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examining the effectiveness of credit risk management on banks: the case of fbc bank

BY

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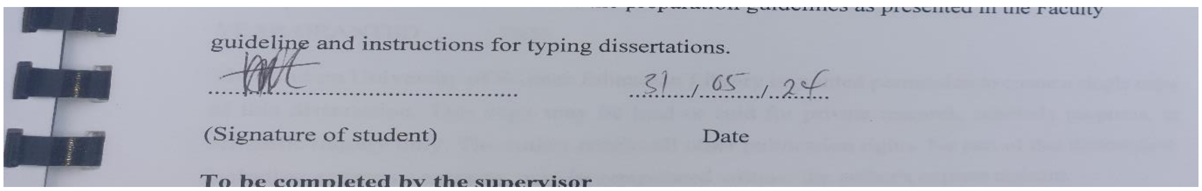
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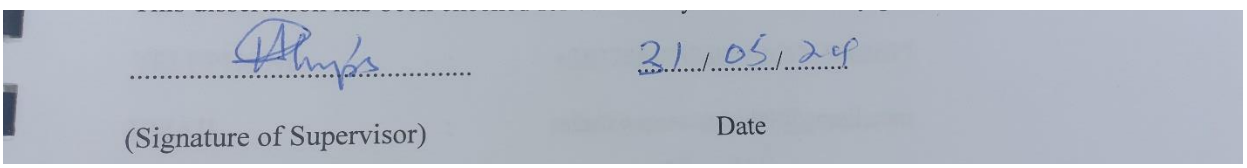
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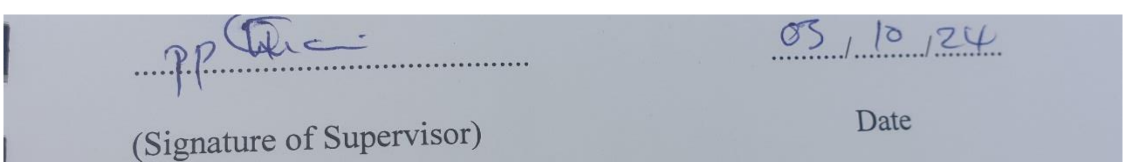
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DEDICATION

My family's unwavering love has provided a foundation of cherished memories. While gratitude is a cornerstone virtue, it's through them that I've learned all others. This dissertation is dedicated to my parents, Mr. Jaravaza and Mrs. Beni. Mom and Dad, your lessons have shaped who I am today, and your love will forever reside within me. I extend my gratitude to my supervisor, Mr. Chaparadza, whose insightful guidance and scrutiny have been invaluable throughout my academic journey. Finally, this dissertation is dedicated to my faith in Jesus Christ, the Alpha and Omega. His strength carried me through challenges, and his guidance offered comfort during my academic pursuit.

ABSTRACT

Financial institutions are crucial for economic growth, but Zimbabwe's harsh economic environment since the 2008 recession has exposed them to various risks, particularly credit risk. This study assessed credit risk management practices at FBC Bank. It aimed to identify the main sources of credit risk, evaluate the bank's current techniques for mitigating risk, and recommend strategies for improvement.

The research used a case study design with stratified random sampling. Data was collected through questionnaires (67 respondents) and interviews (13 respondents). The study identified macro-economic instability, non-performing loans, and non-compliance with credit risk policies as the primary sources of credit risk for FBC Bank. Additionally, it found that the bank lacks loan protection insurance, further exposing them to risk, especially for clients.

Based on the literature review and findings, the study recommends several improvements which include regular review of credit risk policies by the board to ensure alignment with current risk tolerance levels, hiring external credit risk analysts to implement advanced evaluation models and ongoing training programs for bank employees on effective credit risk management practices

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I begin by expressing my deepest gratitude to God for His guidance and support throughout this dissertation journey. My sincere appreciation goes to my supervisor, Mr. Chaparadza, for his invaluable time invested in supervising my dissertation. I am particularly grateful to FBC Bank for providing me with this research opportunity, special thanks to Mr. Ronald Chibwe, Managing Director, and Mrs. Daneese Mwale, Operations Manager, for granting me the internship that facilitated this research. I also extend my appreciation to the FBC Bank Harare head office employees who participated in the interviews and completed the questionnaires.

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LIST OF ACRONYMS

CRM	Credit Risk Management
CR	Credit Risk
SSB	Salaries Service Bureau
P.A.R	Portfolio at Risk
NPL	Non-performing loans

CHAPTER 1

GENERAL ORIENTATION

1.0 INTRODUCTION

The heart of any financial system lies in the banking sector. However, credit risk continues to be a problem in Zimbabwean banking system. Banks are able to survive if they are profitable. This is further worsened since if credit risk is not managed, it may lead to bank failures (Makri & Papadatos, 2013). Over the past 20 years, there have been several banking crisis which led to closure of so many banks in Zimbabwe such as Genesis Bank, Royal Bank, Trust Bank, Interfin Bank, Allied Bank and Kingdom Bank. According to Menelisi (2021), many banks in Zimbabwe failed since 2002 due to credit risks being the major cause among some other risks which are liquidity and operating risks. It is necessary to remember though that banks vary from one to another in many aspects in particular, their goals, services and strategies (Alquisie, 2018). Banks face various risks in their day to day operations. Bearing in mind those risks, markets affected the profitability of commercial banks as it was in case of Zimbabwe in 2007, where the Global financial crisis contributed to a major currency depreciation falling share values and thus to political and economic turmoil. The aim of credit risk management is to minimize bank's risk adjusted rate of return by maintaining risk exposure within acceptable boundary (Anderson, 2012). Therefore the researcher needs to examine on how best credit risk can be tackled to enhance profitability for the banks in Zimbabwe.

1.1 BACKGROUND OF THE STUDY

George Santayana said, "Those who cannot remember the past are condemned to repeat it". Clifford, (1982; Harrington and Niehus, (2003; Heins and Williams, (1995) dated the origin of modern risk management to 1955 – 1965. Snider (1956) discovered that risk management had been sidelined during that time. Banking is a risky business, always has been and presumably always will be (George G Kaufania). During the 1930s, there were specific risks which were discovered in banking sector and those risks have not been changed over the years. The risks included fraud, credit, interest, liquidity, foreign exchange, operations and regulatory.

However, according to Henry Sidgwick, (2013) risk regulation was important before the great expansion in bank regulation in 1933- 1935. From 1975 through 1919, the rate of commercial banks failures averaged slightly below that of non-financial firms although the annual variance was greater. Banks played a crucial part in economies. Banks' risk shape is thus a policy concern considering risks such as credit risk can upset the entire financial system and the whole country as a whole. Between 2007 and 2008, Zimbabwean banks faced a critical financial crisis and that showed how fast excessive exposure to credit risks can wane the banking industry and the economy.

To maintain the stable position in the international financial system, Basel Capital Accord named Basel I was introduced in 1988, however due to its weakness Basel II was introduced in 2004 (Altunbas et al, 2007). The prime objective of Basel Accord was to strengthen the bank's capital position and minimization of risks. However Basel II was overcame by the financial crisis of 2007-2008 thereby creation of Basel III in 2010. Due to the recent financial crisis, questions have been raised to the mind of the policy makers about the effectiveness of capital regulation and its effect on the bank risks profitability performance. Therefore as a researcher it was of no surprise to increase the concern about the investigation on the linkage between bank capital, risks and profitability.

Credit risks affected both banks, clienteles and other stakeholders through worsening systematic monetary fragility and spillover effects by its contagion effect and also systematic risk (Panageas, 2010). Extreme exposure to risks directed to bank failures in Zimbabwe both post and prior to adoption of the multi-currency administration and this disturbed financial inter-mediation and also the whole development of the economy.

