KWAME NKRUMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY

SCHOOL OF BUSINESS

ASSESSING CREDIT RISK MANAGEMENT OF ZENITH BANK GHANA

A THESIS SUBMITTED TO SCHOOL OF BUSINESS, KWAME NKRUMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF

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DECLARATION

I hereby declare that this submission is my own work towards the MBA and that, to the best of my knowledge, it contains no material previously published by another person nor material which has been accepted for the award of any other degree of the University, except where due acknowledgement has been made in the text.

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I declare that I have supervised the student in undertaking the research reported herein and I confirm that the student has my permission to present it for assessment.

……………………… Date…………………

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I confirm that the student has duly effected all corrections suggested by the examiners in conformity of the Departments requirements.

……………………… Date…………………

(Head of Department)

DEDICATION

This book is dedicated to my supervisor and God father Mr. Michael Adusei and his entire family. God bless you all.

ACKNOWLEDGEMENTS

I wish to express my appreciations to the Almighty God for his divine province, love and care which has sustained me for all these years.

I would like to take this opportunity to express my sincere thanks to all those who made significant contributions towards the success of this work especially Miss Angela Amuzu, may the Almighty God richly bless you for your invaluable contribution, time and documentary support which has made this piece of work a success.

I am highly indebted to Mr. Michael Adusei, my supervisor who in spite of his numerous work schedules, advised, directed, supervised, offered contributions and saw to the successful completion of this work

I also wish to register my appreciation to all authors of books and articles from which I cited references for my work and the respondents who co-operated with me in providing vital information that made this research work complete.

Finally, I am grateful to all those who contributed in one way or the other in making this work a success, God richly bless you all.

ABSTRACT

This study sought to assess the credit risk management of Zenith Bank Ghana with focus on the credit staff of the bank. The objective of the study was to identify the knowledge of and adherence to credit risk management, factors affecting the credit risk management causing problem loans as well as mechanisms in place to mitigate problem loans. Probability sampling was employed to select 30 credit staff who answered questionnaires. The study revealed that the bank has laid down organizational policies and practices regarding risk management and that there was an enforcement policy in place to ensure adherence. Poor credit appraisal and poor loan monitoring were brought to the fore as some of the causes of problem loans. Based on the findings of the study, recommendations such as education and training of credit staff, intensification of monitoring of the credit staff by management among others have been proposed.

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CHAPTER ONE

BACKGROUND TO THE STUDY

1.0 INTRODUCTION

In every economy there are bound to be some economic spending units whose investments and or expenditures far exceed their savings and those whose investments fall short of their accumulated savings. The former group is termed deficit units and the latter, the surplus units. Economics progress is achieved by efficient redistribution of the temporary free resources of the surplus units to meet the temporary needs of the deficit units. This is the crucial point in the mechanism of financial intermediation. Financial intermediation is, simply, the process of channelling funds between surplus and deficit units.

Banks traditionally make money through buying and selling of money. The money is bought through deposit taken from customers. This is commonly done through susu, fixed deposit, current deposits and savings. The selling of money is made by banks through the process of investments by the money bought from customers who have deposited money with them. These investments are of two types; risky assets and risk free assets. Higher risks come with higher returns while lower risks come with lower returns. Therefore, banks need to balance their investment portfolio in order to make profit. This is termed financial mediation.

The main motive of banks is to make profits. Credit is made available through depositors‟ money which those who want to borrow can access at an agreed interest rate. This stands to mean that in order to maximize returns, credit needs to be properly managed. Due to this, effective credit management has become the priority of every bank since it has a bearing on the solvency of the banks.

According to Carey (2001), risk management is of importance and that the management of financial risk is crucial for all financial institutions. Over the years, financial institutions have not taken it easy as banking problems continue to increase. These problems are known to stem from poor portfolio risk management, poor credit standards, poor attention to economic changes and poor internal management. These have the tendency to reduce the credit standing of banks and their counter parties.

Proliferation of Banks is a common position in every country, bringing about competition among the banks for customers in order to make profit. To a certain level, a bank"s ability to grant credit influences the numbers of customers it will acquire but measures available to guide the repayment of these credits are always deficient.

The management of banks credit appropriately is now the order of the day, however, bad loans are also on the rise due to non-payment of loan by borrowers. This affects the banks" financial strength.

According to Tetteh (2012), profitability is negatively affected and this serves to affect the capital base of banks because of nonperforming assets. Despite these, credit would have to be made available for customers to borrow.

The unwillingness or inability to of a counterparty to meet requirements of credit in relation to settlement, and other financial requirements leads to banks" portfolio loss as a result of outright default. The risk of credit comes from a bank"s transaction with an individual person, corporate entities and other financial institutions. The management of

Credit risk covers identifying, measuring, monitoring as well as the controlling of the credit risk vulnerabilities.

These activities include the various means of addressing the issue of reducing loss to lenders.

"*However, the goal of credit risk management is to maximize a bank's risk adjusted rate of return by maintaining credit risk exposure within acceptable parameters*" (Casuetal, 2006).

The management of risks inbuilt in portfolio needs to be managed by banks in order to maximize profits.

On the global scene, bad debts as well as non-performing loans have become the most common cause of credit risk among financial institutions."Losses among banks are attributed to guarantees, that is either from third parties or any posted collateral, of recovery after bankruptcy and the liquidation of assets. Going on, it is also responsible for the implementation of actions that limit the lending exposure of an organization and performs several functions aimed at reducing the risk associated with company financial assets and banks. Credit policies and procedures, credit analysis and credit review help to prevent poor lending decisions and protect company investments" (Jentezen, 2012).

According to Kumah and Asare (2013), "most organizations differentiate between two types of risks. First, regulatory bodies and/or government demand that management are externally assessed. Environmental risks come into this category. Second, there are the classic risks of internal and external fraud and theft inherent in any business dealing with money. The third type of risks is those where there is no clear self-preservation reason for the organization to try and manage them".

1.1 PROBLEM STATEMENT

In a developing economy like Ghana, the sector of finance is known to be in the nursery stage and that banks are still in the preliminary stages of standardizing risk management principles to prevent adverse events, especially with loans.

The surviving big commercial banks however may have some form of risk management framework in place, but how strong and adherent that framework is, is a question of examination or inquiry.

Credit risk management in a bank basically involves "negotiation", or in other words, to bring to a minimum the risk exposure and occurrence. For commercial banks, such as Zenith Bank Ghana Limited, lending is an important and non-negligible part of its products. "More than 70% of a bank"s balance sheet generally relates to this aspect of risk management". Therefore, any banks survival depends on proper management of risks.

Credit risk comes about when borrowers are not willing and able to pay off their loans which pose a threat to the financial stability of the banks. In banking industry, it comes about when payments are delayed or not made at all which affects the capital flow of the bank and consequently its profits, usually termed bad loans.

Despite Zenith Bank Ghana"s achievements and awards in 2014 Ghana Banking Awards, as the Best Bank in Corporate Banking, Trade Finance Deal of the Year and as a second runner up in Trade Finance, the bank may not be free of hitches in the management of credit risks. Although the bank"s percentage of gross non-performing loans improved from 5.40% in 2013 to 4.38% in 2014 it still needs to still keep the streak high which is possible with effective management ofthe risk in credit. The current study assesses the management of credit risk in the bank and gives recommendations thereof.

1.2 OBJECTIVES OF THE STUDY

The general aim of this study was to assess the risk management of Zenith Bank Ghana Limited. The specific objectives were;

1. To assess the lending procedures of Zenith Bank Ghana Limited.
2. To assess the common sources of problem loans at Zenith Bank Ghana Limited.
3. To ascertain loan recovery strategies of Zenith Bank Ghana Limited.

