CREDIT RISK MANAGEMENT AND PROFITABILITY OF COMMERCIAL BANKS: A CASE STUDY OF ABSA BANK KABALE BRANCH

BY

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A RESEARCH REPORT SUBMITTED TO THE FACULTY OF ECONOMICS AND MANAGEMENT SCIENCE IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE A WARD OF A DEGREE IN BUSINESS **ADMINISTRATION** OF KABALE UNIVERSITY

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DECLARATION

I, Akanyijuka Bruno, hereby declare that this report is my original work and that it has not been submitted for any other award of a degree or certificate at any university or institution.

Signed .. /11~ Date: 18/02/23

APPROVAL

Thus research report has been prepared under my supervision and is now ready for submission **and** examination with my approval.

Signed ...... ~………………   Date: 20/02/23

Ms. **NYANGOMA MIRIA**

DEDICATION

This research report is dedicated to my beloved parents for their endeavors to pray and support ds the successful completion of my studies.

ACKNOWLEDGEMENT

Firstly, I thank the Almighty GOD for the gift of life, knowledge, wisdom and understanding he gave me throughout my education cycle a success.

Special thanks go to my supervisor Ms. Nyangoma Miria, who provided me with all the needed guidance thus writing this research successfully. I also wish to thank my respondents who furnished me with the necessary data for this study.

I also take this opportunity to thank my colleagues for their support they gave me during my studies.

May the Almighty God bless them abundantly.

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ABSTRACT

The study assessed the credit risk management and profitability of commercial banks taking ABSA bank Kabale Branch as a case study. The objectives of the were; to analyze credit risk management and profitability of commercial banks, to examine the present status of nonperforming loans, cash reserve ratio and capital adequacy ratio in commercial banks and to analyze the relationship between credit risk management and profitability of commercial bank.

The study adopted a quantitative paradigm since it statistical tools. The study used a descriptive design in order to describe the profile of the respondents in terms of age group of owners, level of education. The study population for this study involved all the staff of ABSA bank, Kabale branch. These included all the 64 staff of the institution from all the departments. The data was organized and financial ratios computed using Excel program in order to obtain the study variables. Data from questionnaires were summarized, using frequencies and percentages.

The study found that non-performing loans as a percentage of total loans has decreased from 8.3% year 2015 to 5.6% year 2022. Also the findings indicate that the average (mean) of default rate over the period of the study is 6.186% and this implies a bank's problem of defaulting loan by the customers. The study revealed that the gross loans have increased from 130.7 billion to 495. 7 billion and non-performing loans from 10.893 billion to 32.9 billion. In relation to what extent credit appraisal is used by ABSA, the majority (42.9%) of respondents reported to a great extent, 21. 4 % reported to a moderate extent, 19. 6% reported to a very great extent, while just 16.1 % reported to no extent by evaluating the character, record of meeting past obligations, repayment capacity, credit history as well as moral aspect of loan applicant, by requiring collateral as security for the loan, by considering the relationship with the customer, account performance, deposits etc.

This research also concluded that credit risk management practices including client appraisal, credit risk analysis, credit risk monitoring and control, lending policies are mostly used by ABSA to some great extent. The study also concluded the credit risk management contributes to bank performance and improves to some extent the financial performance of ABSA. This means credit risk management practices affect the bank performance and contribute to financial performance.

The study recommended the banking institutions to develop internal risk rating system to monitor the quality of loans portfolio. The study also recommends conducting credit risk analysis on businesses and individuals before lending. There is a need for banking institutions to enhance their internal credit risk assessment practices, develop a credit risk scoring analysis tools to assess loans applicants' capability as well as developing their own internal risk rating system to monitor the quality of all loans portfolio.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The banking industry worldwide has been more complex over the years because of rapid development and growth of financial security market. Consequently, the banks started to practice multiple compound operations without even perceiving the risks associated with these transactions (World Bank, 2016). As a result, the risk attitude and risk exposure of banks became more composite and subject to system failure and thus they caused to break down to economic system of the country where they operate. The governments of various countries tried to control the situations by practicing regulatory reforms in order to stabilize the economy (International Monetary Fund, 2017). However, it is worth to declare that these reforms did not work well and ended up with the similar outcomes such as financial volatility and economic downturn around the globe including UK. USA and other economies on which worlds' institutions are based to great extent.

During all the circumstances the most exposed risk, which was difficult to discover, was the credit risk. The significance of credit risk is enlarged by the reality that it is associated with the collateral problem. Hence, it becomes the most controversial topic to be discussed and explored. For dealing with credit risk, Basel II also practiced and adopted different Credit Risk Management Practices techniques. The primary objective of these practices was to improve the quality of Credit Risk Management without limiting the competitiveness of the banks worldwide.

Risk management means, increasing the likelihood of success, reducing the possibility of failure and limiting the uncertainty of all the overall financial performance. Best (2000) argues that the purpose of risk management is to prevent an institution from suffering unacceptable loss. He goes on to explain that "unacceptable loss" is one which either causes an institution to fail or materially damages its corporate position. Banks must monitor the ever changing micro and macroeconomic environment to identify the risks therein and find ways of managing these risks.

Well-regulated banks play a pivotal role in any given country's economy by providing financial services. Their intermediation role is a catalyst for economic growth (Kolapo, Ayeni & Oke, 2012). However, some commercial banks have approved loans without critical analysis of a snua.tion and ended up having defaulters, non-performing loans and extended credit (Kithinji, 2010). This clearly shows how commercial banks are exposed to risk. Risk lacks a universal definition because different scholars use different approaches to define risk. According to Gallati (2003) risk is a condition experienced in an environment of adversity or where there is possibility of deviation from a desired outcome that is expected or hoped for. Kanchu & Kumar (2013) defined risk as anything limiting the achievement of a certain predefined objectives. This definition agree with the business dictionary which defines risk as the probability or threat of damage, injury, liability, loss or any other negative consequences caused by external or internal vulnerabilities and that may be avoided through preemptive action.

Kanchu and Kumar (2013) defines risk management as a measure used to identify risk in advance, analyze and respond to a particular risk. Management of risk does not only involve reduction of chance of bad happenings but also ensuring the likelihood of good things occurring. Kithinji (2010) adds that good management is both a "defensive mechanism and offensive weapon" that is used by banks depending on the corporate governance. Risk management is undoubtedly crucial in financial institutions such as commercial bank and it calls for keen attention from shareholders, regulators, practitioners and scholars since many huge losses are witnessed as result of poor risk management an organization (Imane, 2014). Risk management culture should percolate from the first line employee to the board level (Crouhy, Gala & Marick, n.d.). Many corporate governance principles provide regulation and strategy with a sound risk management mechanism. There is a need to understand information regarding the portfolio of risks which according to Oldfield & Santamero (1997) can be segmented as: first, eliminable or avoidable risks through simple business practices; secondly, transferable risks like through insuring; and lastly, risk that call for active management at all level.