1.2 STATEMENT OF THE PROBLEM

Banks were exposed to risks mostly the credit risk. Credit risk is a matter of worry where other firms and persons are failing to resolve their debts due to bad economic environment. When a bank is affected by credit risk, it leads to harm of confidence in terms of its sustainability therefore there will be reduced capacity development in the bank. For instance, overdue payments exposes and suppresses the forthcoming development of the bank as a result of deferred investments and therefore leads to a notch of uncertainty about the sustainability of the banking institutions.

Credit risk is also exposing banks in experiencing extra expenses in the course of trying to recuperate back the large sums in arrears through recovering expenses that are comprehensive of visits, analysis and legal costs. In the scenario of legal practices via the courts, organizations suffers financially since the court procedure may be costly and time consuming till the ruling of how the organization will be repaid is given, the processes included are expensive to the organization.

Failure to repay also harmfully affect the performance of banks in such a means that lending programs lose credibility, thus the reliability on every loaning policy program is threatened on time for repayment of the loan. The difference among the arranged date of repayment and the debt settling date cause financial anomalies henceforth weakening the loaning system. Delayed loan settlements or faulty loan responsibilities by the debtor will lead the time factor to be discredited therefore, leaving the program not reliable.

The writer focused on credit risk management procedures in FBC Bank, examining how the bank overpowers loan defaults and bad-debts and also to make recommendations on effective credit risk management application.

1.3 RESEARCH OBJECTIVES

Primary objectives

- The researcher sought to examine the effectiveness of credit risk management to the profitability of Banks.

Secondary objectives

- To analyze FBC Bank's sources of credit risk
- To evaluate the credit risk management system at FBC Bank

- To suggest suitable measures for managing credit risk.

1.4 RESEARCH QUESTIONS

- What are the sources of credit risk at FBC Bank?
- What type of systems does FBC Bank use to combat credit risk?
- What should be done to minimize credit risk in Banks?

1.5 JUSTIFICATION OF THE STUDY

This study intends to examine the effectiveness of credit risk management of Banks in Zimbabwe. In accordance to other researches banks faces a number of risks, however credit risk is the major risk which can affect the profitability and performance of banks. Issuing credit might benefit the Bank probably if the credited funds have been repaid in full with interests. It also helps the borrowers since they are given money in the period of needy. However, sometimes debtors might fail to repay the funds, thereby need for credit management to avoid banks closure. Issuing credit is beneficial to both the poor and the rich in the society probably depending on the conditions of issuing the loan, but however it must not be a burden which affects the lender (bank). It is argued that despite how banks are trying to eliminate credit risk, there is no conclusive measure which has been taken and eliminated credit risk completely.

1.6 ASSUMPTION OF THE STUDY

The study based on the assumption that credit risk has a negative impact on the profitability of Banks in Zimbabwe which is even leading to closure of other banks. In the context that credit risks have been dealt with, banks will smoothly survive in Zimbabwe.

1.7 DELIMITATION OF THE STUDY

The study was conducted in Harare Zimbabwe, therefore the research was not applicable in any other city which is not Harare Zimbabwe due to the differences in policies that drive the economies and cities. The study was from August 2023 up to May 2024. This period permitted the researcher to gather enough information of the problem.

1.8 LIMITATIONS OF THE STUDY

The research was affected by deficiency of resources. This was the major impact on the quality of the research results. Transport costs deterred the investigator from moving around all branches to gather enough data for the investigation therefore the investigator used Skype and e-mails to distribute questionnaires to respondents at branch level.

1.9 SUMMARY OF THE CHAPTER

The background of the study of FBC Bank was mainly focused in the above chapter. The statement of problem, objectives of study, research questions used, assumptions, significance, delimitation, limitations, terms definitions in the chapter and the arrangements of the project were also focused on. The proceeding chapter will focus on literature review.

CHAPTER 2
LITERATURE REVIEW

2.0 INTRODUCTION

This chapter explores existing research on credit risk management. It examines various studies and publications by other scholars. Literature reviews, typically analyze different sources including theoretical frameworks, conceptual framework and empirical review. As Adjei (2023) explains, a literature review surveys existing knowledge on a specific topic, theory, or research question. "Literature" in this context refers to all informative sources on the subject. These sources provide valuable insights into previous research conducted in your chosen area. In essence, a literature review critically analyzes and summarizes relevant scholarly works to build a foundation for your research

2.1 REVIEW OF RELATED LITERATURE

2.1.1. CREDIT RISK

Credit risk, as explained by Kyle (2023), arises from the possibility that a borrower might not fulfill their financial obligations. This can manifest as an actual default or a less severe situation where their creditworthiness weakens. While the likelihood of default is a crucial factor, Kyle emphasizes the importance of considering potential exposure at the time of default and the possibility of recovering some of the loaned amount. Factors like loan size, collateral provided, guarantors involved, and loan maturity all influence the overall credit risk associated with a loan.

2.1.2. CAUSES OF LOAN DEFAULTS IN BANKS

The causes of loan defaults can vary depending on various factors. According to Allen & Saunders (2004), they include financial mismanagement, unemployment, economic downturn, lack of collateral, health Issues or emergencies, inadequate risk Assessment, lack of financial education.

2.2 THEORETICAL LITERATURE

2.2.1 THE HIGHS AND LOWS THEORY

Merton C. R. (2015), postulated that, the highs and the lows is a theory of pricing, managing and assessment credit risk during the business cycle. Merton proposed the idea which he developed using three fundamental building elements which are:

Financial institutions navigate a choice between conservative, lower-risk loans and potentially riskier, higher-reward loans. This selection is heavily influenced by public confidence in the institution's ability to assess and manage credit risk. The success of these loans depends on the underlying economic climate, which can be a combination of the institution's skill and external factors. There's an assumption that economic conditions can be either "skill-driven," where the institution's expertise plays a major role, or "luck-driven," where outcomes are influenced by external forces beyond the institution's control.

Merton (2015) highlights the initial uncertainty surrounding the dominant economic state (skill-driven or luck-driven). While there might be prevailing beliefs about the likelihood of each state, no one is certain at the outset. This uncertainty influences loan selection. Financial institutions are likely to prioritize safe loans if success is perceived as purely random (luck-driven). Conversely, if institutions are viewed as skilled in managing risk (skill-driven), they may be able to attract capital for riskier ventures with the potential for higher returns. This dynamic creates a situation where a history of successful loan repayments can lead to increased investment in riskier loans, as long as market participants believe the success stems from the institution's skill.

Building on Merton's (2015) framework, this principle acknowledges that economic conditions can evolve over time. If initial loan success is attributed to skill, institutions may be able to secure funding for riskier ventures in subsequent periods. However, the crucial factor is the market's evolving perception of success. If the belief persists that outcomes are solely driven by luck, investors may continue to support successful institutions even in the absence of a crisis, potentially leading to an increase in risk-taking behavior across the market.

The framework also considers the inherent risk associated with short-term funding for long-term loans (interim refinancing). Financial institutions typically rely on debt with shorter maturities than the loans they issue. This creates a vulnerability if the economic climate changes (macroeconomic uncertainty regime shift) before the loans mature. Since all institutions face this risk from the same underlying factors (systematic risk), the failure of one institution to refinance its debt can trigger a domino effect, impacting the entire financial system.

Merton (2015) emphasizes the role of learning and adaptation within this framework. As experience accumulates (rational learning), perceptions about lending skill can be revised. In an environment where the economic climate can be influenced by both the institution's skill and external factors, a string of successful loan outcomes can lead to overconfidence. This can affect all participants in the financial system, including the institutions themselves, their investors, and regulators. They may start to assign an unrealistically high probability to the institutions' ability to manage risk effectively.

2.2.2 ANTICIPATED INCOME THEORY

According to the theory, regardless of the nature and character of a borrower's business, the bank aims to liquidate the term loan from the borrower's anticipated income. A bank can preserve its liquidity if loan repayments are planned based on the borrower's anticipated income rather than the intended usage or collateral given (Gordy, 2003). Thus, this theory indicates that when providing loans, banks should rely on borrowers' income and it’s covering of debt-service requirements. The anticipated income approach bases the analysis on cash flow projections, which provides a reliable indication of the liquidity of the loan being financed; thus, the borrower's future cash-flows, rather than the nature of specific transactions being financed, ensures the self-liquidating character of a loan because it determines a borrower's overall ability to meet interest and principal payments as they fall due.