1.3 RESEARCH QUESTIONS

1. What are the lending procedures of Zenith Bank?
2. What are the sources of problem loans at Zenith Bank?
3. What are the debt recovery strategies of Zenith Bank?

1.4 SIGNIFICANCE OF THE STUDY

This study is significant to three categories of people; academics, bankers and national policy makers. For those in academia, findings of this study will contribute to the current body of knowledge of credit risk management with empirical evidence from the selected bank.

Furthermore, by revealing the understanding and the view point of relevant practitioners of the credit risk management, other banking officials will gain better appreciation of the issues and bottlenecks which they may have created themselves without knowing that these things impeded the effectiveness of the same cause that they stand to increase its quality.

The research study also aids policy makers in enacting good policies that will positively affect both lenders and borrowers.

1.5 JUSTIFICATION OF THE STUDY

Solvency of banks is highly dependent upon the quality of their credit risk management practices. Many researches on the causes of bank dissolution revealed that poor management of credit risk is one major cause. Banks are failing because of poor credit risk management practices. It is against this backdrop that this study investigated the credit risk management of Zenith Bank Ghana to ascertain the industry sets and other factors that auger well or not to the bank"s performance in the Ghanaian financial sector.

1.6 SCOPE AND AREA OF STUDY

The focus of this study was limited to Zenith Bank Ghana. The study considered credit risk management in the Ghanaian context with reference to the bank under study. This study stayed within and did not extend beyond the boundaries of credit risk management having in light Zenith Bank Ghana. This helped to give an in-depth understanding of the practice by the bank in question and commercial banks in general.

1.7 BRIEF METHODOLOGY

This study adopted a case study design employing triangulation in collecting and analysing data with the used of questionnaires. The main source of data was the primary source from the population of interest. A total sample size of 30wasconsidered and used for the research work and was through simple random sampling which is a variant of probability sampling techniques.

1.8 LIMITATIONS OF THE STUDY

Limitations in research are considered as the militating factors that stand against the successful achievement of research objectives. No research goes without limitations.

This research faced the problem of time constraints and response rate due to the work schedule of the employees in the selected bank.

Budget within the means of the researcher was done to make this study a reality. In order to deal with delays in answering the questionnaires, phone calls were made as a follow up to remind the respondents.

1.9 ORGANIZATION OF THE STUDY

This study was in five chapters. Chapter one was introduction, chapter two was the review of related literature on the topic under study. Chapter three dealt with methodology, four dealt with the presentation and analysis of the data collected from the field. The last chapter which was chapter five also looked at the summary of key findings in the study, concluded and gave recommendations bearing in mind the findings.

CHAPTER TWO

REVIEW OF RELATEDLITERATURE

2.0 INTRODUCTION

This chapter critically reviews writings by other scholars and authorities on the topic of interest understudy. Various publications and internet sources on credit risk management and its importance in financial institutions are also reviewed. This review will seek to define what is meant by credit, risk, the management of credit risk and its adherence in the lending industry, factors negatively impacting on effective credit risk management, the situation in Ghana and then a summary of the emerging understanding. This review is to give the study a course and path so as not to deviate in the analysis of data to be collected.

2.1 CREDIT

In general terms credit is considered in loose terms in debt finance. Credit is considered as simply the direct opposite of debt. Debt is the responsibility to repay back something in the near future. Credit is the power or ability to receive repayments. So, credit is "*The right to receive payment or an obligation to make payment on demand or at some future time on account of the immediate transfer of goods (securities)*" (Johan & John 1994).

Credit is the ability of one or trust of one to provide money for others to pay back in the near future which make the counterparty indebted which brings about debt to be paid by the counterparty.

In this expatiation by Sullivan is the idea of giving out money or goods and then the trust that the person who took it will definitely pay back and with interest and at the agreed time agreed upon. We are therefore considering any deferred payment which a creditor gives money to a debtor to pay back later.

The inability and unwillingness to pay back money result in credit losses. The reasons vary from increase new technology, increase in prices, decline in demand, competition and substitutes oversupply position in the market, government regulations, excessive leverage, mismanagement, death of key persons, defective diversification business cycles, over-ambitious projects, financial losses, concentrated exposure and what have you.

Those whom we agree can pay back possibly with interest are the one we extend credit to. Different reasons are used to access credit by enterprises, individuals as well as other corporate entities. According to Tetteh (2012), the nature of credit can be short term (not more than 5 years), medium term (between 5 and 10 years) and long term (more than 10 years).

2.1.2 PROCESS OF CREDIT GRANTING

Banks should conduct their activities in very good atmosphere where they can grant access to credit in a well-defined manner of sound measures. These measures ought to be inclusive of a deeper grasp of borrowers and how repayment can be made and from what source and structure. Clearly established ways and means should be in place to assess eligibility before granting credit to borrowers and this should be done in agreement. Care must be taken in monitoring credits granted to individuals and companies in order to mitigate risks of connected lending.

The credit granting standard must set out indicators of credit worthiness among others before granting credit. Sufficient information must be received by banks in order to make sound decision in granting credit. At least, the variables to be looked and booked in sanctioning credits must be inclusive of: purpose of credit and how repayment if going to be done; the reputation and credit history of the borrower among others (Oldfield & Santomero, 1997).

Once these have been cross checked, the bank needs to see to it that the information is accurate and that the money to be given out as credit would be paid at the agreed time and with no delays in payment so as to make it available for others also.

2.2 RISK

"*Risk is the potentiality that both the expected and unexpected events may have an adverse impact on the bank's capital or earnings*". It is considered that the perceived loss of credit is borne by the borrower that is why they are to pay back with interest (Arunkumar & Kotreshwar, 2005).

Systematic risks and unsystematic risks are the risks inherent in the financial market. Systematic risk is that which is positively related to market and can be brought down by using diverse management practices of risk. The unsystematic risk on the other hand is consorted with the worth of the asset.

Oldfield and Santomero (1997) described three risk standards which are risk avoidance, risk transfer and risk acceptance. According to Arunkumar and Kotreshwar (2005), the risks in banks‟ portfolio can be put into three;

1. Risk of Transaction: This happens mainly with administration in the financial institutions where there can be underwriting and other such things.
2. Intrinsic Risk: These are default risks that come with financial institutions and every institution has these types of risks.

3. Risk of Concentration: This is risk of transaction plus intrinsic risk combined.

Discussed below are the various sources of risks that banks deal with.

2.2.1 ECONOMIC CONDITIONS

Serious economic changes can impact on the management of risks for banks. Changes in unemployment and national income have the tendency to affect the liquidity of banks and thus profitability. All these have the ability to influence borrower"s capacity in repayment."In addition, legal and regulatory change could cause financial institutions to change how they oversee a transaction, as well as the quality and ability of debt collection".

2.2.2 COMPETITION

Market competition in the credit market has the tendency to increase the amount of loans given out in the economy which will give rise to more loan defaults resulting in problem loans. Since the financial institutions are competing, it gives the borrower the chance to avoid being caught of bad credit history.

2.2.3 UNDERWRITING STANDARDS

"This is a process to determine what kind of, to whom, for what purpose and when to credit granted. Appropriate approval process credit should include adequate guidance on how and methodology in assessing solvency, the establishment of the credit line and appropriate interest rate to borrowers and credit risk" (Calmès, 2009).