In the banking industry, there exist many different types of risks that affect the performance and activities of banks. Risk class is deemed to be either systematic (market) or unsystematic risk or financial and non-financial risk. More specifically these classes contain distinct risks according to what causes them such as credit risk, liquidity risk, operational risk, market risk, political risk, currency risk, strategic risk among others (Imane, 2014).

A study in Jordan by Imane (2014) examining risk management practices and financial performance in Islamic banking found out that liquidity, credit and operational risk management have negative and significant impact on financial performance while market risk management showed a positive and significant with financial performance. A different study in Bangladesh banks was conducted by Noman et al., (2015) on effect of credit risk on banking profitability. Credit indicators were non-performing "loan to gross loan (NPLGL), loan loss reserve ratio (LLRGL), loan loss reserve to non-performing loan (LLRNPL) and capital adequacy ratio (CAR) and profitability was assessed return on average asset (ROAA) and return on average equity (ROAE). The study using panel data revealed that there was a negative and significant NPLGL and LLRGL on all profitability indicators. CAR showed a negative and significant to only ROE.

Financial profitability refers to the act of performing financial activity. In broader sense, financial performance refers to the degree to which financial objectives being or has been accomplished. It is the process of measuring the results of a firm's policies and operations in monetary terms. It is used to measure firm's overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation.

Therefore, any instability in the banking sector can pose problems to the economic system as a whole. As financial institutions widen their territories, proper Credit Risk Management Practices plays a vital role in this regard by avoiding a framework for the entire credit management process and thereby resulting into good financial performance. Because poor Credit Risk Management Practices has historically been a major cause of bank losses and failures, effective management of this anomaly is fundamental to the bank's safety and soundness to stand in business. Credit Risk Management Practices is of great concern to financial institutions not only because it constitutes the largest asset and main source of revenue but also because it is the main cause of bank failure and closure (Adewale, 2008).

Profitability is the ability to make profit from all the business activities of an organization, company, firm, or an enterprise. It measures management efficiency in the use of organizational resources in adding value to the business (Soyemi, Ogunleye & Ashogbon, 2014). Profitability is the relationship of income to some balance sheet measure which indicates the relative ability to eam income on assets. Irrespective of the fact that profitability is an important aspect of business, it may be faced with some weakness such window dressing of the financial transactions **and** the use of different accounting principles (Aduda, 2011). Return on Assets (ROA) is a major ratio that indicates profitability of a bank. It is a ratio of income to its total assets (Khrawish, 2011). ROA shows the percentage of how profitable company assets are generating revenue (Susan et al., 2008). In other words; it shows how efficiently the resources of a company are used to generate income. Wen (2010), states that a higher ROA shows that a company is more efficient in using its resources.

Return on Equity (ROE) is a financial ratio that refers to how much profit a company earned compared to the total amount of shareholder equity invested or found in the balance sheet (Ongore, 2011). Willie and Hopkins (1997) indicated that the ultimate measure of strength of any financial institution is not its asset size, number of branches or the pervasiveness of its electronics but rather the true measure of its return on equity. Thus, the higher the ROE the better the company is in terms of profit generation. Therefore, the current study will adopt ROA and ROE as the measures of profitability in the commercial banks due to the efficiency utilization of resources and being indicator of financial institution strength respectively.

Absa Group Ltd (Absa Group) is a financial services provider. It offers banking, insurance, and financial products and services to individual, corporate, and SME clients. Its portfolio of banking products includes current and savings accounts, debit and credit cards, home and personal loans, vehicle and asset finance, and transactional and deposit products. It provides trade and working capital solutions and infrastructure and equity investments. Absa Group offers insurance coverage for life, death, disability, funeral, and retrenchment. Its service offerings include risk management, cash management, financial advisory, investment management, electronic banking, retirement, and fiduciary services. Its operations are spanned across Botswana, South Africa, Ghana, Kenya, Mauritius, Uganda, Tanzania, Mozambique, Seychelles, and Zambia. Absa Group is headquartered in Johannesburg, Gauteng, South Africa.

As one of Africa's largest financial services institutions, has expanded its consulting relationship with PIC Solutions by signing a Risk Mentor retainer contract. This Risk Mentor contract ensures that Absa Bank has access to professional resources from any area of PIC Solutions expertise. This includes credit risk management consulting, analytics, project management and software services. The Risk Mentor service is on a retainer-basis and ensures maximum **productivity,** combined with fixed monthly budgeting. This consulting contract will cover a year of support for the bank and it is planned that the PIC Solutions risk consultants will work across a wide range of banking decisions. The banking environment is constantly changing and clients' needs are changing with it This has created a great opportunity to expand our target market and product offering. We have enjoyed a close working relationship with PIC Solutions for a number of years and this Risk Mentor contract will provide Absa with an innovative means of obtaining consulting expertise, whenever it is required."

Collections and risk management will remain key focus areas. It is going to become increasingly important to invest in resources and technology to ensure that the Group has the right collections capability and optimal scorecards to ensure the correct balance between risk and reward.

1.2 Problem statement

Due to the cut through competition in the financial markets banks seem to be ready to grant much more loan, advances and other credit facilities against the spirit of credit policy guidelines. Unsecured loans and investment may cause the liquidation of those commercial banks on the funds. One wrongly invested without thinking any financial risk, systematic risk and their related facts, the bank cannot obtain profitable return as well as it should sometimes lose its principle (Poudel, 2017). Credit risk management is indeed a very difficult and complex task in the financial industry because of the unpredictable nature of the macroeconomic factors coupled with the various microeconomic variables which are peculiar to the banking industry or specific to a particular bank. Unfortunately, banks in Uganda have found themselves in such an unpredictable macroeconomic environment for a very long time. While there are several strategies of addressing the problem of instability and efficiency, the research attempts to investigate the factors that influence the determination of the banks' credit risk (Garr, 2013). Commercial banks of Uganda are exposed to five types of core risks through their operations which are credit risks, assets/liability risks, foreign exchange risks, internal control and compliance risks and money laundering risks. Among these risks management credit risks are complicated and more attention seeker. Credit risk is one of the vital risks for banks. Credit risks arise from non-performance by a borrower. It may arise from either and inability or an unwillingness to perform in the pre commitment contract manner. Credit risk affect book value of bank as well. The more credit risk, the more probability of bank to be insolvent. Therefore, it is from this background that the researcher intends to carry out a study on the effect of credit risk management and profitability of commercial banks.

1.3 Objectives of the study

The main objective of the study was to present the credit risk management and its impact on profitability of commercial banks.

1. To analyze credit risk management and profitability of commercial banks.

2. To examine the present status of non-performing loans, cash reserve ratio and capital adequacy ratio in commercial banks.