2.2.3 THE COMMERCIAL LOAN THEORY

Harris (2001) proposed that “the commercial-loan idea, is also known as the doctrine of real banknotes. He claims that banks are experiencing a liquidity-earnings issue”. Banks prioritizes complete safety by keeping all depositor funds as cash in a vault (fully liquid assets). While this approach guarantees immediate access to cash for depositors, it has a significant drawback: the bank wouldn't be able to generate any income. This is because banks typically use deposited funds to provide loans and other financial products. These activities generate interest income, which allows banks to operate profitably and offer returns to depositors.

According to the theory, riskier financial ventures can offer potentially higher returns. However, this creates a challenge for banks, as they cannot solely focus on high-risk, high-reward loans (Harris, 2001). While such loans might be lucrative, their illiquidity makes them unsuitable for all situations. As Harris (2001) points out, "it would be difficult to quickly convert these loans to cash" if depositors need their money. The concept of self-liquidating loans, also known as "real bills," offers a solution to this dilemma. These loans are secured by assets that can be readily sold to repay the loan if necessary. This approach allows banks to Pursue Profitable Opportunities, by including self-liquidating loans in their portfolio, banks can participate in riskier ventures with the potential for higher profits and Maintain Liquidity, the security provided by the underlying assets ensures that banks can access cash quickly if needed, even if some riskier loans are outstanding. Therefore, self-liquidating loans can be a valuable tool for banks to achieve a balance between profitability and liquidity.

2.3 **EMPERICAL LITERATURE**

In a study by Bhattarai (2016), researchers examined the relationship between credit risk and the performance of commercial banks in Naples. The study employed a combined descriptive and causal-comparative research design. Data was collected from 14 banks operating in Naples for the period 2014 to 2019.

This research examines the connection between credit risk and bank performance. One study by Bhattarai (2016) focused on commercial banks in Naples. It found that a higher ratio of non-performing loans (NPL) negatively impacted bank performance, while the cost of loan assets had a positive effect. Interestingly, the study also identified a positive relationship between credit risk indicators and bank size with performance. However, capital adequacy and cash reserve ratios seemed to have no significant impact. This suggests that the study may not have captured the full picture of how credit risk management practices influence bank performance.

Another study by Alshatti (2015) investigated the impact of credit risk management itself on Jordanian commercial banks' financial performance. This research, examining data from 2005 to 2013, found a clear connection between effective credit risk management and improved financial results. The study emphasizes the importance of managing credit risk indicators, such as non-performing loans, leverage ratio, and provisions for loan losses. However, its focus was on the outcomes of credit risk management (like NPL ratio) rather than the specific practices employed (e.g., credit risk identification, appraisal, control, and monitoring).

Several studies explore the intricate link between credit risk and a bank's financial health. One such study by Bhattarai (2016) examined commercial banks in Naples. It revealed that a higher ratio of non-performing loans (NPL) negatively impacted performance, highlighting the potential losses associated with bad debt. Interestingly, the study also found a positive correlation between credit risk indicators and bank size with performance. This could be due to larger banks having a greater capacity to absorb losses or a wider range of loan products that might mitigate risk exposure. However, the lack of significant impact from capital adequacy and cash reserve ratios suggests the study might not fully capture the influence of credit risk management practices.

Another study by Alshatti (2015) took a different approach, investigating the direct impact of credit risk management on Jordanian commercial banks' performance from 2005 to 2013. This research found a clear link between effective credit risk management strategies and improved financial results. It emphasized the importance of managing key credit risk indicators like non-performing loans, leverage ratio, and loan loss provisions. However, the focus was on the outcomes (like NPL ratio) rather than the specific practices employed for managing credit risk, such as loan appraisal, risk identification, and monitoring.

These studies highlight the complex relationship between credit risk and bank performance. While Bhattarai (2016) suggests credit risk indicators and bank size play a role, it emphasizes the potential need to explore credit risk management practices more thoroughly. Alshatti (2015) confirms the positive impact of effective management but focuses on the outcomes rather than the specific strategies used. Future research could bridge this gap by examining how specific credit risk management practices influence the various credit risk indicators and ultimately contribute to a bank's financial health.

Kalui and Kiawa (2015) examined how credit risk management practices influence the performance of Banks institutions in Kenya. Their study employed a descriptive design and surveyed credit managers and officers from Banks within Nairobi County. The research identified four key credit risk management processes which are Risk Identification, Risk Monitoring, Risk Assessment and Risk Analysis The study found that all surveyed Banks considered these processes essential for establishing a robust credit risk management framework. It's important to note that this research focused specifically on Kenyan Banks and may not be generalized to commercial banks or Banks in other countries.

Kibor, Ngahu, and Kwasira (2015) investigated the link between credit risk management techniques and loan performance in Nakuru Town banks. They employed a combined descriptive and correlation research design. The study involved all 37 commercial bank branches in Nakuru, and data was collected through questionnaires.

The research identified a moderately positive relationship between loan performance and lending policies, suggesting that well-defined lending practices contribute to a healthier loan portfolio. Additionally, a statistically significant positive association was found between loan performance and credit standards. This highlights the importance of stringent credit assessment procedures in reducing loan defaults.

It's important to note that this study focused specifically on the impact of credit risk management practices on loan performance, not necessarily the overall financial performance of the banks. Tanui, Wanyoike, and Ngahu (2015) investigated the role of credit risk management practices in the financial performance of Savings and Credit Cooperatives (SACCOs) in Nakuru County, Kenya. They employed a descriptive survey design, targeting credit officers and managers from a sample of 90 SACCOs. Questionnaires were used to collect data from the participants.

The study identified a strong positive relationship between credit scoring and the financial success of SACCOs. This suggests that implementing a system for evaluating borrower creditworthiness can significantly improve financial performance. Additionally, the research found a significant correlation between credit administration practices in deposit-taking SACCOs and their financial health. This highlights the importance of effective loan management processes, including loan monitoring and collection activities.

The study emphasizes that for Kenyan SACCOs to enhance their financial performance, strengthening credit scoring and credit administration practices are crucial elements of effective credit risk management. It's important to note that this research focused on SACCOs, and the findings may not be directly applicable to commercial banks in Kenya.

Li and Zou (2014) examined the relationship between credit risk management and profitability in European banks. Their study analyzed data from 47 banks across Europe from 2007 to 2012. The research found a positive impact of credit risk management on bank profitability. Interestingly, the study suggests that credit risk management practices, as measured by the Non-Performing Loan Ratio (NPLR), had a significant influence on both Return on Assets (ROA) and Return on Equity (ROE). However, the Capital Adequacy Ratio (CAR) did not show a statistically significant impact on profitability. The study also observed fluctuations in the relationships between these measures over the period (2007-2012).

It's important to note that this research focused on credit risk indicators, specifically the NPLR, as a proxy for credit risk management effectiveness. While the NPLR reflects loan defaults, it doesn't directly assess the specific practices employed in managing credit risk, such as risk identification, appraisal, control, and monitoring. Building on the theme of credit risk management and bank performance, Idowu and Awoyemi (2014) conducted a separate study focusing on Nigerian banks.

This study examines the relationship between credit risk management and bank profitability over a seven-year period (2005-2011) using data from seven banking institutions. A panel regression model was employed to analyze the financial report data collected. The study focused on Return on Equity (ROE) and Return on Assets (ROA) as measures of financial performance. Additionally, Non-Performing Loans (NPLs) and the Capital Adequacy Ratio (CAR) served as indicators of credit risk management effectiveness.

The research revealed a significant positive impact of credit risk management on bank profitability. However, it's important to note that the study did not delve deeper into the specific credit risk management practices used by the banks. These practices could include processes like risk identification, appraisal, control, and monitoring.