2.2.4 COMPETENCE OF STAFF

Poorly trained staff can undermine the performance of financial institutions. If the staff are not competent enough to deal with clients and appraise client properly before approving loans, the financial institution is sure to fail since people who are not credit worthy may be given loans and cannot pay back with interests.

2.2.5 MANAGEMENT INFORMATION SYSTEM (MIS)

Proper management information system can help to track clients and see their progress on loan repayments and even to track their past credit history which will help the organizations to determine who deserves to be given loan or not.

2.2.6 POORCREDIT QUALITY ASSESSMENT

This is where there is poor evaluation of the institutions finance and the market in which they operate. This usually results from poor information availability to rely upon for evaluation and decision making. Simple indicators can be used by management to assist in the assessment of credit quality in order to reduce the risks inherent in credit.

2.2.7 NEW PRODUCTS OR SERVICES

Institutions who neglect to evaluate inherent risks in any product they try to put into the marked is bound to face the problem of high risk associated with the products. Not because we want to increase the variety of products we have so we are just being innovative in bringing about products but also how those products will fare is of importance.

2.2.8 SUBJECTIVENESS OF DECISION MAKING

This happens regarding credit approvals is a known common risk that financial institutions face. Before credit approval, the credit worthiness of the borrower needs to be assessed to find out if the borrower is in right standing in terms of income to pay back the loan with interest. However, there are some times where subjective decisions are taken and loans granted. This poses risks to the financial institution.

2.2.9 LENDING ABOVE COLLATERAL VALUE

If a loan is over and above the amount of collateral collected, the financial institution stands the face risk since in times of non-payment, the institution cannot guarantee the collateral to be able to pay off the loan. This means that if a financial institution is giving out loans, it should consider the value of the collateral before giving out the loan. Care must be taken so that the amount of loan given out commensurate with the value of the collateral.

2.2.10 BUSINESS CYCLENEGLIGENCE

If the business cycle is neglected and credit is just given with no consideration, the bank stands no chance of surviving. If the business environment is not profiting, the bank has to hold on to giving out money to some customers and consider other customers rather. This will help maintain profit

Properly considering the business cycle allows the bank to map out strategies to overcome the difficulties that lead to bad loan and loan defaults.

2.2.11 CREDIT REVIEW

Poor credit review that is poor appraisal of the credit history of customers is known to bring about loan defaults in most banks. If there is proper and honest credit review, the bank benefits and vice versa.

2.2.12 SELF–DEALING

Self-dealing which is sometimes called insider dealing is when credit are given to insiders with no interest rate on those monies. This has the tendency to reduce the credit standing of the firm and also there is the high risk of non-payment.

2.2.13 TECHNICAL INCOMPETENCE

This is evident when management cannot obtain and assess credit information in order to analyse the viability of credit products. Such management weakness can eventually lead to loan losses.

2.2.14 LACK OF PROPER SUPERVISION

Improper appraisal of credit arises when there is lax in the supervision by management. When this happens, the credit staff are allowed to do as they please with credit which does not auger well for the institution.

All banks are facing a number of risks and so the need for proper supervision by management to ensure that these risks are brought to a minimum. In other words, banking is a business of risk. Carey (2001) indicates that "*risk management is more important in the financial sector than in other parts of the economy. The purpose of financial institutions is to maximize revenues and offer the most value to shareholders by offering a variety of financial services and especially by administering risks*".

2.3 CREDIT RISK MANAGEMENT

The business arena of banks has expanded in the last few decades (Calmes, 2009). Despite the fact that deposit and lending continue to be the leading transactions by these institutions, they have now added still more important activities in order to achieve credit targets and maximize profit. This has led to their exposure to financial markets.

Due to this banks have adopted sophisticated risk-management practices.

Carey"s (2009) research opened new understanding of the management of risk by asserting that risk management is a must for banks.

The primary aim of the financial institutions is to maximize their profits by conforming to the expenditures of the institution and increase the income of those who have stakes in the business. These institutions are now offering more services with more risks than usual in order to make profit (Hakim & Neaime, 2005). He further posited in his work that "*efficient risk management is not a costly process but the financial institution will suffer adverse effect like failure of the banking system if not implemented at the right time*"."The establishment of frameworks that defines corporate priorities and other activities dealing with loss reduction is now the corner stone of every institution (David, 1997).

Credit risk management practices can be put into curative measures and preventive measures. The curative measures are in place to deal with risks that has already been born such as risk sharing and law enforcement while the preventive measures deal with preventing the risks from occurring in the first place such as portfolio diversification.

The reduction of different types of risks is the aim of credit risk management. It can refer to threats by technology, environment, organizations, humans and politics. On the other hand it involves all means available for any risk management entity.

From the above discourse it can be realised that there are inherent risks in the operation of the financial industries and their management is a serious priority that need not be ignored by the institutions.

2.4. PORTFOLIO THEORY AND CREDIT RISK MANAGEMENT

Credit concentrations are known to affect the financial viability and performance of commercial and other banking entities in their quest to survive. As a result, quantitative approaches are now adopted by banks to deal with the management of credit. Significant progress are been made towards developing tools that measure credit risk in a portfolio context.

2.4.1 ASSET-BY-ASSET APPROACH

This is based on credit rating system and problem loan identification based on systematically assessing the assets of the firm. Here the assets of individuals who opt for loans are also assessed in the light of established standards set.

2.4.2 PORTFOLIO APPROACH

This is where in order to avoid risks, the portfolio of the bank is diversified and so as to make up for any loss in area. This kind of approach is very common as the financial market is becoming diversified itself.

2.5 TRADITIONAL APPROACH

It is difficult differentiating the “traditional” approach and the “modern” approach since the modern approach or new approach incorporate into it many of the old or traditional approach. The new approach is subdivided into four and is as discussed below.

2.5.1 EXPERT SYSTEMS

In this system, the decision on credit is left in the hands of the officer in charge of credit who will then make all decisions because he is considered an expert in the field in credit. This is particularly common in the recent style of the microfinance institutions where the credit officers are themselves the ones who take care of credit granting right through monitoring to recovery. This is based on the five “Cs”. These are; “Character”, “Credibility”, “Capital”, “Collateral” and “Cycle.

2.5.2 BANKS INTERNAL RATINGS

This is where past credit history of the banks are weighted and ranked with time. Here ratings are used to decide on the risks and the level of risks to take for any credit given out.

2.5.3 CREDIT SCORING SYSTEMS

Credit scoring is the statistical means of assessing the credit worthiness of a borrower and his or her ability to pay back at the time assigned. Here the borrower‟s credit history with the bank is assessed statistically with statistical tools and techniques to decide.

“Most financial institutions have collapsed or experienced financial problems due to inefficient credit risk management systems typified by high levels of insider loans, speculative lending, and high concentration of credit in certain sectors among other issues. Credit risk management practices and poor credit quality continue to be a dominant cause of bank failures and banking crises worldwide. The extents to which banks manage their credit risk have an impact on their entire financial performance or survival. The causes of high non-performing loans are as a result of low credit risk management system and this may affect profitability”

2.6. MODELS OF PROBABILITY OF DEFAULT (PD)

These models are for groups of borrowers who possess the same kind of characteristics and can be statistically predicted to default in a given time frame. Probability of Default (PD) "as the estimate of the likelihood of the borrower defaulting on its obligations within a given horizon. PD is calculated for each client who has a loan (for wholesale banking) or for a portfolio of clients with similar attributes (for retail banking)".

"The credit history of the counterparty/portfolio and nature of the investment are also taken into account to calculate the PD".

The following footprints are used to define the PD:

1. Analyse the credit risk aspects of the counterparty/portfolio;
2. Map the counterparty to an internal risk grade which has an associated PD: and
3. Determine the facility specific PD.