3. To analyze the relationship between credit risk management and profitability of commercial bank.

1.4 Research questions

1. What is the status of credit risk management and profitability of commercial banks of Uganda?

2. What is the present status of non-performing loans, cash reserve ratio and capital adequacy ratio in commercial banks?

3. What is the relationship between credit risk indicators and profitability of Uganda's commercial banks?

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1.5 Scope of the study

1.5.1 Content Scope

The study aimed at examining the effect of Credit Risk Management and profitability of commercial banks. The study was limited to three major areas; credit risk management, the relationship between credit risk management and profitability and the present status of nonperforming loans, cash reserve ratio and capital adequacy ratio of Uganda's commercial banks.

1.5.2 Geographical Scope

The study was carried out from ABSA Bank Kabale Branch which is situated at along Kabale Kisoro highway next to MTN offices on plot 56, Kabale Road.

1.5.3 Time Scope

The study period scope was from 2015 to 2020. This period was so critical in Uganda's banking sector, as it's a period where many financial institutions were either closed or taken up by others like the Crane Bank that was taken over by Development Finance Company of Uganda Bank Limited (Turyahebwa, 2013).

1.6 Justification for the study

Owing to the increasing variety in the types of counter parties and the ever-expanding variety in the forms of obligations, credit risk management has jumped to the forefront of risk management activities carried out by commercial banks. It is designed to shed light on the current loan practices and its effect on banks.

The question of credit risk and common exposures are clearly of enormous importance for the regulators, industry participants and investors. The results of this research will have implications and importance to various stakeholders as follows:

1.6.1 Management of Commercial Banks

The Management of Commercial banks had advanced knowledge on risk management in commercial banks in Uganda. This advanced knowledge helped them formulate and implement such important policies which ensured that the effective risk management in commercial banks increases the revenues and give the firm a competitive edge. They will also be able to address the outstanding challenges of effective risk management in commercial banks.

1.6.2 Other Researchers

This study will benefit scholars and researchers, as it will expand their knowledge on risk management in commercial banks and related areas. They will be able to come up with other relevant areas of study within the study; moreover, this study is very helpful as a source of secondary data for reviewing the literature.

1.6.3 Government of Uganda

The government has a responsibility to ensure that public utilities for public benefits are well protected. Risk management in commercial banks have proved to be a difficult procedure for Public sector and even government itself The successful completion of this study will furnish the government with relevant information that will enable it to make strict measures and policies that will help address the challenges of risk management in commercial banks. The study will provide findings and recommendations that will aid the government with possible suggestions to the risk management in commercial banks in Uganda.

1.7 Definition of operational terms

Credit risk is most simply defined by the Basel Committee on Banking Supervision as "the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms." The goal of Credit Risk Management Practices is to maximize a bank's riskadjusted rate of return by maintaining credit risk exposure within acceptable parameters. A credit risk is therefore the risk of default on a debt that may arise from a borrower failing to make required payments. In the first resort, the risk is that of the lender and includes lost principal and interest, disruption to cash flows, and increased collection costs (Brigo, etal (2007).

Risk identification is the process of determining risks that could potentially prevent the program, enterprise, or investment from achieving its objectives (Shephard, R (2007). It includes documenting and communicating the concern. It's about Determining what risks or hazards exist or are anticipated, their characteristics, remoteness m time, duration period, and possible outcomes.

Credit risk mitigation is the employment of various methods to reduce the risks to lenders, banks and other business which offer credit. The methods can include risk based pricing, or adjusting the cost of credit according to the credit strength of the borrower; credit tightening, or reducing the amount of credit available to higher risk applicants; diversification, or increasing the portfolio mix of borrowers and purchasing credit insurance (Morcov, 2021).

Profitability is the degree to which the value of a farm's production exceeds the cost of the resources used to produce it. An absolute measure of profitability is net farm income. If the opportunity costs for the farmer's own labor and capital are subtracted, the remainder is profit and return to management. A positive profit means that the farm has produced crops and livestock that have a greater value than the seed, fertilizer, fuel, labor, feed, and other inputs that were used up in their production (Saari, $. (2011).

Financial profitability is revenue minus costs, as answered earlier. Sometimes people are confused with the concept itself, however. Typically we calculate the profit of a company, which is a legal unit separate from its owners (shareholders), or employers and executives (Jorgenson, 2014).

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter presents the major existing literature on the topic. The study literature is in three sections, namely: Literature Survey which contains local research and writings that provide the gaps of this study.

2.1 Credit risk management and profitability of commercial banks.

Kithinji (2010) carried out a study whose main objective was to determine the relationship between credit risk management and profitability of commercial banks in Kenya. The study identified credit risk management as stringent, conservative, lenient and customized and globally standard credit risk management policies. Data non-performing loans and credit was collected from 2004 to 2008 with the amount of credit being measured by loans and advances to customers divided by total assets, non-performing was measured using non-performing loans divided by total loans and total profit was measured using ROTA (Return on Total Assets). A regression model was developed to explain the relationship between amount of credit, non-performing loans and profits during the study period. The R squared test indicated that 38.7% of profitability of commercial banks could be explained by amount of credit and non-performing loans. The adjusted R squared at -0.226 indicated that the amount of credit and non-performing loan did not explain the level of profit made by commercial banks. The study further ascertains that the model did not explain the relationship between profits, level of non-performing loans and amount of credit.

Li and Zou (2014) conducted a study whose main objective was to determine the relationship between credit risk management and profitability of commercial banks in Europe and ascertain whether the relationship is stable or fluctuating. The study obtained annual and risk reports for the selected 47 largest commercial banks in Europe between the period of 2007 and 2012 from which they obtained information on return on assets (ROA), return on equity (ROE) which were used as proxies of profitability while non-performing loan ratio (NPLR) and capital adequacy ratio (CAR) were proxies of credit risk management. The research findings established that credit risk management did not have a positive effect on commercial bank profitability. As with regards to credit risk management NPLR had a significant relationship on both ROA and ROE while CAR had an insignificant relationship on both ROA and ROE. The researcher further established that there was a fluctuating relationship between profit and credit risk management during the period under investigation. The researchers recommended that managers ought to put more effort on credit risk management specifically to control non-performing loans.

Aduda and Gitonga (2011) embarked on a study whose main aim was to determine the relationship between credit risk management and profitability of commercial banks in Kenya. The study adopted a descriptive research design with the target population being the commercial banks listed as at 31st December 2011.Both primary and secondary was used with structured and unstructured questionnaires being administered while secondary data was obtained from banks financial statements and annual reports between 2000 and 2009 from NSE library, bank secretaries and banks supervision department at the CABSA. Bank profitability was measured using ROE with credit being measured using NPLR. The research findings obtained :from the regression model indicated that there was an effect of credit risk management on profitability at reasonable level with 27.8% possibility ofNPLR in predicting variance in ROE.