Kimari (2013) investigated the influence of credit risk management on the financial performance of deposit-taking Savings and Credit Cooperatives (SACCOs) in Kenya. The study targeted the heads of credit risk management from all 215 SACCOs supervised by the Sacco Societies Regulatory Authority (SASRA). Employing Pearson correlation analysis and a multiple regression model, the research found a positive correlation between effective credit risk management and the financial performance of SACCOs. This suggests that robust credit risk management practices contribute to a healthier financial standing.

The study emphasizes the importance for SACCO management to carefully analyze various factors beyond just credit risk. These factors include capital adequacy, earnings, and liquidity, as they all demonstrate a positive relationship with a SACCO's Return on Equity (ROE). It's important to consider that this research focused on deposit-taking SACCOs in Kenya. Their activities and regulatory environment may differ from those of commercial banks.

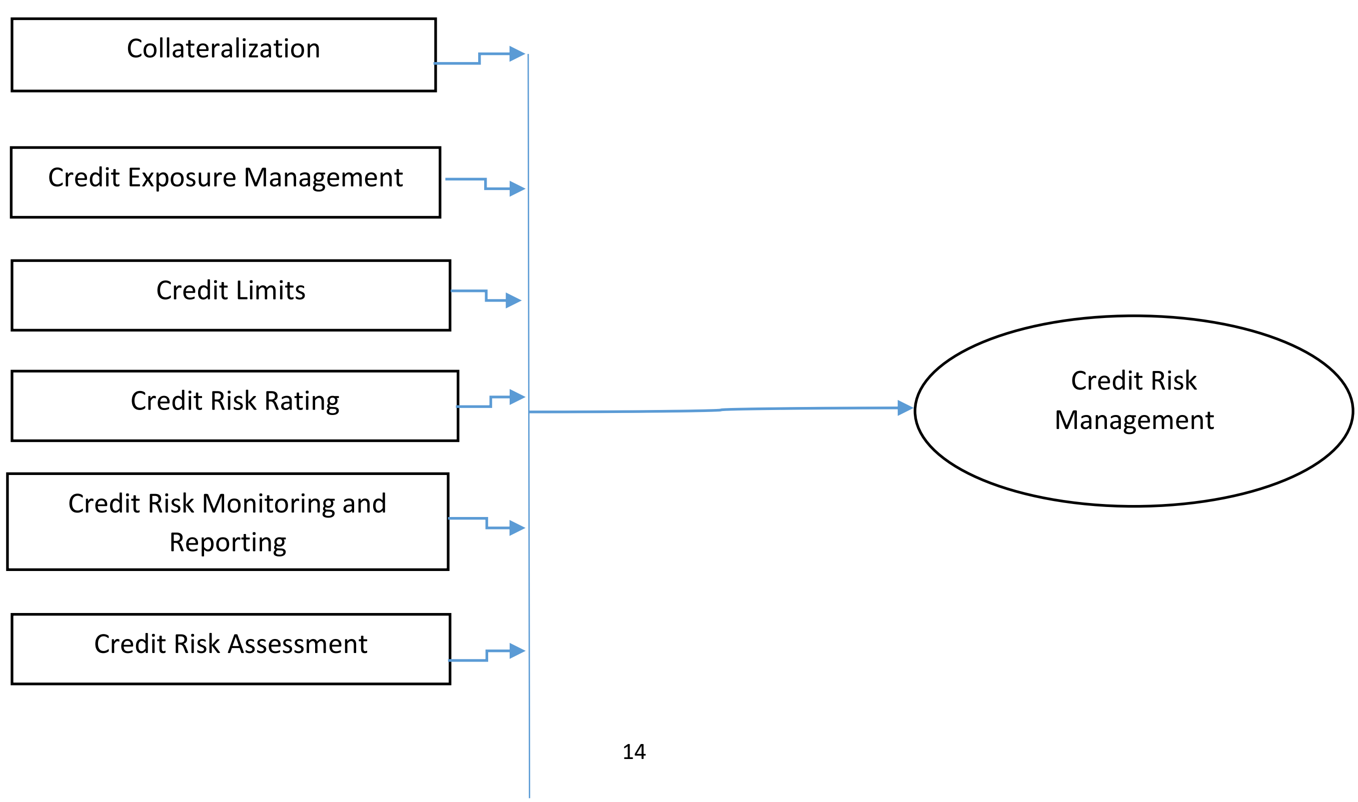
Poudel (2014) investigated parameters linked to credit risk management as they affect the financial performance of banks using correlation and regression analysis. The factors comprised the cost per loan asset, the default rate, and the capital adequacy ratio. For eleven years (2001-2011), the study relied on secondary data from 31. The study discovered that the cost per loan asset, rate of default, and ratio of capital sufficiency had an inverse link on the banks' financial performance; nevertheless, the rate of default is the key predictor of the banks' financial performance. It was suggested that banks develop or devise techniques to increase their profitability while reducing their credit risk exposure.

The study overlooked a key aspect of commercial bank operations: credit risk management. Banks utilize a set of tools to manage this risk, including identifying potential problems early, assessing borrower creditworthiness, setting lending terms based on risk, and continuously monitoring loan performance.

2.4 CONCEPTUAL LITERATURE REVIEW

Saunders (2003) claims that conceptual frameworks are used in research to purposes a preferred perspective to an idea, to describe potential courses of action or both. According to Saunders (2003), a conceptual framework is a kind of intermediary theory that aims to link every facet of an investigation, including the definition of the problem, its goal, the literature review, methodology, the data collection and its analysis.

2.4.1. Credit Risk Management in Banks



Credit Risk Mitigation

Risk management is primarily concerned with reducing earnings volatility and avoiding large losses (Allen & Saunders, 2004). A comprehensive risk management process requires identifying risks, measuring and quantifying risks, and developing risk management solutions. Risk is a crucial aspect of bank operations (Basel Committe on Banking Supervision, 2006). Banks face the risk of borrower default when they make loans, thereby credit risk. "Any institution that engages in cash transactions or makes investments runs the risk of losing these funds." Banks, on the other hand, should neither avoid risk (thus restricting institutional scope and impact) nor dismiss risk because the scale of expansion will make their activities inherently complex and sophisticated, necessitating the implementation of a Risk Management Framework."

Risk identification, measurement, treatment, implementation, and evaluation are the primary processes in credit risk management. Implementing credit risk management can take the form of creating awareness, developing an appropriate framework to identify risks and measure their potential impact on the bank, developing policies and procedures to minimize the effect of the risks identified, enforcing compliance with policies and procedures, and continuous evaluation. Management should be aware of the risks the banks assumes and understand the extent of the exposures and their potential implications for the bank. There are credit risk management mitigation strategies which include;

2.4.1.1. Collateralization

A recent study by Gregory, (2021) emphasizes that collateralization offers an extra layer of protection against credit risk, on top of the benefits of netting. Netting, while helpful, can leave banks exposed if a counterpart defaults on a large positive net exposure. Collateral agreements mitigate this risk by requiring one party to provide a collateral to cover potential losses.

According to Jorion, (2012) “collateral security allows a creditor to hold a legal interest in personal property owned by the debtor or a third party, entitling the creditor to take possession of the property and sell it to satisfy the obligation if the debtor or third party fails to settle the debt or perform an obligation. Household electrical items, title deeds, motor cars, and third-party guarantees are the most typical types of collateral security employed by banks.

Gregory, (2021) explains that collateral management follows a simple concept: exchanging cash or valuables between parties to secure a loan or credit line. However, while collateralization reduces the risk of borrowers defaulting, it introduces new challenges like market fluctuations, operational issues, and difficulties accessing the collateral quickly if needed. Therefore, it's vital to thoroughly understand, assess, and manage these additional risks.