"The nest step after the PD has been calculated, the related credit spread and valuation of the loan is also tackled".

In a general form, the PD is given as (Cantor *et al.*, 2006): $PD = \frac{EL}{LGD \, X \, EAD}$

2.7 LOSS GIVEN DEFAULT MODELS (LGD)

"This attempts to predict the amount of loss in a credit in the event of default. It is based on the characteristics of the facility, i.e. collateral covenants etc.". The Loss Given Default is "the loss incurred in the event of default and it is equal to one minus the recovery rate at default". Loss Given Default assessments are opines about "expected loss given default on fixed income obligations expressed as a percent of principal and accrued interest at the resolution of the default". Loss Given Default assessments are given to preferred stock issues, loan of individual and bonds. “The firm-wide or enterprise expected LGD rate is a weighted average of the expected LGD rates on its constituent liabilities (excluding preferred stock), where the weights equal each obligation's expected share of the total liabilities at default”.

“Expected LGD is the difference between value received at default resolution (either through bankruptcy resolution, distressed exchange, or outright cure) and principal outstanding and accrued interest due at resolution”. The Loss Given Default is stated mathematically as: $1 - R_1$

“Where R_1 is the value received at default resolution or the recovery rate of the default instrument”. As a result, the anticipated Loss Given Default rate is given as:

$$\frac{\text{Expected LGD}}{\text{Expected amount of principal and interst due at resolution}}$$

2.8 EXPOSURE AT DEFAULT MODELS (EAD)

“It is based on characteristics and purpose of the facility and the behaviour of the borrower”. “The total value that a bank is exposed to at the time of default or the nominal value of the borrower‟s debt is what is termed as Exposure At Default (EAD) (Baixauli and Alvarez, 2009). Each underlying exposure that a bank has is given an EAD value and is identified within the bank's internal system. Using the internal ratings board (IRB) approach, financial institutions will often use their own risk management default models to calculate their respective EAD systems”.

“The expected loss (EL) indicates the expected level of the credit loss on the loan /credit portfolio and this is given as”; $EL = PD \times LGD \times EAD$

2.9 CREDIT RISK AND BANK PERFORMANCE

Lower risk in credit and higher gain in loan portfolio means more profit. Anggbazo (1997) posits that "banks with larger loan portfolio appear to require higher net interest margin to compensate for higher risk of default".

"Variations in credit risks would lead to variations in the health of banks" loan portfolio which in turn affect bank performance". "Viability of bank profitability is due to effective credit risk management. They claim profitability changes are due to bank credit risk management changes.

Heffernann (1996) posited "*credit risk is the risk that an asset or loan becomes irrecoverable, in the case of outright default or the risk of delay in servicing of loans and advances*".

2.10 CHAPTER SUMMARY

This chapter has brought to bear some writing on the issue at stake. An understanding of the issue by other scholars have been addressed and accurately reviewed in the light of this study. The next chapter zooms into the methods and employed for this work.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 INTRODUCTION

"Methodology is simply a guideline or approach for solving a problem or an issue, with particular components such as phases, tasks, methods, techniques and tools". It is considered as a set or system of methods and principles that is to say rules for regulating a given discipline, coming out with a solution or finding out what is. Methodology seeks to measure the procedure and techniques researchers use to come out with a body of knowledge together with the reasons and logic behind the techniques chosen.

3.1 RESEARCH DESIGN

This study adopted a case study and used qualitative and quantitative methods of data collection and analysis, using Zenith Bank Ghana as the selected case. It was an exploratory study because it sought to find out "*what is happening; to seek new insights; to ask questions and to assess phenomena in a new light*". Kumekpor (2002) defines research design as "the planning, organization and execution of social investigation". It may then be defined as the conceptual framework within which the whole research is conducted. Thus, it is the term used to describe how data was collected, analysed and interpreted with respect to a particular research topic.

3.2 DATA SOURCES

The study considered and used both "primary" and "secondary" data. The primary source of data was data collected from the field of study by the use of questionnaires on employees in the selected bank.

The secondary data on the other hand was obtained from already existing information in documents such as archives, journals, internet, relevant articles, reports and text books relevant to the study.

3.3 POPULATION AND SAMPLING FRAME

The population universe of the study was all employees employed in Zenith Bank Ghana. The target population however was the employees in the Zenith Bank Ghana who are involved in the management of credit risk in their day-to-day duties.

The sampling frame for this study was the number of employees who were employed in the bank‟s credit department. From this frame, sample was drawn.

3.5 SAMPLE SIZE

For the purpose of this study, a sample size of 30was selected from the employees at the bank‟s credit department. These employees were involved in the administration and management of loans after disbursement.

3.6 SAMPLING TECHNIQUE

The sampling technique adopted for this study was the simple random sampling. Here, all employees concerned with credit risk management were numbered on paper slips and put into an opaque jar. Thirty was randomly picked from the jar without replacement.

3.7 DATA COLLECTION INSTRUMENT

The main instrument of data collection was questionnaire. This instrument served to elicit data from the respondents. Since all the persons of interest were educated and could read and write, the questionnaires were self-administered.

Both “Open ended” and “close ended” questions were asked on the questionnaire. The “open ended” was to allow the staff express their own thoughts on pertinent issues.

3.8 PILOT TESTING

The data collection instrument was tested on employees who were also concerned with credit management issues in another commercial bank in the Kumasi metropolis. This bank was Ecobank Ghana Limited. This was to help restructure or reorder some questions if the need be and to find out if the questions were really going to answer the objectives of the study. After the pilot testing, only few changes were made.

3.6 METHOD OF DATA PRESENTATION AND ANALYSIS

Descriptive method of data analysis was used by the researcher. This involved the use of comprehensive sentences in the explanation of charts, frequency tables and percentages. These were based on data collected from the sample of interest.

There was also the calculation of Severity Index. Likert scale items were presented to the credit officers to rank items that they deem as severely impacting credit risk management of the bank. This was also done for common factors that cause problem loans. The determinant variables were prepared and listed according to their importance. These were then given a five point likert scale options to choose from for each variable. Severity index was then calculated using the equation:

Severity Index (SI) $= \sum_{i=1}^{5} yi\ xi$

Where the i was defined by i= 1, 2, 3, 4, 5

The constant y in the equation was to determine a quantitative value of measure from the responses chosen from the likert scale. The responses were assigned as shown below; y_1 = 0/4 for „Strongly Disagree" y_2 = 1/4 for „Disagree" y_3 = 2/4 for „Neutral" y_4 = 3/4 for „Agree" y_5 = 4/4 for „Strongly Agree"

X_i = "the variable expressing the frequency of the i-th response, for i = 1, 2, 3, 4, 5 and illustrated as follows":

X_1 = "the frequency of Strongly Disagree response"

X_2 = "the frequency of Disagree response"

X_3 = "the frequency of Neutral response"

X_4 = "the frequency of Agree response" X_5 = "the frequency of Strongly Agree response"

Let"s look at the following for illustration:

Considering the variable, *poor management*. For 30 respondents, the frequencies of this factor are:

- "Strongly Agree = 8 = 26.7%"
- "Agree = 12 = 40%"
- "Neutral = 7 = 23.3%"
- "Disagree = 2 = 6.7%"
- "Strongly Disagree = 1 = 3.3%"

The severity index is:

Is = (4*26.7+3*40+23.3*2+1*6.7+0*3.3)/4 = 70%

This means that if all respondents choose "Strongly Agree" than the severity index for that variable will be 100% and will rank first on the list of variable. However, if the opposite happens, then the variable will rank last among the variables. Thus, severity index is from 0 to 100%.

