Ethiopia 2014 directive SB-43-2007

Oesterreichische National bank (OeNB) in cooperation with the Financial Market Authority (FMA) December, 2004credit approval process and credit risk management

Pirner, D 2003, ‘Risk Management v českémbankovnictví‘, Bankovnictví)

Risk Basel Committee on Banking Supervision September, 2000Principles for the Management of Credit

TakangFelizachou&Ntui Claudine Tenguh 2008 Bank Performance and Credit Risk Management in Qatar”

TibebuTefera2011Credit risk management and profitability of commercial banks in Ethiopia

Tshore, Aboagy and Koyerhoah Coleman 2011 Credit risk and management and its impact on performance of banks

http://www.2merkato.com/news/alerts/3290-ethiopia-private-banks-made-46-billion-birr-gross-profit

http://www.addischamber.com/file/ICT/20140716/Addis%20Business%20June%20News%202006%20web.pdf

http://www.combanketh.et/AboutUs/CompanyProfile.aspx

http://www.economist.com/news/schoolsbrief/21584534-effects-financial-crisis-are-still-being-felt-five-years-article

http://www.economist.com/news/schoolsbrief/21584534-effects-financial-crisis-are-still-being-felt-five-years-article.

****