2.4.1.2. CREDIT EXPOSURE MANAGEMENT

According to Horcher, (2015) highlights credit exposure reduction as a key method for managing credit risk. While the specific techniques used can differ across organizations, financial institutions tend to prioritize actively managing their credit exposure. This focus is understandable given the critical role credit plays in their core activities like lending, trading, and managing assets. To further mitigate risk, any company can consider establishing a dedicated credit risk management function and exploring strategies to diversify their credit exposure.

2.4.1.3. CREDIT LIMITS

A cornerstone of credit risk management is selecting borrowers and counterparts with strong creditworthiness, as emphasized (Crouhy,et al,2006). Diversification is crucial to avoid excessive exposure to specific regions, countries, or sectors. Limits play a vital role in controlling overall counterparts exposure arising from both financial transactions and business activities. These limits reinforce and formalize diversification principles. Similar to asset management, credit risk management also utilizes limits. A portfolio with weakly or negatively correlated exposures is generally considered less risky than one with highly correlated exposures.

Financial institutions engaged in active trading use position limits to restrict the size of a trading position and potential losses. These limits for individual traders and trading desks are determined by experience, performance, risk monitoring and modeling, and the overall risk tolerance of the institution. Both daylight limits (restrictions lifted at the end of the trading day) and midnight limits (restrictions lifted at the next business day) can be employed. As highlighted by Vasicek (2017), many companies, especially banks, actively monitor counterpart limits on a global, real-time, and aggregate basis. This ensures continuous oversight and helps to identify potential issues early on.

2.4.1.4. CREDIT RISK RATING

Credit risk is comprised of default risk, recovery risk, exposure risk, and maturity risk. Bond investors and financial institutions used to rely on external credit ratings to determine the relative creditworthiness of a specific issue or issuer. Gregory, (2021) described credit rating as “a published score based on financial analysis that is intended to quantify a company's, or individual's ability to satisfy future obligations”. Cole (1998) emphasized the importance of a complete credit rating system that takes into account all of an applicant's available qualities. “In order for the credit rating process to be effective in the risk management process, originality is of the utmost importance in constructing both the credit rating system and credit rating form, as opposed to the pre-selection of particular qualities proven advantageous in some instances”.

2.4.1.5. CREDIT RISK MONITORING AND REPORTING

The danger of existing roles is constantly evaluated, according to Benson (2018), Individual transactions may become riskier, particularly with longer maturities or significant changes in the financial condition, market condition, or macroeconomic condition. The risk department also examines the bank's risk position at the portfolio and institution levels. It keeps track of whether the bank's risk profile is evolving as expected.

Regular monitoring of loan disbursements is essential for lenders to reduce defaults. This process involves assessing a borrower's creditworthiness, including their income history, internal strengths and weaknesses, and overall financial health. Regulatory authorities may require a probationary monitoring period before allowing the loan to be included in a bank's capital calculations. Banks might also face additional monitoring standards related to independent design, internal assessments, audits, validation, documentation, reporting, and external oversight.

Alistair and Coyle, (2002) recommend conducting quarterly reviews of each loan exposure in addition to the standard credit approval process during loan renewals. This separation of duties helps to ensure objective credit risk assessments and allows for continuous evaluation of a bank's overall exposure. By combining regular monitoring with frequent reviews, lenders can proactively identify and address potential problems, ultimately reducing the risk of defaults.

Banks should also ensure that management develops a framework for assessing various risks, a mechanism for relating risk to the institution's capital level, and a process for monitoring compliance with internal regulations. The board of directors should consider implementing and supporting effective internal controls, which are critical components of credit risk management, as well as adhering to documented policies and procedures. The board should also make certain that management communicates these policies and procedures effectively throughout the firm.

According to Benson (2018) financial institutions should set up an adequate system for monitoring and reporting risk exposures as well as the impact of risk profile changes on capital levels. Risk management must be structured in such a way that the risk profile and capital requirements are periodically disclosed to senior management and the board of directors. The frequency of reporting is determined by the risk type, degree, and change, and banks should also adhere to the policies and processes used by banks to monitor and analyze credit risk.

2.4.1.6. CREDIT RISK ASSESSMENT

According to Gakure et al, (2012), credit risk assessment serves as the final step in transforming the raw materials gathered through credit analysis into a concrete outcome which is the credit decision. All the information gathering and interpretation efforts culminate in this critical decision.

Croughy, et al, (2006) evaluates credit risk using two primary metrics which are expected loss (EL) and economic capital (EC), while Overbeck, & Wagner (2013) stated that "economic capital is the amount of capital required to cover unexpected losses that is, if actual losses are higher than expected losses, it is the responsibility of the board of directors and senior management of each financial institution to maintain loan loss provisioning."

2.4.1.7. CREDIT RISK MITIGATION

The plan's purpose is to identify as many potential risks as possible, and it is the organization's obligation to perform risk reduction, monitoring, and management in order to create a quality product. The sooner risks are discovered and avoided, the less likely it is that the risk's consequences will be faced. Risk mitigation, according to Duffie & Singleton (2003), is the reduction of risk by, for example, contemplating collateral security, securing credit derivatives, or adopting an offset position pursuant to a netting agreement.

Financial institutions can mitigate excessive exposure to a particular counterpart by acquiring credit protection (Benson ,2018). This protection, often called credit enhancement, comes in the form of guarantees from financial guarantors or credit derivative products. These tools effectively improve the credit quality of the insured assets.

2.5. RESEARCH GAP

As some previous scholars have examined the effectiveness of credit risk management on financial institution, there has been a general agreement that credit risk is the major concern on bank failures and it can not be eliminated, rather it can be mitigated. Other literature suggested a number of way by which credit risk can be avoided.

Most studies focused on other factors which leads to credit risk for example economic recession among other credit risk mitigation strategies. Although credit risk mitigation strategies were being used, other banks are still closing, which means somehow there is a need for further researches to avoid banks closure due to credit risk. The researcher identified that other scholars were not considering that credit risk management practices must be evolving in banks over time because of the movement of technology, credit risk is hitting differently, therefore the banks must also mitigate differently from previous ways. This involves analyzing the impact of changes in regulations, credit management systems and bank strategies.

2.6. CHAPTER SUMMARY

This chapter dug into existing research on credit risk management in banking. It explores various sources, including review of related literature,theoretical review, empirical literature and conceptual framework. The author critically examines the research objectives and findings of these prior studies, ultimately identifying a gap in current knowledge. A substantial body of research, as exemplified by Bhattarai (2016), highlights credit risk management as a crucial element of a company's overall risk management strategy and its impact on the performance of financial institutions. Further research by Poudel (2014) and Sumon & Shilpi (2023) investigated the connection between credit risk management practices and bank performance. The focus of these studies has primarily been on commercial banks. The chapter also acknowledges research conducted in Kenya by Kalui & Kiawa (2015) and Tanui et al. (2015), which examined credit risk management in Banks and Savings and Credit Cooperatives (SACCOs), respectively. Additionally, Kibor et al. (2015) explored the relationship between credit risk management and loan performance specifically within Kenyan banks. By comprehensively reviewing existing research, the author identifies a scarcity of studies that specifically assess the influence of various credit risk management strategies on the financial performance of banks. This identified gap paves the way for the research methodology outlined in the next chapter.

CHAPTER 3

METHODOLOGY OF THE STUDY

3.0. INTRODUCTION

This chapter will describe how the research will be carried out. The researcher will go over every method he utilized to collect data for this study. The investigation was carried out utilizing a case study approach. The chapter will cover research design, sample size and sampling methodologies, data presentation and analysis research instruments, target population, validity of data of instruments, and a summary.

3.1. RESEARCH DESIGN

According to Creswell (2014), research design is a framework of circumstances for acquiring plus aggregating statistics in a way that purposes to syndicate significance for study purposes with efficiency in procedure. As a result, the research design is the abstract framework in which research is conducted; it includes the framework for data gathering, quantification, also assessment. Adopting a study strategy permits the research to be as effectual as possible whilst generating the information. The function of study design is to let for the collecting of relevant proof with the least amount of effort, time, and money.