According to Kungwani(2014), financial risk means the probability that the returns expected by the financial institution would be different and lower than what was expected. This indicates that there is a chance in all probability that some part of the investment or major part or totally could be lost in the process (Kungwani, 2014).

An empirical study conducted by Jarrow & Protter (2005) focusing on different types of risks which are faced by banks reported that operating technology was a major challenge which was encountered and risk loss which was encountered due to agency. The study concluded that calculation of net present value in measuring operational risk was crucial and critical since it would lead to major deviations in the entire issue if it is not considered (Jarrow & Protter, 2005) A study conducted by Tafri et al., (2009) examined the relationship between financial risk and profitability of the conventional and Islamic banks in Malaysia for the period between 1996 and 2005. The components of financial risk comprised credit risk, interest rate risk and liquidity risks. The study employed panel data regression analysis of Generalized Least Squares of fixed effects and random effects models and found that credit risk has a significant impact on profitability of the conventional as well as the Islamic banks. The relationship between interest rate risk and ROE were found to be weakly significant for the conventional banks and insignificant for the Islamic banks. The effect of interest rate risk on ROA is significant for the conventional banks. Also liquidity risk to have an insignificant impact on profitability (Tafri, Hamid, Meera, & Omar, 2009)

A similar study conducted by Lake (2013) examined the impact of financial risk on the profitability of eight commercial banks in Ethiopia for the period of 2000-2011. The quantitative part of analysis was carried out by ordinary least square (OLS) method. The findings of the study showed that credit risk and liquidity risk have a negative and statistically significant relationship with banks' profitability. However, the relationship for interest rate risk and foreign exchange rate risk was found to be statistically insignificant (Lake, 2013).

2.2 The present status of non-performing loans, cash reserve ratio and capital adequacy ratio in commercial banks.

Non-performing loan (NPL) is defined as sum of borrowed money on which the borrower has not made interest payments or repaid any principal for at least 90 days. IMF (2005) reported that a loan is classified by the bank as non-performing when interest and principal are past credit due for more than 90 days. It is an overdue loan that is not paid according to the agreed terms between the bank and the customer.

The Bank of Kigali (2016) reported to assess probability of customer default using an internal rating scale tailored to the various categories of counter party. The bank has developed the rating scale which reflects the range of defaulting probabilities and customers are segmented into five rating classes as follows: Grade 1: Normal risk (between 0-30 days), Grade 2: Watch risk (between 31-90 days), Grade 3: Substandard risk (between 91-180 days), Grade 4: Doubtful risk (between 181-360 days) and Grade 5: Loss (over 360 days).

Only loans classified in the latter three categories in the bank"s internal credit risk assessment are considered non-performing loans. These loans are further differentiated according to the degree of difficulties to recover those assets. This was confirmed by William Gasore (2017) who said that the increase in NPLs shows that the banks have difficulty to collect the interests and principal on their credits.

He further said that the Central bank urged the financial institutions to make adequate provisioning of bad loans as required by the regulations. In this context, specific provisions are made on these classes to cover bad loans; those bad loans are written off from the books of the bank. Non-performing loan is further considered as a probability of losses which require provision against the expected loan losses. Thus high NPLs increase the provision while reduces the profit so the banks need to do more to reduce their high non-performing loans (NPLs).

Kolapo, et al, (2012) further indicated that non-performing loans is considered as a percentage of loan that are not serviced for three months and above. Non-performing loan ratio (NPLR) is defined as the ratio of non-performing loans (loss, doubtful and substandard) over total loans, expressed as a percentage (BNR, Annual Financial Stability Report, June 2014-June 2015, November 2015). Non-performing loans ratio (NPLR) indicates how banks manage their credit risk because this default rate defines the proportion of loan losses amount in relation to total loan amount (Hosna, Manzura and Juanjuan, 2009) It can be said that NPLR is a financial indicator that demonstrates the bank loans quality, the high non performing loan ratio indicates increasing had quality of loans and inefficient credit risk management in loans portfolio.

Gizaw, Kebede and Selvaraj (2015) evaluated the impact of credit risk on profitability performance of commercial banks in Ethiopia and found that non performing loan ratio has a significant impact on the profitability of those banks. Felix and Claudine (2008) investigated the relationship between bank performance and credit risk management. Their findings revealed that return on equity and return on asset both measuring profitability were negatively related to the non-performing loan ratio of financial institutions thereby lead a decline *in* profitability. Contrary, Li and Zou (2014) studied the impact of credit risk management on profitability of commercial banks in Europe and concluded that there is a positive relationship between credit risk management and profitability of commercial banks.

2.3 The relationship between credit risk management and profitability of commercial bank.

Credit risk arises when counterparty is unable to perform loan agreement on time as per agreed terms. For banking institutions, loans are the largest and most obvious source of credit risk because of the nature and complexity of banking lending activities resulting in large loan portfolios (Kolapo, et al, 2012).

Banking institutions need to manage credit risk inherent in the entire portfolio as well as the risk in individual credits and transactions.

In addition, according to Bessis (2002), effective credit risk management is a key issue for bank to become successful since the default of a small number of important customers affects the financial performance of banks and can lead to possibility banks go bankrupt. This said that the success of banking business depends on accurate credit risk management.

Additionally, in its report, Basel Committee witnessed an increasing credit risk in various financial instruments other than loans including acceptances, interbank transactions, trade financing, foreign exchange transactions, financial futures, swaps, bonds, equities, options, as well as in the extension of commitments and guarantees and the settlement of transactions. Meanwhile, according to the same report, credit risk of loans is obviously the largest and most risk which the many banks face. However, every bank needs to identify, measure, monitor and control credit risk and also look for how credit risks could be lowered. It means that banks set aside adequate capital to cover expected losses from failing loans. Basel Committee made up a set of capital requirements or capital standards to protect the banks from divers types of financial and operational risks they face.

According to Kithinji (2010), the main source of credit risk including limited institutional capacity, inappropriate credit policies and laws, volatile interest rates, poor portfolio management, low capital and liquidity levels, direct lending, massive licensing of banks, poor loan underwriting, laxity in credit standards for borrowers, poor lending practices, government interference and inadequate supervision by the central bank, lack of attention to changes in economic or any other circumstances that can lead to a deterioration in the credit standing of bank's counterparties.

Moreover, Tandelilin, et al, (2007) acknowledged that the way credit risk management is handled by banking institutions impacts not only the bank performance but also the economic growth. Poudel (2012) furthermore added that credit risk management is crucial on bank financial performance since it has a significant contribution to the bank performance.

Financial performance is operational strength of a firm in relation to its revenue and expenditure as revealed by financial position. Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation (Investopedia: Financial Performance https://www.investopedia.com).

Brealey and Myers (2003) focused on different ways to measure financial performance of an organization including Return on Equity (ROE), as well as Return on Asset (ROA). They are the key measures of the bank profitability and gauge the profitability.