3.7 BRIEF PROFILE OF THE CASE

Zenith Bank is not a Ghanaian bank but came in from Nigeria where it was established in May 1990, starting operations in July same year. It is listed on the Nigerian Stock Exchange (NSE). In Ghana, "Zenith Bank (Ghana) Limited is a privately owned African bank incorporated in April 2005 under the Ghana Banking ACT 2004 (ACT 673) and a Subsidiary of Zenith Bank PLC". This study will cover Zenith Bank Ghana, credit department, head office, Accra.

CHAPTER FOUR

DATA PRESENTATION, ANALYSISAND DISCUSSIONS

4.0 INTRODUCTION

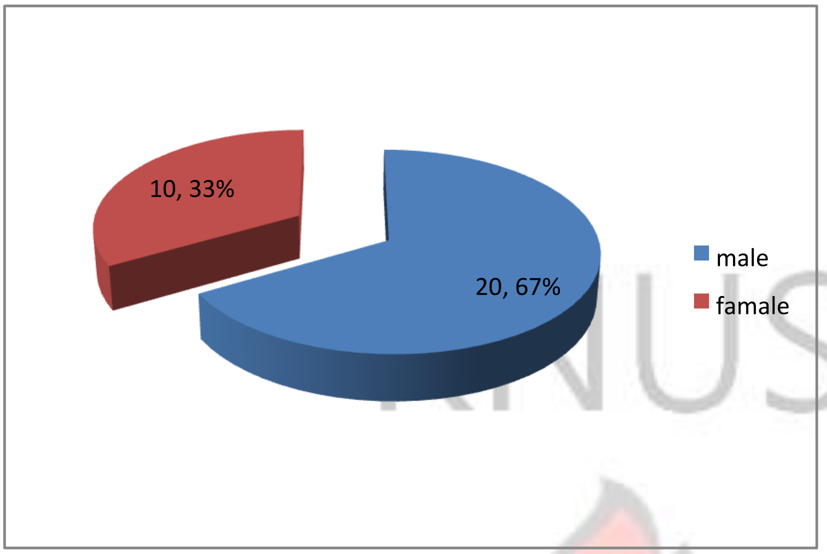
The data collected from the 30 credit staffs are presented, analysed and discussed. Among the 30 sampled credit staffs, all of them responded to the questionnaires. This gave a response rate of 100%. This chapter is subjugated into five sections with each section insightfully taking the section heading into consideration. The objectives of this study are thus captured in these subsections.

4.1 PROFILE OF RESPONDENTS

4.1.1 Sex of Credit Staff

Among the 30 sampled credit staff, 20 representing 67% were males and 10 representing 33% were females. This is clearly depicted by the pie chart in figure 1.

Figure 1: Sex of Credit Staff

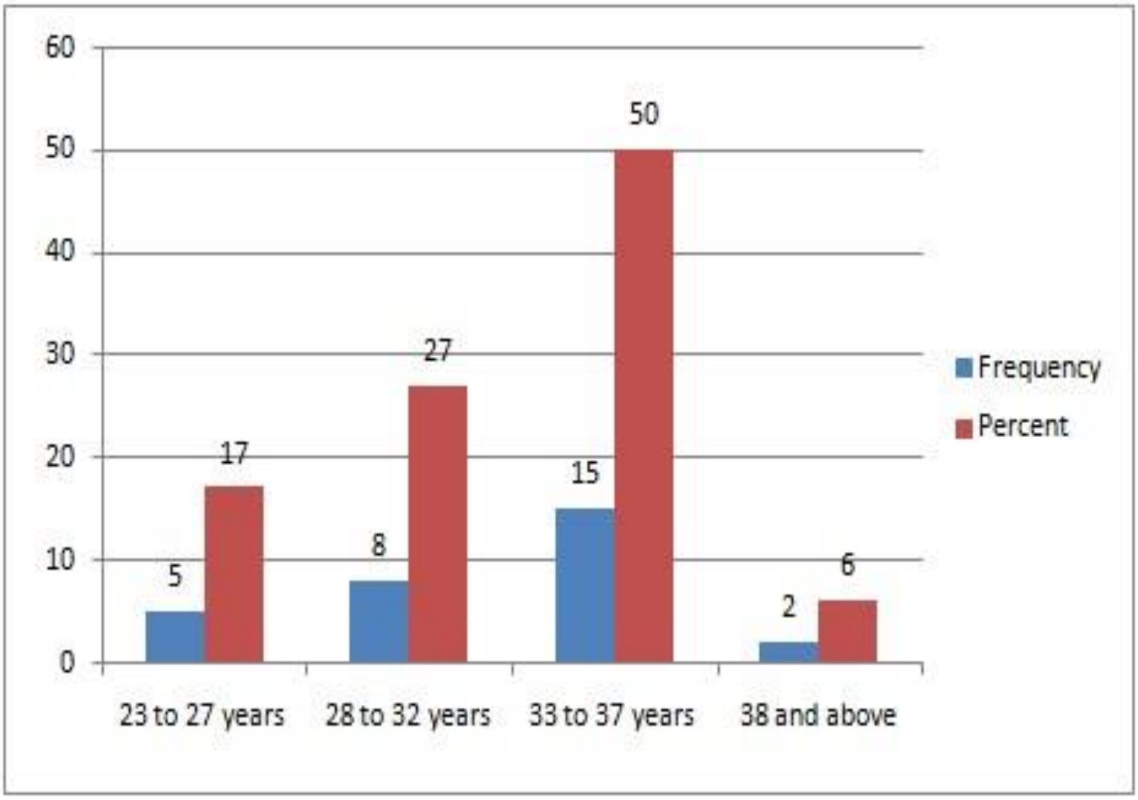


Source: Field Survey, 2015

4.1.2 Age group of Credit Staff

Most of the credit staffs (15 representing 50%) were from the ages of 33 to 37 years. This was followed by those from the ages of 28 to 32 years who were eight representing 27%. Five representing 17% were from the ages of 23 to 27 years with only two representing 6% above the age of 37 years. This is shown in figure 2.

Figure 2: Age Group of Credit Staff



Source: Source: Field Survey, 2015

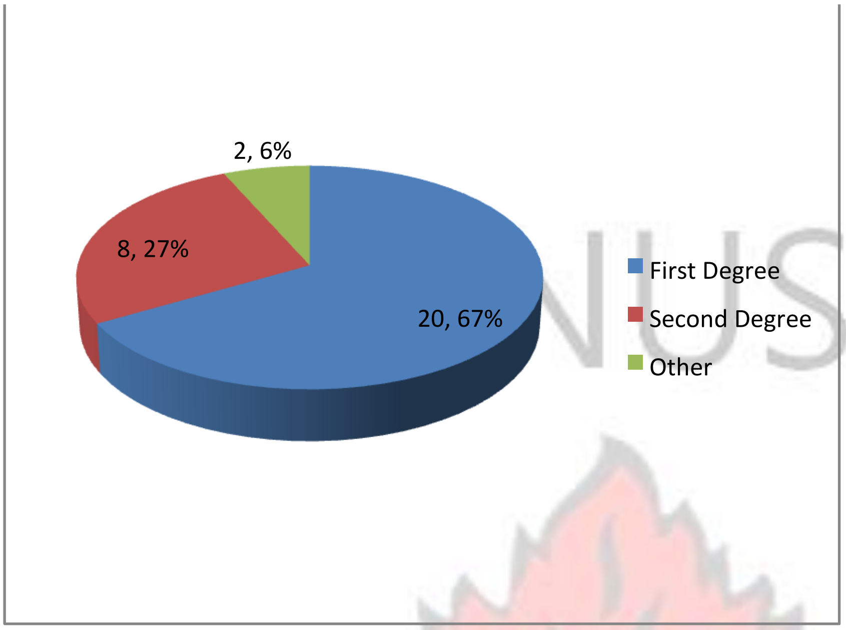
4.1.3 Qualification

The level of qualification of the respondents was asked. This was to help ascertain if they qualify academically for the job as credit officers. It was revealed that all the respondents had tertiary education. This was because the minimum qualification for a person to work at Zenith Bank Ghana was Bachelor"s Degree or First Degree.