The researcher used a case study research design for this survey. Johnson & Onwuegbuzie (2004) suggested that a research design is that focuses on unexpected incidents. Depending on the content, it might be both qualitative and quantitative. According to Creswell (2014), while predominantly a qualitative analysis style, is common in quantifiable research. A situation might be a person, collection of people, public, scenario, episode, and an occurrence; consequently, the entire study population must be treated as a single entity.

Case study research design in financial institutions aids in gathering appropriate information relevant to the firm's key activities. The emphasis of attention in a case study is on the instance in its distinctive complexity, not on the entire population of cases. A case study research design is appropriate for studying zones where tiny is known or else after you wish to partake a full grasp of the banking sector for analyzing the effectiveness of credit risk management in banks.

3.2. BENEFITS OF CASE STUDY RESEARCH DESIGN

In accordance to Creswell (2014), utilizing a case study investigation has benefits which are: When exploring a new area or when you want to gain a comprehensive grasp of a scenario, occurrence, episode, location, group, or community, it is a highly favorable design. This method is extremely useful while the goal of a research is to thoroughly investigate and also comprehend than just confirm and quantify. It gives a summary and detailed comprehension of cases processes and interaction subtleties inside an element of the research but does not claim to make any inferences to a population yonder situations identical to ones investigated.

3.3. POPULATION

United Nations (2019) well-defined population as any collection of people that share features that are of interest in research. Neuman (2014) defines target population as the percentage of the population that the investigator wishes to simplify.

It defines the whole factors from which data will be extracted. The targeted group in this study was the employees of FBC Bank, which is headquartered in Harare, Zimbabwe. The research was done in five branches of the business, with an entire target population of thirty five (50) employees, (10) fifteen managerial workers, and thirty (20) credit managers.

3.4. SAMPLE POPULATION

The data for the study will be gathered using a case study method. The case study is focusing on a registered bank (FBC Bank) one of the top organizations in Zimbabwe's banking sector. The study focuses on (6) six managerial employees, (18) eighteen credit officers, and (42) forty two other FBC employees. The population selected for the study is revealed in Table 3.1 below.

Table 3.1 Total Population

Class	**Overall quantity of workers**	**Quantity of respondents to be nominated**
Senior Management	10	6
Credit officers	20	18
Other Employees	50	42
Total 80 40	80	66

Source: primary data

The sample size of the study was calculated using Taro Yamane Formula as shown below;

$$\mathbf{n = \frac{N}{1 + N\,(e^2)} = \frac{80}{1+80(0.05^2)} = 66}$$

n= required sample size

e= desired margin of error (expressed as a proportion, usually ranging from 0.05 to 1.0)

Using a target population of 80 people and a margin error margin of 0.05, a sample size of 66 respondents was achieved.

3.5. SAMPLE TECHNIQUES

According to Cochran (2007), a sample is a minor group that is selected to be the characteristic of the whole cluster. It operates by the objective of gaining correct and dependable information on the cluster with the smallest quantity of expense, energy and time as well as describing the limits of such approximations correctness. The researcher employed stratified random sampling and judgmental sampling.

3.5.1. STRATIFIED RANDOM SAMPLING

According to Creswell (2014) in stratified random sampling, the researcher strives to stratify the population so that the stratum population is homogeneous in terms of the qualities on which it is stratified. The researcher separated his population into strata based on some known traits, and he randomly selected a predefined number of units from each of these smaller homogeneous groupings (strata). For example, when developing questionnaires, the researcher employed stratified random sampling, which categorizes or stratifies the population based on branches and employment type, such as management and credit officers or senior loans officers. The researcher used stratified random sampling because it is the best representation of the population and is considered an advance over previous sampling procedures. The researcher employed stratified random sampling to select questionnaire respondents because it is an objective way of sampling that enables observations to be used for inferential purposes.

3.6. INSTRUMENTS FOR RESEARCH

The researcher employed a variety of study and statistics collection techniques. According to Cochran (2007), an instrument in research refers to a piece of equipment used to collect statistics, for example interviews, observations and surveys. The investigator will conduct the research using interviews and questionnaires in this study.

3.6.1. QUESTIONNAIRE

Cochran (2007) said a questionnaire is a sequence of questions printed in an exact order on form(s). The researcher sent e-mails questionnaires to respondents, who are anticipated to read and appreciate the questions and respond in the areas given on the questionnaire.

Benefits

There are several advantages to using questionnaires which are relatively inexpensive and easy to administer making them a cost-effective way to gather data. Secondly, they can be distributed to a large number of employees, allowing to get a broader range of responses.

Weaknesses

There are also some disadvantages to using questionnaires for credit risk management which include questionnaires may not capture the nuances of a particular situation. For example, a question may be phrased in a way that does not allow for a full understanding of the issue at hand. Additionally, respondents may not always be truthful in their answers, and may give answers that they think the researcher wants to hear. Finally, questionnaires can be time-consuming to complete, which may lead to people abandoning them before they are finished.

Strategies for reducing the drawbacks of using questionnaires

According to the study, expressing the goal of the questionnaire actually aids in decreasing the drawbacks connected with questionnaires. To get amazing results while utilizing a questionnaire to gather data, simple and straight forward methods of communication with respondents should be used to improve cooperation and ensure that respondents grasp the expectations of the surveys by providing recommendations or assistance when necessary.

3.6.2. INTERVIEWS

The interview method of data collection, according to Cochran (2007), entails the delivery for spoken stimuli and responses in the form of oral responses. This strategy can apply via interviews, which the investigator will conduct in order to obtain reliable and bias-free information. The researcher will thoroughly assess the situation and develop interview questions in order to obtain the required data from the correct people. Interviews can be organized or unorganized.

Benefits of interviews

There are several benefits for interviews, firstly interviews allows to gather information from a wide range of sources, including employees and other stakeholders, secondly interviews can help to build relationships with the people who are being interviewed which can be valuable when it comes to getting information and support for the project and

Disadvantages of Interviews

One potential disadvantage is that interviews can be time-consuming, and it can be difficult to schedule them around the busy schedules of the people you need to talk to. Additionally, interviews can be affected by social desirability bias, where people may say what they think you want to hear rather than the truth. Finally, interviews can be subjective and prone to interviewer bias, which means that the information you get from the interviews may not be completely accurate

Strategies for reducing the drawbacks of using Interviews

When the interviewer asks questions that are not imprecise or confusing, interviews are an appropriate method of data collection. To reduce the bias associated with interviews, the researcher should be able to determine the interviewee's emotional state prior to conducting the interview. Respondents must also be informed that their responses will be kept confidential before an interview and promise of releasing the results account, must be provided.

3.7. VALIDITY AND RELIABILITY OF DATA COLLECTION INSTRUMENTS

Creswell (2014) defines reliability as research tool's capacity to give similar outcomes when used frequently under same settings. A research tool's reliability reflects its exactness, constancy, and expectedness. The researcher performed pilot testing, in which questionnaires interrelated to the study were casually given to a few workers first, and a small number of inquiries from respondents were questioned of specialists in article and journal texts based on credit risk management. The investigator also used peer to peer rating. Marion (2007) said peer to peer evaluation is the procedure of placing investigation techniques and outcomes to the inspection of others who are specialists in the similar field, with a goal of preventing the distribution of irrelevant findings. The project supervisor also reviewed the research study to confirm its validity and reliability.

3.8. PROCEDURES FOR DATA COLLECTION

The researcher conducted individual interviews with other employees at FBC Samora branch. The questioner launched the discussion and composed information from multiple respondents noting their replies with differing ideas. The researcher also gave questionnaires to the head office's officials and other credit officials. Questionnaires were also distributed to separate branches of the firm via e-mail and Skype with the assistance of management in order to acquire important information from credit officers. The questionnaires were filled out by the respondents and scanned back to the management team.