Moreover, Joshua Kennon (2017) reported that Return on Equity (ROE) reveals how much after tax a company earned in comparison to the total amount of shareholder equity found on the balance sheet. It is what the shareholders look in return for their investment. He further reported that a business that has a high return on equity is more likely to be one that is capable of generating cash internally, so higher the return on equity the better the company is in terms of generating profit.

Olusegun Adekunle (2015), in his study of credit risk management and financial performance of commercial banks in Nigeria, found that credit risk management has significant effect on financial performance of commercial banks and recommends that maintaining minimum level of non-performing Loans enhance financial performance.

Adeusi, Stephen Oluwafemi (2014) studied the Risk Management and Financial Performance of Banks in Nigeria, his findings show that that there is a significant relationship between risk management and bank performance. He further noted that better risk management in terms of managed fund, reduction in cost of bad and doubt loans resulted in better bank performance. Thus, it is of crucial importance that banks practice prudent risk management and safeguard the assets of the banks and protect the shareholders interests.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the research methods that were employed to achieve the objectives of this study. It shows the research design, the study population, sampling and sample size, sampling procedures, research instruments, validity and reliability of instruments, data gathering procedures, data analysis, ethical considerations and limitations of the study.

3.2 Research Design

Research design is the arrangement or structure of examination expected to get answers to research questions or research hypotheses (Mugenda & Mugenda, 2003). The study adopted a quantitative paradigm since it statistical tools. The study used a descriptive design in order to describe the profile of the respondents in terms of age group of owners, level of education.

3.3 Study Population

The study population for this study involved all the staff of ABSA bank, Kabale branch. These included all the 64 staff of the institution from all the departments.

3.4 Sampling and sample size selection

Department	Population	Sample size	Sampling method
Corporate Credit	14	13	Random sampling
Legal services and collections	10	10	Purposive sampling
Retail Credit Risk	25	20	Random sampling
Risk and Compliance	15	13	Purposive sampling
Total	**64**	**56**	

Source: ABSA Bank, 2022.

3.5 Data sources

Primary and secondary data sources were used in the study. The primary source was obtained with the use of the Self Administered Questionnaire. Primary data was collected from the staffs of ABSA bank Kabale branch. Questionnaires were prepared and administered to the staff working in the risk management department, IT department, Finance department, Credit department, operations department, branch manager and the branch supervisor. This helped to understand the risk management and profitability of banks since the response was considered to be knowledge in that field.

3.6 Research Instruments

A questionnaire was the major instrument which was used for data collection. The questionnaire was preferred for this study because it enabled the researcher reach a larger number of respondents within a short time, thus made it easier to collect relevant information. The first section in the questionnaire was the face sheet, to collect data on profile of respondents. The second section in the questionnaire was on variable of financial risk management (credit risk, liquidity risk, operational risk); the third section of the questionnaire had questions of profitability of the bank. All the questions were measured on a Likert Scale on five points ranging from 1 = strongly disagree, 2 = disagree, 3 = Neutral, 4 = Agree and 5=strongly agree. The questionnaire contained close-ended questions to collect quantifiable data relevant for precise and effective correlation of research variables. They were also preferred to save time, enable respondents to easily fill out the questionnaires and keep them on the subject and relatively objective.

3.7 Validity and Reliability of the instruments

3.7.1 Validity of the instruments

The researcher ensured the validity of the instrument by face validity analysis using research supervisors who went on checking if aII the items which were constructed, helped achieve the aim of the study. This was done by giving copies of questionnaire to the supervisor to judge the validity of the questions according to objectives. A content validity index (CVI) was computed using the following formula:

3.7.2 Reliability of the instruments

The research instrument was examined for its reliability by using Cronbach's Alpha value. All the items included in the scale adopted from reviewing literature were subjected to reliability testing. According to Cronbach Alpha Coefficient Test, the questionnaire is considered reliable if all the coefficients are greater than 0.70 (Sekaran, 2003).

3.8 Data collection procedure

The researcher sought the permission from the bank authorities to access the required data for the specified period. The panel data was extracted in excel format for easy arrangement and analysis. The Panel data was preferred since it helped to study the behavior of the variables in this study over time and across space. It is also efficient and economical because data collection is typically the most time-consuming and expensive part of a research project.

Questionnaires were administered to the staff of ABSA bank from departments concerned with risk management as well as the bank administrators, manager and supervisor. This is because they are knowledgeable about the risks and financial performance of the bank.

3.9 Data processing and analysis

The data was organized and financial ratios computed using Excel program in order to obtain the study variables. Data from questionnaires were summarized, using frequencies and percentages.

CHAPTER FOUR

DATA INTERPRETATION, ANALYSIS AND PRESENTATION 4.0

Introduction

This chapter presents the findings of the study as per questionnaires distributed for data collection and analyzed using the SPSS version 16. It consists of demographic information of respondents, analysis and interpretation of data collected with questionnaires basing on research objectives. The general objective of this research was to examine the impact of credit risk management on profitability of banking institutions in Uganda. All respondents were employees of ABSA Bank Kabale office from different departments:

4.1. Respondents bio-data

4.1.lGender

Table 2: Respondents gender

Gender	**Frequency**	**Percentage**
Female	29	52
Male	27	48
Total	**56**	**100**

Source: Field data 2022.

Table 4.1 shows the respondents distribution according the gender. From the analysis, it occurred that, a majority 52% of respondents of the study were female and male represent only 48% of them as shown in table above. This finding indicates that most of respondents who answered the questionnaires of the study were female.

4.1.2 Educational level

Table 3: Respondents education levels

Educational level	Frequency	Percentage
Masters	04	07
Degree	51	91
Diploma	01	02
Short course	00	00
Total	**36**	**100**

Source: Field data 2022

In this study, majority of respondents (91 %) reported to have completed university studies, 07% reported to hold a master's degree, whereas only 02% of them hold a diploma. This shows us that the bank is in excellent position in terms of educational level of the staff From the year 2010, the bank continued to recruit staff for new branches and departments and retained the best talent in the market. The ABSA choice was to recruit the young graduates from various universities.

4.1.3 Time spent working with ABSA

Table 4: Respondents responses on time spent working with ABSA bank

Time spent with ABSA	Frequency	Percentage
Below 2 years	03	05
2-5 years	18	32
6-10 years	25	45
Above 10 years	10	18
Total	**36**	**100**

Source: Field data 2022.

From the table above, the researcher found that 44.6 percent of all respondents have a work experience between 6-10 years, 32% of them have a work experience between 2-5 years while 18% of them have a work experience above 10 years, overall the results show that 95% of respondents have a work experience above two years. The finding shows that the respondents are experienced and understood the concept of credit risk management and the information they gave could be accurate and reliable. Additionally, the employees of ABSA Bank are very stable in their organization of work. They are motivated through attractive salary and other benefits structures. Likewise the staff reciprocated through their contribution to the bank performance. Moreover, ABSA trained its employees in various areas including customer service, credit risk management and front office operations in order to improve their skills.