Due to this, as much as 20 representing 67% were first degree holders, eight representing 27% were second degree or master"s degree holders while the remaining two representing 6% held some other qualifications.

These other qualifications were Certificate of Association of Certified Chartered Accountants and Certificate from the Chartered Institute of Banking. This is shown by the pie chart in figure 3.

Figure 3: Qualification of Credit Staff



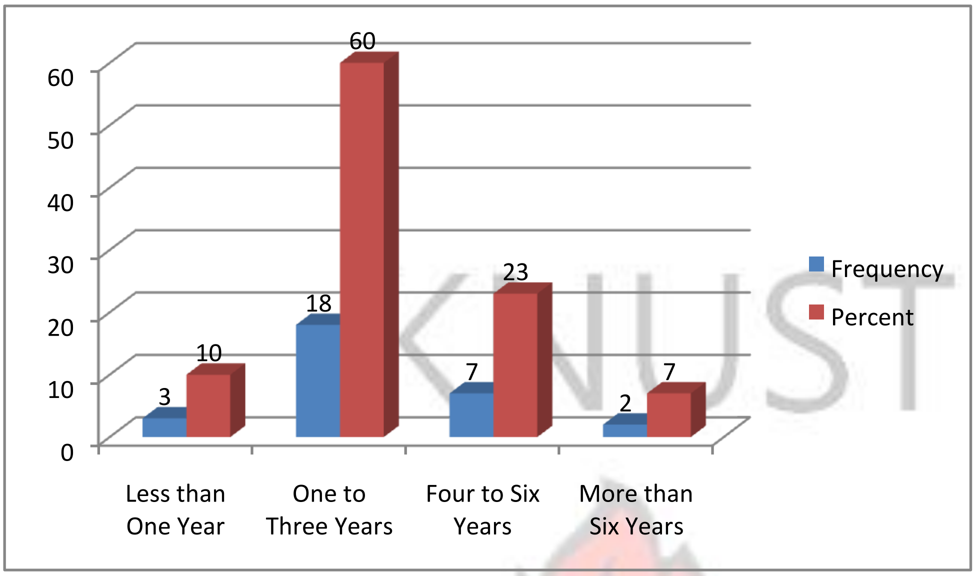
Source: Source: Field Survey, 2015

4.1.4 Number of Years Working with Organization

The data gathered from the respondents showed that three of them representing 10% had worked with the organization for less than one year. As much as 18 representing 60% had worked with the organization for one to three years. This was followed by those who have worked with the organization for four to six years who were seven representing 23%. Only two had worked with the organization for more than six years representing 7%.

The number of years of working with the organization was considered important as it can a bearing with the experience and knowledge of the staff.

Figure 4: Number of Years of Working with the Organization



Source: Source: Field Survey, 2015

4.2 CREDIT RISK MANAGEMENT (KNOWLEDGE AND ADHERENCE)

4.2.1 Specific Policies for the Management of Credit

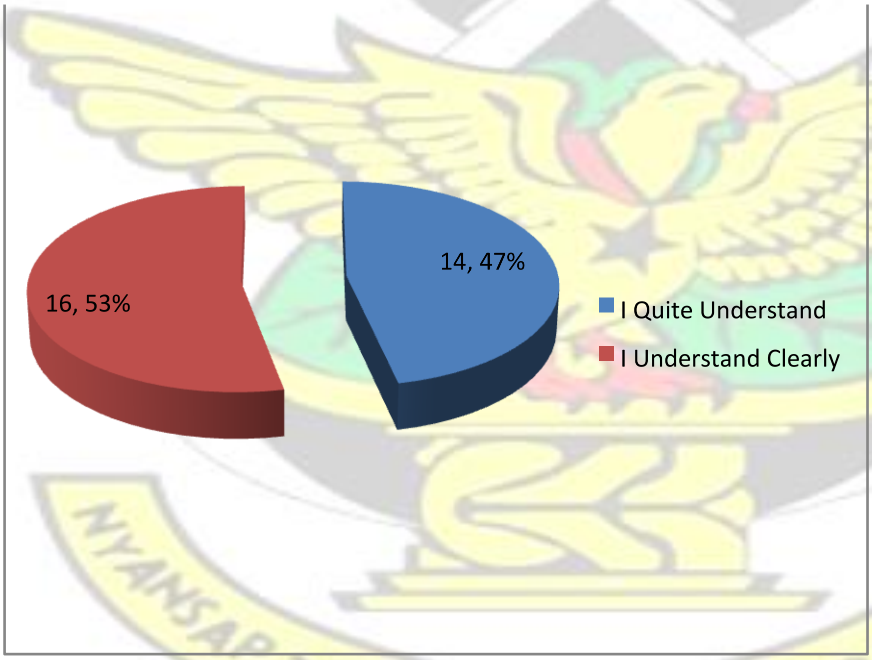
This study sought to find out if Zenith Bank Ghana Limited had specific policies for the management of credit. When the credit officers were asked, they all responded that the Bank has its own policies in place for the management of credit. According to their definition, these methods and strategies are adopted by a firm and not any individual in the firm or department in the firm. It is against this background that the respondents were asked if there existed any credit management policies that they adhered to.

As a follow up question, the credit officers were asked how often they reviewed the credit policies of the Bank. They were all in agreement that the policies were reviewed as and when the need arose and that there was no fixed timing for the reviewing of the policies.

4.2.2 Understanding of Bank's Risk Management Policies of its Product and Services

Having existing credit policies in the Bank does not guarantee understanding and implementation. With this in mind the credit officers were asked of their level of understanding of the policies risk management in the direction of the bank‟s credit activities relating to products and services. Nearly half (14 representing 47%) said they quite understood the bank‟s policies towards risk management regarding services as well as products. Sixteen representing 53% said they clearly understood the policies of risk management in place concerning the bank‟s products and services. This is shown in figure 5.