3.9. DATA PRESENTATION, ANALYSIS AND INTERPRETATION

For ease of understanding and comprehension, data composed was displayed suitably to the decided state in the format of tables and pie charts. Each data set was presented and debated concurrently, resulting in data that was subjected to both quantitative and qualitative examination. Content analysis was used to analyze and convey qualitative data. Quantitative data was examined using SPSS to generate frequency tables, pie charts and percentages of real values, but ultimately deriving inferences that were utilized to make recommendations.

3.10. ETHICAL CONSIDERATIONS

Stakeholders in research are quantitative and qualitative. It is critical to consider moral considerations in regard to each of them. There are numerous ethical considerations to consider while collecting information, obtaining consent, offering incentives, and obtaining sensitive information from research participants. Creswell (2014) proposed that when collecting data from respondents or involving subjects in an experiment, "one must carefully consider whether their participation is likely to harm them in any way, if it is, the risk must be kept to a minimum”. The term "minimal risk" refers to "the extent of harm or discomfort in the research being no greater than that normally encountered in daily life." When conducting research, it is unethical to use methods that cause fear or harassment, therefore, the researcher adopted the following methods to minimize harm;

- Maintaining confidentiality
- Avoiding bias
- Using appropriate research methodology
- Appropriate use of the information obtained

3.12. CHAPTER SUMMARY

The chapter looked at the investigator's data collection process. The section primarily addressed research design, research tools, validity and reliability, data presentation, population analysis, data collection processes and interpretation. The sample magnitude was also tinted, data sources and their benefits and disadvantages. The pros and drawbacks of questionnaires and interviews were also investigated, as were approaches to mitigate the downsides connected with the data collection methods used. The section also discussed various ethical considerations for the investigator. The following section will go over data analysis and presentation.

CHAPTER 4
DATA PRESENTATION AND ANALYSIS

4.0. INTRODUCTION

This chapter is intended to assess and interpret study findings gathered through the researcher's questionnaires and interviews. The chapter also describes the procedures used to analyze the acquired data in order to reach reasonable conclusions. The data was analyzed using SPSS data analysis software to create tables and pie chart that were congruent with the study's research aims and questions.

4.1. ANALYSIS OF DATA RESPONSE RATE

4.1.1. QUESTIONNAIRE RESPONSE RATE

Table 4.1 Questionnaire response rate

Type of research instrument	Distribution	Response	Response Rate
Questionnaire (Senior management)	10	6	60%
Questionnaire (credit officers)	20	18	90%
Other Employees	50	42	84%

Source: primary data

Table 4.1 shows the response rate achieved after executing the research investigation. The researcher distributed 80 questionnaires to FBC Bank workers, of which 6 were filled out by senior management, 18 by credit officers and 42 by other employees. The researcher received a good response from both the senior management team, the loan officers and other employees which was a positive reaction and provided the researcher with adequate conditions to draw conclusions.

4.1.2. INTERVIEW RESPONSE RATE

Table 4.2 interview response rate

Type of research instrument	Distribution	Response	Response Rate
Interviews(Clients)	20	12	60%

Source: primary data

Interviews were also conducted in the head office. The desired number of clients was 20, but owing to personal constraints, including time, the researcher was able to interview 12 clients. The rate of response to both questions and interviews was good.

4.2. DEMOGRAPHICS OF RESPONDENTS

Table 4.3 Demographics of respondents.

GENDER

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Male	29	70.7	70.7	70.7
	Female	12	29.3	29.3	100.0
	Total	41	100.0	100.0	

Table 4.3 shows that 41 respondents completed the questionnaire. The first table reveals the gender of the respondents; 71% were male, and 29% were female. This demonstrated that the organization is gender biased with regard to gender equality.

AGE

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Below 25	9	22.0	22.0	22.0
	25 - 30 Years	17	41.5	41.5	63.4
	40 - 60 Years	15	36.6	36.6	100.0
	Total	41	100.0	100.0	

The second table of Table 4.3 shows the age of the respondents, Showing that the majority of FBC employees are between the age of 25 - 30 years of age with a percentage of 41.5%. However, inclusion of all age groups into the organization is seen with 22% for people below 25 Years and those who are between 40 - 60 Years having 36.6%. FBC does not accommodate the age group above the age of 60 because that's when it issues out pension service.

LEVEL OF EDUCATION

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	High School or Equivalent	2	4.9	4.9	4.9
	Bachelor's Degree	28	68.3	68.3	73.2
	Master's Degree	7	17.1	17.1	90.2
	PHD	4	9.8	9.8	100.0
	Total	41	100.0	100.0	

The third table of Table 4.3 shows the level of education of FBC Bank employees. According to the table, 4.9% of employees have secondary and equivalent qualifications, 68.3% have bachelor's degrees, 17.1% have Maters' degree and 4% have PHDs. The study found that 100% of FBC Bank workers are educated and, to a greater extent, grasp the ideas of credit risk management in order to eliminate credit risk within the organization.

PERIOD AT FBC BANK

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Less than one Year	4	9.8	9.8	9.8
	1 - 2 Years	11	26.8	26.8	36.6
	3 - 4 Years	19	46.3	46.3	82.9
	5 Years and above	7	17.1	17.1	100.0
	Total	41	100.0	100.0	

The fourth row in table 4.3 shows how long the worker has worked for the bank. 9.8% of the firm's personnel have less than one year of work experience, 26.8% have (1-2) years of experience, 46.3% have (3-4) years of experience, and 17.1% have (5 years or more).

CURRENT POSITION AT FBC BANK

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Managing Director	2	4.9	4.9	4.9
	Credit Officer	23	56.1	56.1	61.0
	Supervisor	3	7.3	7.3	68.3
	Other	13	31.7	31.7	100.0
	Total	41	100.0	100.0	

The table shows that 56.1% of the respondents were credit officers where 31.7% were from outside the credit department, 4.9% managing directors and 7.3% supervisors.

4.3. SOURCES OF CREDIT RISK

Table 4.4 sources of credit risk

SOURCES OF CREDIT RISK

		Frequency	Percent	Valid Percent	Cumulative Percent
	Macro-economic instability	23	56.1	56.1	56.1
Valid	Weak credit risk management policies	2	4.9	4.9	61.0
	Non-Perforating loans	10	24.4	24.4	85.4

	Non Compliance with credit risk management policies	6	14.6	14.6	100.0
	Total	41	100.0	100.0	

Source: primary data

Table 4.4 shows the elements that contribute to credit risk at FBC Bank, as well as the firm's primary sources of credit risk. 40% is described to micro-economic volatility, 9% to poor credit risk management policies, 20% to non-performing loans, and 13% to noncompliance with credit risk management regulations.

The data reveals that over half (55%) of respondents consider macroeconomic volatility to be the biggest threat to creditworthiness. This instability in Zimbabwe's economy stems from declining growth and development, leading to a cash shortage. This situation worsened with fluctuating exchange rates between the USD and Bond notes. The cost of living skyrocketed, with basic goods exceeding a 50% increase while salaries remained stagnant. This scenario created significant credit concerns for banks as the Bond note's value depreciated due to currency rate volatility, weakening its purchasing power. This economic turbulence has forced some borrowers to take on excessive debt to cover basic needs. This, in turn, has led to a rise in foreclosures, non-performing loans, and the likelihood of defaults. Borrowers' capacity to meet their debt obligations has been significantly compromised. According to the survey, macroeconomic instability has prompted the bank to strengthen its credit risk management strategies, with a particular focus on securing collateral. This is because the borrowers' inability to repay is largely attributed to the economic climate. The respondents indicated that 55% of the credit risk faced by FBC Bank is attributed to macroeconomic instability, which they claim is the leading cause of loan defaults and non-performing loans. Consequently, this factor impacts the entire financial sector, including Banks and insurance brokers. As highlighted in Chapter 2, non-performing loans themselves contribute to credit risk, a point further emphasized by the respondents.

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Sanderson (2014) defines a non-performing loan (NPL) as one that is in or near default. Non-performing loans expose the firm to credit risk since no payments, interest, or principle are collected from the loan by the due date, lowering the firm's profitability. According to Sanderson (2014), there is a negative correlation between non-performing loans and performance. According to the findings, 25% of FBC Bank's loans are non-performing.