4.2 Understanding of the concept of credit risk

Table 5: Respondents understanding of the concept of credit risk

Response	Frequency	Percentage
Very great extent	24	43
Great extent	29	52
Moderate extent	03	05
Total	**56**	**100**

Source: Field work 2022.

Table 5 illustrates the respondents rating on level of understanding of the credit risk concept. The findings of the study indicate that majority of the respondents (52%) reported to a great extent, 43% of them reported to a very great extent and 05% reported to a moderate extent. Nearly 94.7% overall reported to a strong understanding of credit risk management concept. This illustrate that the concept of credit risk management is very understood within ABSA bank. As a result the researcher believes information they gave is accurate and reliable.

4.3 Assessing credit risk management practices in ABSA Bank

4.3.1 Client appraisal

Table 6: Respondents on client appraisal

Client appraisal assessment	SA	A	N	D	SD	Mean	S.D
Client appraisal evaluates the character of loan applicant, his record of meeting past obligations, credit history as well as moral aspect.	31 (55.3%)	23 (41.1%)	02 (3.6%)	00	00	4.52	.572
While appraising client, the bank requires collateral as security for the loan. If the borrower defaults the security can be seized and sold to repay the loan.	33 (58.9%)	18 (32.2%)	05 (8.9%)	00	00	4.50	.661
Failure to evaluate the capacity of customers to repay impacted to some extent the quality of loans book of the bank	40 (71.4%)	15 (26.8%)	01 (1.8%)	00	00	4.70	.502
Loan approval is based on the relationship with the customer; the bank considers the account performance, deposits for at least three semesters before applying loan.	35 (62.5%)	20 (35.7%)	01 (1.8%)	00	00	4.61	.528

Source: Field data 2022.

The study established the level of at which respondents agreed with the statements related to client appraisal in credit risk management. Table 6 illustrates the respondents" rate of agreement on client appraisal. The average scale rating of agreement for all statements ranges between 4.50 and 4.70 with overall average of 4.58. From findings, a good proportion of the respondents (55.3%) strongly agreed that client appraisal evaluates the character ofloan applicant, his record of meeting past obligations, credit history as well as moral aspect as shown by a mean of 4.52, 58.9% of the respondents strongly agreed that the bank requires collateral as security while appraising client, if the borrower defaults, the security can be seized and sold to repay the loan as shown by a mean 4.50, a large proportion of the respondents (71.4%) strongly agreed that failure to evaluate the capacity of customers to repay impacted to some extent the quality of loans book of the bank. as shown by a mean of 4.70, 62.5% of respondents strongly agreed that loan approval is based on the relationship with the customer; the bank considers account performance, deposits for at least three semesters before applying loan as shown by a mean of 4.61. The majority of respondents gave a positive rating on the client appraisal. This implies that client appraisal is very important in credit risk management at ABSA Bank.

Table 7: Credit risk analysis and assessment

Credit risk analysis and assessment	SA	A	N	D	SD	Mean	S.D
The bank operates within a sound, well-defined credit grating criteria for assessmg credibility of each loan applicants	34 (60.7%)	20 (35.7%)	02 (3.6%)	00	00	4.57	.568
The bank has established appropriate internal credit risk assessment practices and developed credit scoring analysis tools for preliminary analysis and pricing (rate)	35 (62.5%)	15 (26.8%)	06 (10.7%)	00	00	4.52	.687
The bank has clearly established process for approving credits facilities including new credits and renewal of existing credits facilities	31 (55.4%)	17 (30.4%)	08 (14.2%)	00	00	4.41	733
The bank conducts a credit risk analysis on businesses and individuals before lending	36 (61.3%)	18 (32.1%)	02 (3.6%)	00	00	4.68	.508
The bank refers to credit reference bureau report for decision making before lending to the customers	32 (57.1%)	17 (30.4%)	07 (12.5%)	00	00	4.45	.711
The bank undertakes a credit worthiness analysis for loan request, reviews financial statements and future cash flows projections of borrower's business before grating loan.	42 (75%)	10 (17.9%)	04 (7.1 %)	00	00	4.68	.606

Source: Field data 2022.

The study sought to determine how much the respondents agreed with the above statements related to credit risk analysis. From the findings, it is shown that the mean response range between 4.41 and 4.68 on measurement scale. The overall mean is 4.55 which represent a good positive response on measurement scale. From the table 4.10, the respondents indicated that bank operates within a sound, well-defined credit grating criteria for assessing credibility of each loan applicants as shown by a mean of 4.57, the bank has established appropriate internal credit risk assessment practices and developed credit scoring analysis tools for preliminary analysis and loan pricing (rate of loan) as shown by a mean of 4.52, the bank has clearly established process for approving credits facilities including new credits and renewal of existing credits facilities as shown by a mean of 4.41, the bank conducts a credit risk analysis on businesses and individuals before lending as shown by a mean of 4.68, the bank refers to credit bureau reports for decision **making** before lending to its customers as shown by a mean of 4.45, the bank undertakes a credit worthiness analysis for loan request, reviews financial statements and future cash flows projections of borrower's business before grating loan as shown by a mean of 4.68. This shows that credit analysis is much appropriate and important in credit risk management practices.

Table 8: Credit risk monitoring and control

Risk monitoring and controlling	**SA**	**A**	**N**	**D**	**SD**	**Mean**	**S.D**
The bank has developed its own internal risk rating system as an important tool to monitor the quality of each individual credit as well as all loans portfolio.	36 (64.3%)	18 (32.1 %)	02 (3.6%)			4.61	.562
The bank has put in place effective management information system to ensur qualitative, detailed and timely reporting of performance of credit facilities such as timel repayment of loans, maturing facilities, credit lines efficiency	20 (35.7%)	02 (57.1%)	04 (7.2%)			4.29	.594
The bank has developed and implemented a monitoring system for assessing quality of individual credit as well as al portfolio credits.	12 (21.4%)	34 (60.7%)	10 (17.9%)			4.04	.631
The bank continuously monitors loan portfolio to ensure that all loans are disbursed with the bank guidelines, credit terms and conditions	16 (28.6%)	23 (41.0%)	14 (25.0%)	03 (5.4%)		3.93	.871
The bank regular monitors the loans repayment on day-to-day basis in order to ensure good performance of	32 (57.1%)	20 (35.7%)	04 (7.2%)			4.50	.632

credit facilities, promptly detect vulnerable counterparties and take corrective measures							
There IS 1n place effectiv management system for internal reporting system in order to manage effectively bank's loan portfolio	17 (30.4%)	26 (46.4%)	11 (19.6%)	02 (3.6%)		4.04	.808

Source: Field data 2022.