Figure 5: Understanding of Risk Management Policies



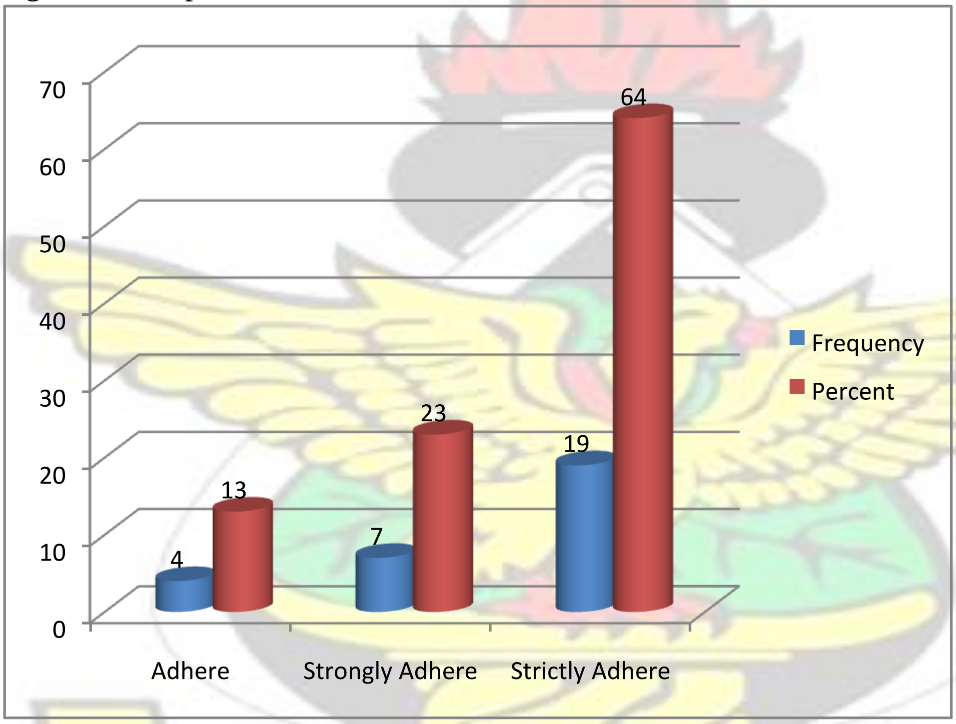
Source: Source: Field Survey, 2015

4.2.3 Compliance Level

Knowledge ability is not compliance. The respondents were required to rank their compliance level on a likert scale of one through to five. With one meaning non adherence, two meaning somewhat adhere, three meaning adhere, four meaning strongly adhere and five meaning strictly adhere.

Four representing 13% said they adhered to the risk management policies of the bank. Seven representing 23% said they strongly adhered to the risk management policies of the bank. However, as much as 19 representing 64% said they strictly adhered to the risk management policies of the bank. This means that all the credit staff implemented the risk management policies but in varying degree. This is shown in figure 6.

Figure 6: Compliance Level



Source: Source: Field Survey, 2015

As a follow up question was asked due to the high level of compliance that was ascertained, the credit staff were asked if the bank has any plans in place to enforce the adherence to the management of credit by the staff. All the staff were in agreement that there existed an organizational plan to enforce compliance. According to Scheufler

(2002), enforcement of strict adherence to these set of goals will go a long way to make the organization perform.

4.2.4 How Credit Risk Management is practiced

The credit officers were asked to write in their own understanding how credit risk management was practiced in the bank. Three main themes emerged after analysing their responses. First, customers were assessed based on their past credit history with the bank and possibly other banks as well. They are checked to make sure they have
"clean slate" before granting of loans. Second, strict assessment based on the purpose of the loan was as also done so as to make sure that loans were going to be used for purposes that will make repayment easy. The last theme drawn from their responses was that of monitoring. Loan monitoring was also another means that credit officers considered as being used in the practice of credit risk management.

4.2.5 Formal Training on Credit Management

All the credit officers were asked if they had ever received any form of training in credit management per the dictates of the bank. All of them responded in agreement that they have received such training before. However, they were asked how often they receive such training. On the timing of receiving such training, they all said the training was conducted as when the need arose. This means that they were only trained after needs assessment dictate it.

4.3 FACTORS NEGATIVELY AFFECTING CREDIT RISK MANAGEMENT

Respondents were given some factors and were asked to rate these factors on the scale from one meaning strongly disagree, two meaning disagree, three meaning neutral, four meaning agree and five meaning strongly agree. Their responses were used in calculation of severity index. This is because they were to consider the factor which severely impacts negatively on credit risk management in the bank. This was to help come out in ranked order factors that severely affect the credit risk management of the bank.

Table 1: Severity Index for Factors Negatively Affecting Credit Risk Management

Severity Index (%)	**Determinant**	**Ranking**
84	Poor Monitoring by Management	1st
72	Lack of Adequate Education and Training	2nd
70	Poor Management	3rd
62	Too many Financial Service Provided by the Bank	4th
59	Lack of Employee Motivation	5th

Source: Source: Field Survey, 2015

From the severity index table it can be seen that poor monitoring by management ranked first with a severity index of 84%. This means that the credit staff envisaged poor monitoring by management as the overriding factor severely impacting credit risk management negatively. This was followed by lack of adequate education and training with a severity index of 72% and so ranked second and poor management ranking third with a severity index of 70%. Too many financial services provided by the bank ranked forth with a severity index of 62% and lastly lack of employee motivation ranking fifth with a severity index of 59%. This clearly shows in ranked order the factors that employees consider as negatively impacting on the management of credit risk.

The respondents were asked if there were any other factors that negatively impacts on the credit risk management which was not provided on the severity scale. Two main responses were envisaged. First, when facilities were not used for the intended purpose, it impacts on the management of the credit risk. This was so because the diversion of funds may make repayment difficult. Secondly, over ambitious projects also stand to negatively impact the credit risk management.

4.4 COMMON CAUSES OF PROBLEM LOANS

Respondents were given some factors and were asked to rate these factors on the scale of one standing for strongly disagree, two standing for disagree, three standing for neutral, four standing for agree and five standing for strongly agree. Their responses were used in the calculation of severity index. This is because they were to consider the factor they see as a common cause of problem loan. This helped in bringing out the most common cause of problem loans in the bank. The severity index is as shown below.

Table 2: Severity Index of Common Causes of Problem Loans

Severity Index (%)	**Determinant**	**Ranking**
82	Lack of Adequate Employee Education and Training	1st
79	Poor Credit Appraisal	2nd
76	Poor Loan Monitoring	3rd
63	Funds Diversion by Customers	4th
60	High Interest Rates	5th
58	Willful Default	6th

Source: Source: Field Survey, 2015

From the severity index table above it can be seen that lack of adequate employee education and training ranked first with a severity index of 82%. This means that the credit staff envisaged lack of adequate employee education and training as the overriding factor causing problem loan. This was followed by poor credit appraisal with a severity index of 79% and so ranked second and poor loan monitoring ranking third with a severity index of 76%. Funds diversion by customers ranked forth with a severity index of 63% and high interest rates ranked fifth with a severity index of 60%.

The last factor, ranking sixth as a common factor causing problem loan was wilful default with a severity index of 58%. This clearly shows in ranked order the factors that employees consider causing problem loans.

The credit officers were asked if they thought non-compliance with credit policies accounted for problem loans in Zenith Bank Ghana. All the credit officers were of the opinion that non-compliance was a cause of problem loans in the bank.

4.5 MECHANISMS IN PLACE TO MANAGE BAD LOANS

4.5.1 Managing Bad Loans

In the management of bad loans, the credit officers were asked to describe how they dealt with bad loans of the bank. This question was asked as bad loans are inevitable in banking institutions due to unforeseen risks with loans. In their description, the following was said. First, the loan gets restructured with rearranged repayment plans for the customer to pay back the loan. This forms the initial phase of dealing with problem loans. If this initial phase yields no result, an external solicitor or debt collector is contracted to come and help with the debt collection. However, if this proves futile, legal action is taken as the final measure to deal with bad loans. It is worthy to note that it was considered uncommon for Zenith Bank Ghana to write off bad loans. The above means are strictly adhered to collect debts.

4.5.2 Collateral

Banks are known to take collaterals which can serve as security in case the loans are not repaid. These collaterals stand against that risk. All the 30 credit officers said there is always the taking of collaterals before loans are granted. However, not all collaterals are physical properties that the individual has.