The study sought to establish how much the respondents agreed or disagreed with the statements relating to credit risk monitoring and control. Data in table 8 above shows that the mean response of all statements range between 3.93 and 4.61 on measurement scale with average mean of 4.24, the bank has developed and implemented its own internal risk rating system to monitor the quality of each individual credit as well as all loans as shown by a mean of 4.61, the bank has put in place relevant management information system to ensure qualitative, detailed and timely reporting of perfonnance of credit facilities such as timely repayment of loans, maturing facilities, credit lines efficiency as shown by a mean of 4.29, the bank has developed and implemented a monitoring system for assessing the credit quality of individuals as well as all portfolio credits as shown by a mean of 4.04, the bank continuously monitors loan portfolio to ensure that an loans are disbursed with the bank guidelines, credit terms and conditions as shown by a mean of 3.93, the bank regular monitors the loans repayment on day-to-day basis in order to ensure good performance of credit facilities, promptly detect vulnerable counterparties and take corrective measures as shown by a mean of 4.50, there is in place effective management system for internal reporting system in order to manage effectively bank's loan portfolio as shown by a mean of 4.04. The average mean is 4.24 which is more than midpoint on the five point Likert scale. This implies that credit risk monitoring and control is essential and very important in credit risk management.

Table 9: Lending policies

Lending policies	SA	A	N	D	SD	Mean	S.D
The bank has established credit policies and systems which are reviewed regularly to reflect changes in market conditions	23 (41.1%)	26 (46.4%)	05 (8.9%)	02 (3.6%)		4.25	.769
There is in place credit risk policies and procedures offering the bank the ability to identify, measure, monitor and control or transfer credit risk in its lending activities	20 (35.7%)	33 (58.9%)	03 (5.4%)			4.30	.570
The bank has in place policies regarding information on customers and documentation needed to grant new credits facilities and top up the existing ones	23 (41.0%)	30 (53.6%)	03 (5.4%)			4.36	.586
Know your customer policies are applied to customers seeking loans facilities to be sure bank is dealing with customers of good reputation and creditworthiness	18 (32.1%)	28 (50.0%)	07 (12.5%)	03 (5.4%)		4.09	.815

Source: Field data 2022.

The study sought to determine the level to which respondents agreed with the statements related to lending policies. Data in the table 9 above showed that the bank has established credit risk management policies and procedures that are consistent with its credit risk tolerance and business goals as shown by a mean of 4.25, there is in place credit risk policies and procedures that offer the bank the ability to identify, measure, monitor and control or transfer credit risk in its lending activities as shown by a mean of 4.30, the bank has in place policies regarding information on customers and documentation needed to grant new credits facilities and top up the existing ones as shown by a mean of 4.36, know your customer policies are applied to customers seeking loans facilities to be sure bank is dealing with customers of good reputation and creditworthiness as shown by a mean 4.09. The average mean of all statement response is 4.25 which also represent a good positive response on Likert scale. This indicates that bank considers lending policies in credit risk management.

4.2.3 Relationship between credit risk management practices and profitability of ABSA bank Credit risk management practices and financial performance are directly related to each other, the increase of one implies the increase in other. In other words, credit risk management practices give an opportunity to greatly improve bank financial performance. To establish the relationship between variables of this study, the researcher collected the secondary data from annual reports of ABSA from year 2015 to 2 Return on equity, Return on assets, Current ratio and Debt to equity ratio are considered as dependent variables while non-performing loans to total loans is considered as an independent variable, default loans in particular indicates how bank manage its credit risk because it defines the proportion of non-performing loans amount to total loans.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

The research was intended to examine the impact of credit risk management on the profitability of banks in Uganda taking ABSA Bank as a case study. From analysis of data collected the foregoing summary of findings, conclusion and recommendation were made.

5.1 Summary of findings

This section presents the summarized data of findings based on the research objectives as established at the beginning of the study. In this study, the findings were presented in line with objectives of the study. The main objective of the study was to examine the impact of credit risk management on profitability of banks in Uganda. The study aimed at examining the status of performing and non-performing loans, assessing credit risk management and to find out whether there is a relationship between credit risk management practices and profitability of banks.

This study employed primary and secondary data. The primary data was gathered using questionnaire prepared for that purpose. The secondary data was collected through analysis of financial reports from 2015-2022. The population under study was 64 employees of Bank of Kigali and sample size was 56 respondents selected by means of Krejcie and Morgan Table from ABSA departments including Corporate Credit, Retail credit, Risk, Compliance, Legal Services and Collections departments. The response was 100% of distributed questionnaires and data was analyzed using SPSS version 16 on the information gathered to generate descriptive and correlation statistics. Presentation of results was done in tables in forms of frequency and percentages, conclusion and recommendations given.

5.1.1 To examine the status ofnon-perfonning loans

The study examined the status of perf orrning and non-performing loans. In relation to the status of non-performing loans in ABSA, the study found that non-performing loans as a percentage of total loans has decreased from 8.3% year 2015 to 5.6% year 2022. Also the findings indicate that the average (mean) of default rate over the period of the study is 6.18% and this implies a bank's problem of defaulting loan by the customers. The study revealed that the gross loans have increased from 130.7 billion to 495.7 billion and non-performing loans from 10.893 billion to 32.9 billion.

5.1.2 To assess credit risk management practices in **ABSA**

The study assessed different credit risk management practices. In relation to what extent credit appraisal is used by ABSA, the majority (42.9%) of respondents reported to a great extent, 21.4% reported to a moderate extent, 19.6% reported to a very great extent, while just 16.1% reported to no extent by evaluating the character, record of meeting past obligations, repayment capacity, credit history as well as moral aspect of loan applicant, by requiring collateral as security for the loan, by considering the relationship with the customer, account performance, deposits etc.

In relation to what extent bank considers credit risk analysis, the study found the that majority (57.1%) of respondents sais very great extent, 35.7% of respondents said great extent, 5.4% of respondents said moderate extent while 1. 8% of respondents said little extent through operating within a sound, well-defined credit grating criteria for assessing credibility of each loan applicants, establishing appropriate internal credit risk assessment practices and credit risk scoring analysis for preliminary analysis and loan pricing, clearly establishing process for approving credits facilities including new credits and renewal of existing credits facilities, conducting credits risk analysis on businesses and individuals before lending, referring to credit bureau reports for decision making before lending, undertaking credit worthiness analysis for loan requests.

In relation to what extent ABSA uses credit risk monitoring and control, the study found that a majority (46.4%) of respondents reported to a great extent, 30.4% of respondents reported to a very great extent, 19.6% of respondents reported to a moderate extent while 3.6% reported to little extent by developing and implementing the internal risk rating system as an important tool to monitor the quality of each individual credit as well as all loans portfolio, a relevant management information system to ensure qualitative, detailed and timely reporting of performance of credit facilities, a monitoring system for assessing the credits quality of individuals as well as all loans portfolio, continuously monitoring loans portfolio to ensure that all loans are disbursed with the bank guidelines, credit terms and conditions, regular monitoring the loans repayment on day-to-day basis in order to ensure good performance of credit facilities, promptly detect vulnerable counterparties and take corrective measures, also by establishing effective management system for internal reporting system in order to manage effectively bank's loan.