4.5.3 Mechanisms to Reduce Bad Loans

The credit officers were asked of mechanisms they personally know that can help reduce the incidence of bad loans. They were asked this question because they have worked in the credit department of the bank and may have developed their own ways of reducing bad loans in the bank. They were of the view that standard methods of credit appraisal and standard credit policies are effective mechanisms to reduce bad loans.

CHAPTER FIVE

SUMMARY OF KEY FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.0 INTRODUCTION

This chapter basically has as its aim to provide the summary of key outcomes or findings of the research study, bringing to light pertinent issues. A brief conclusion and recommendations having in view the findings of the study is given in this chapter.

5.1 SUMMARY OF FINDINGS

The summary of findings will be grouped into the objectives of the study for easy reader comprehension and digestion. The summary of findings will dwell on the objectives of the study.

5.1.1 Knowledge of Credit Risk Management and Adherence

An interesting key finding which was not surprising was that of existing policies for the management of credit. All the respondents were aware of existing policies in the bank that has to be adhered to in the management of its credit risks. However, this study showed that there was no set times for reviewing the policies of the bank and that review was done as and when deemed necessary. There was also staff‟s knowledge and understanding of the policies relating to credit risk management of the bank concerning the banks products and services. This finding was not news as training was organized for the staff when the need arises. Another finding was the high staff compliance with the policies of the bank concerning credit risk management. There was strict adherence as there were enforcement policies to that effect. The practice of credit risk was also seen in the assessment of past credit history of customers and loan monitoring.

5.1.2 Factors Affecting Credit Risk Management

On the factors affecting credit risk management, poor monitoring by management and lack of adequate education and training were considered as the most severe factors negatively affecting credit risk management of the bank.

Lack of employee motivation and too many financial services provided by the bank were found to be less in negatively impacting credit risk management.

5.1.3 Common Causes of Problem Loans

This study found that a major cause of problem loan was lack of adequate employee education and training as well as poor credit appraisal and poor loan monitoring. Noncompliance with credit policy was envisaged by all credit staff as a cause of problem loan.

5.1.4 Mechanism in Place to Manage Bad Loans

On the mechanisms in place to manage bad loans, the this study found out that the bank engages in loan restructuring where repayment terms are reviewed and changes made to enable the borrower pay back.

The bank also engages in the contracting of debt collectors and legal suits. It was revealed that Zenith Bank Ghana hardly writes off loans. Collateral was also a common place in the bank revealed by the study.

5.2 CONCLUSION AND RECOMMENDATIONS

This research work sought to assess the management of credit risk in Zenith Bank Ghana. This study has brought to the fore the existence of and adherence to credit risk management policies in banks. It has revealed that the management of credit risk is very important as it has implications for the solvency of the bank.

The credit department is known for the management of "credit risk" mandated by the bank in order to deal with risks. Also, the common place of collateral as a means ameliorating risks of giving out credit cannot be overlooked.

Some known factors that severely impact on the management of credit risks as well as problem loans cannot also be overlooked as these can affect profit margins of banks and consequently performance of bank‟s credit in general.

Based on the finding of the study the following paragraphed below recommendations were made.

To begin, the bank is commended on its adoption of policies across board on the management of credit risks in the bank. This should be documented and known by every existing and new credit officer and even extend beyond the credit team to the whole officials of the bank. This will serve to make it a responsibility of the entire staff to lookout for it and implement it.

It is also recommended that monitoring by management be intensified so as to deal with deficiencies in "credit risk management" of the bank. This intensification of monitoring will serve to put the credit staff and the other staff on their toes to see to the implementation of the credit policies of the bank.

Employee education and training should also be intensified so as to work against bad loans. As identified as one of the main causes of bad loans, the organization should consider educating and training its members on the issues of credit risk management.

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APPENDIX

QUESTIONNAIRE

ASSESSING CREDIT RISK MANAGEMENT OF ZENITH BANK GHANA

I am a student at the KNUST School of Business, Kwame Nkrumah University of Science and Technology. As part of the programme, I am conducting a research on the above topic. You are kindly requested to read through the items and respond to the questions as objectively as possible. Information provided shall be treated confidential.

Thank you.

DEMOGRAPHIC CHARACTERISTICS OF RESPONDENTS

1. Gender [ ] Male [ ] Female
2. Age in Years [ ] Less than 18yrs [ ] 18-22 [ ] 23-27 [ ] 28-32 [ ] 33-37 [ ] 38 and above
3. Highest level of education [ ] No education [ ] Elementary [ ] SHS [ ] Tertiary
4. Number of years of working with institution [ ] Less than 1year [ ] 1 to 3years [ ] 4 to 6years [ ] More than 6 years

Credit Risk Management (Knowledge and adherence)

5. Does Zenith Bank have specific policies for the management of credit?

   [ ] Yes [ ] No

6. If yes, how often do you review your credit policies? [ ] Quarterly [ ] Semi-annually [ ] Annually [] Others, please specify

____

7. How do you evaluate your understanding of risk management policies towards the bank‟s credit products and services? [ ] I don‟t know any [ ] I know very little

   [ ] I quite understand [ ] I understand clearly
8. What is your compliance level on a scale of one to five, with one being the least level of compliance and five the highest level of compliance? [ ] 1 [ ] 2 [ ] 3 [ ] 4 [ ] 5
9. Are there any plans in place by the bank to enforce adherence to its credit management by the staff? [ ] Yes [ ] No
10. In your own understanding, how is credit risk management practiced in the bank?

    ____

    ____

    ____
11. Have you ever received any formal training as per the dictates of the bank on credit management? [ ] Yes [ ] No
12. If yes, how often? [ ] Once in a year [ ] Twice in a year [ ] thrice in a year [ ] Other, please specify

    ____
13.

FACTORS NEGATIVELY AFFECTING CREDIT RISK MANAGEMENT

14. On a scale of 0 to 4, with 0 = strongly disagree, 1 = Agree, 2 = Neutral, 3 = Agree and 4 = strongly agree, which of the following factors will you consider as severely

impacting negatively on credit risk management in the bank? Please tick appropriately.

No.	Factor	0	1	2	3	4
1	Poor management					
2	Poor monitoring by management					
3	Lack of adequate education and training					
4	Lack of employee motivation					
5	Too many financial services provided by the bank					

15. Which other factor(s) not mentioned in the table do you deem as negatively impacting on the credit risk management of Zenith Bank Ghana?

____

____

____

COMMON CAUSES OF PROBLEM LOANS

16. On a scale of 0 to 4, with 0 = strongly disagree, 1 = Agree, 2 = Neutral, 3 = Agree and 4 = Strongly agree, which of the following factors will you consider as severely impacting negatively on credit risk management in the bank? Please tick appropriately.

No.	Factor	0	1	2	3	4
1	High interest rate					
2	Poor loan monitoring					
3	Lack of adequate employee education and training					
4	Poor weather					
5	Wilful default					
6	Poor credit appraisal					
7	Funds diversion by customers					

17. Do you think non-compliance with credit policy account for Problem Loans in Zenith Bank? [ ] Yes [ ] No [ ] Cannot tell

MECHANISMS IN PLACE TO MANAGE BAD LOANS

18. How do you deal with bad loans? [ ] Take legal action [ ] Write off [ ] Outsourcing (External Solicitor of Debt Collector) [ ] Other, please specify ____

19. Is collateral a must before one is granted a loan? [ ] Yes [ ] No
20. What mechanism do you personally know that has helped the bank reduce bad loans? ____ ____ ________

Thank You

ASSESSING CREDIT RISK MANAGEMENT OF ZENITH BANK GHANA

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