In relation to what extent ABSA uses lending policies, the majority (51. 8%) of respondent reported to a very great extent, 41.1 % reported to a great extent while 7.1 % reported to a moderate extent. The bank has established credit risk management policies and procedures that are consistent with its credit risk tolerance and business goals as well as offering the bank the ability to identify, measure, monitor and control or transfer credit risk, there is in place policies regarding information on customers and documentation needed to grant new credits facilities and top up the existing ones, ABSA applies Know your customer policies to ensure that bank is dealing with customers of good reputation and creditworthiness.

5.1.3 To establish the relationship between credit risk management and bank financial performance

Credit risk management practices contribute to the bank financial performance. The study found a slight linear relationship between the ROE and NPLR with the correlation (R) value of 0.220 and R square of 0.049. The study indicated that 4.9% of changes in return on equity is explained by changes in non-performing loan ratio, the 95.1 % remaining is explained by other causes.

Also the study found a slight linear relationship between ROA and NPLR with the correlation (R) value of 0.189 and R square of 0.036. Furthermore, the study indicated a very weak positive correlation between ROA and NPLR and also the study indicated that 3.6% of changes in the return on assets are explained by changes in the NPLR, The remaining 97. 4 % is explained by other variables. Finally the study found a positive relationship respectively between current ratio and default rate as well as debt to equity ratio and default rate.

5.2 Conclusion

Credit risk is inherent in the banking business and needs to be efficiently managed well through a process of identification, measurement, monitoring and controls and has impact on financial performance. The research concluded, concerning the status of bad loans or non performing loans that they decreased from 8.3% to 5.6% over the period under study with the average default rate of 6.186%.

This research also concluded that credit risk management practices including client appraisal, credit risk analysis, credit risk monitoring and control, lending policies are mostly used by ABSA to some great extent.

The study also concluded the credit risk management contributes to bank performance and improves to some extent the financial performance of ABSA. This means credit risk management practices affect the bank performance and contribute to financial performance.

Furthermore, the study revealed that there is a slight linear relationship between credit risk management and financial performance.

5.3 Recommendations

Basing on research objective, research findings, summary and the conclusions, the researcher presents the following recommendations through which can help to improve credit risk management and financial performance:

The study recommends the banking institutions to develop internal risk rating system to monitor the quality of loans portfolio. The study also recommends conducting credit risk analysis on businesses and individuals before lending. There is a need for banking institutions to enhance their internal credit risk assessment practices, develop a credit risk scoring analysis tools to assess loans applicants' capability as well as developing their own internal risk rating system to monitor the quality of all loans portfolio. Since credit risk management has a very significant contribution to bank performance, the banks are recommended to put more emphasis on credit risk management practices to reduce their high level of bad loans. Other banks should support the development of a secondary market for bad loans.

There is need for commercial banks to provide training to their employees on how to effectively execute their responsibilities. This makes them more creative thus enhancing financial performance as desired.

Further still, ABSA bank should educate their clients to borrow only when it is extremely necessary. This is because borrowing for the sake of it, may lead to misuse of funds leading to difficulties in paying back the borrowed money.

There is need for ABSA bank to ask for collateral security from clients when securing loans. This provides a guarantee of paying back the borrowed money since some of the clients are not trust worthy.

There is need for ABSA bank to make decisions that are rational while allocating their finances to different borrowers. It should not be simply having a loan issued but this should be conventionally issued.

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APPENDICES

Appendix 1: Self Administered Questionnaire

The purpose of this study is purely academic and your participation is entirely voluntary and you retain the right to withdraw at any time. All individual responses will be held in strictest confidence and only group data will be reported. Thank you for agreeing to participate in this questionnaire.

(Tick against the answer of your choice or where necessary make a brief statement)

1. Gender

a) Female

b) Male

2. Educational level

Educational level	
Masters	
Degree	
Diploma	
Short course	

3. How long have you been working with the organisation (years)?

Below 2 years	
2-5 years	
6-10 years	
Above 10 years	

4. To what extent do you understand the concept of credit risk? (Tick one)

Very great extent	
Great extent	
Moderate extent	

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lient appraisal assessment	**SA**	**A**	**N**	**D**	**SD**
lient appraisal evaluates the character of loan applicant, his record f meeting past obligations, credit history as **well** as moral aspee					
While appraising client, the bank requires collateral as security for the loan. If the borrower defaults the security can be seized and sold to repay the loan.					
Failure to evaluate the capacity of customers to repay impacted to some extent the quality of loans book of the bank					
Loan approval is based on the relationship with the customer; the bank considers the account performance, deposits for at least three semesters before applying loan.					

Credit risk analysis and assessment	**SA**	**A**	**N**	**D**	**SD**
The bank operates within a sound, well-defined credit grating criteria for assessing credibility of each loan applicants					
The bank has established appropriate internal credit risk assessment practices and developed credit scoring analysis tools for preliminary analysis and pricing (rate)					
The bank has clearly established process for approving credits facilities including new credits and renewal of existing credits facilities					
The bank conducts a credit risk analysis on businesses and individuals before lending					
The bank refers to credit reference bureau report for decision making before lending to the customers					
The bank undertakes a credit worthiness analysis for loan request, **reviews** financial statements and future cash flows projections of borrower's business before grating loan.					

Credit risk monitoring and control

Risk monitoring and controlling	SA	A	N	D	SD
The bank has developed its own internal risk rating system as an **important tool to monitor the quality of each individual credit as well** as all loans portfolio.					
The bank has put in place effective management information system to ensure qualitative, detailed and timely reporting of performance of credit facilities such as timely repayment of loans, maturing facilities, credit lines efficiency					
The bank has developed and implemented a monitoring system for assessing quality of individual credits as well as all portfolio credits.					
The bank continuously monitors loan portfolio to ensure that all loans are disbursed with the bank guidelines, credit terms and conditions					
The bank regular monitors the loans repayment on day-to-day basis in order to ensure good performance of credit facilities, promptly detect vulnerable counterparties and take corrective measures					
There is in place effective management system for internal repoIUP system in order to manage effectively bank's loan portfolio					

Lending policies

Lending policies	SA	A	N	D	SD
The bank has established credit policies and systems which are reviewed regularly to reflect changes in market conditions					
There is in place credit risk policies and procedures offering the bank h° ability to identify, measure, monitor and control or transfer credit risk in its lending activities					
The bank has in place policies regarding information on customers and documentation needed to grant new credits facilities and top up the existing ones					
Know your customer policies are applied to customers seeking loans facilities to be sure bank is dealing with customers of good reputation and creditworthiness					