Noncompliance with credit risk management procedures is another element that contributes to FBC Bank's credit risk. Chapter two covered credit limits as one of the strategies used to counter credit risk. As a result, employees' noncompliance with credit risk management rules, such as credit limitations established by management, leads to the presence of credit risk within the organization. According to the study, another contributing factor to credit risk at FBC Bank is the implementation of weakened credit risk management policies, such as a low credit risk rating that clients can remove and exploit, such as the authorization of loan payments to an overburdened client due to relationship-based lending.

Chapter 2 delved into the reasons behind loan defaults in banks, highlighting insider lending as a significant contributor. The study's findings, however, are encouraging. Respondents attributed minimal credit risk (0%) to insider lending at FBC Bank. This suggests the bank has implemented effective measures to mitigate insider lending failures. The credit officers' role in the collateralization process likely plays a part in this success.

4.4. AVAILABLE CREDIT RISK MANAGEMENT POLICIES AND THEIR EFFECTIVENESS

4.4.1. CREDIT RISK MANAGEMENT POLICIES

Respondents were asked to describe how they determine the creditworthiness of new and occasional customers. According to the survey, FBC Bank uses a variety of measures to reduce credit risk. The responses are shown in table 4.5 below.

Table 4.5 Technique used in determining credit worthiness to new and occasional clients

CREDIT RISK MANAGEMENT POLICIES

	Frequency	Percent	Valid Percent	Cumulative Percent

Valid	Current Income/ Salary	36	87.8	87.8	87.8
	External Risk Rating	5	12.2	12.2	100.0
	Total	41	100.0	100.0	

Source: primary data

FBC Bank prioritizes a borrower's current income (87.8%) and external risk factors (12.2%) when assessing loan eligibility for new and infrequent clients, as shown in Table 4.5. Chapter 2 discussed the expected income hypothesis, which suggests that basing loan repayments on a borrower's future earnings rather than the loan purpose or collateral helps financial institutions maintain liquidity. Aligning with this principle, the survey indicates that FBC Bank heavily relies on current income verification (87.8%) to approve loan applications. In simpler terms, applicants must meet the bank's minimum income requirements to qualify for a loan.

FBC Bank also uses an external risk rating (12.2%) to determine the credit quality of new and occasional customers; nevertheless, its use is limited because the firm relies on an individual's income. According to the respondents, additional approaches for determining creditworthiness, such as credit scoring and statistical system models, have not yet been introduced or used by the firm. Participants were also asked to identify the actions they impose on defaulters, and their responses are shown in table 4.6 overleaf.

Table 4.6 Measures imposed when default arise

MEASURES FOR DEFAULTS

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Attach collateral	2	4.9	4.9	4.9
	Law suits	4	9.8	9.8	14.6

	Conduct next of keen	2	4.9	4.9	19.5
	All of them	27	65.9	65.9	85.4
	Others	6	14.6	14.6	100.0
	Total	41	100.0	100.0	

Table 4.6 demonstrates the techniques used by FBC Bank when defaults occur; according to the respondents, 4.9% is related to securing collateral security only, 9.8% to lawsuits, and 4.9% to contacting the next of kin, and most of the respondents (65.9%) confirmed that the firm uses all of the techniques stated above and in the questionnaire to reduce default rates. The data demonstrated that the firm no longer used bank stop orders to counter defaults; yet, FBC Bank is stringent about loan default management.

Another 14.6% was ascribed to other procedures used to reduce high default rates, specifically salary service bureau (SSB) deductions. According to the respondents, salary service bureau (SSB) deductions are also utilized to cater for civil servants who are in default, so covering the public sector.

These comprehensive methods have proven beneficial for FBC Bank in combating loan defaults stemming from borrower negligence, limited financial literacy, or delinquency on repayments. As highlighted in Chapter 2 on credit risk management strategies, the research observed that the bank distributes its credit risk mitigation efforts across various approaches, achieving diversification. This aligns with the respondents' emphasis on adopting complementary strategies, such as establishing a dedicated credit risk management function and enhancing creditworthiness through the use of credit derivatives that act as a form of financial protection.

Another key aspect of credit risk management is the duty for approving credit risk management methods. To this purpose, respondents were asked to identify particular people who have responsibility and influence over the approval of credit risk management plans, and their replies are illustrated in Figure 4.1 below.

N=80

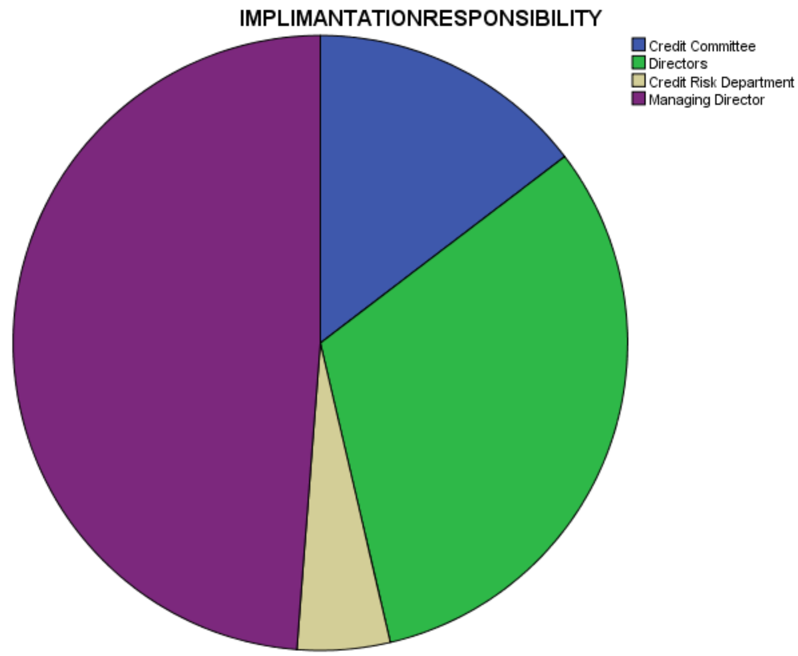


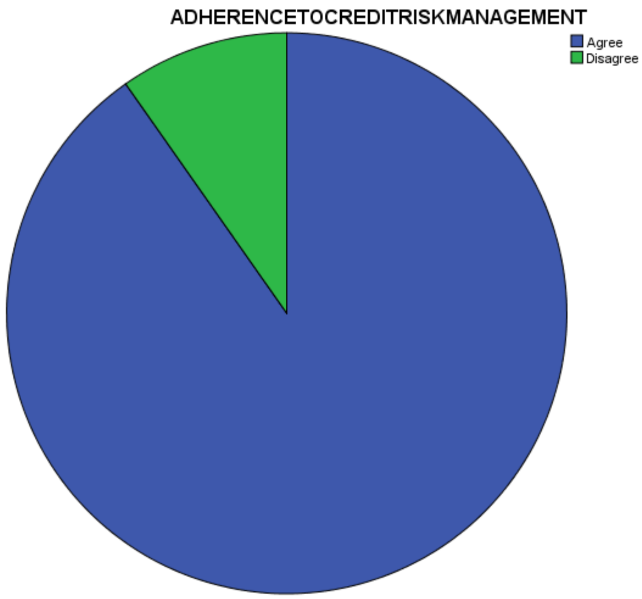
Fig 4.1 Responsibility of approving credit risk management strategies

Source: primary data

Figure 4.1 reveals that respondents perceive the managing director to hold the most significant influence (50%) in approving Credit Risk Management (CRM) strategies. Directors hold some sway (30%), while the credit committee and credit risk department have a perceived influence of 15% and 5% respectively. These findings suggest that the managing director plays a central role in shaping CRM policies, with a lesser perceived influence from directors, the credit committee, and the credit risk department.

The study identified a potential vulnerability in the bank's credit risk management framework. Currently, approval for credit risk management guidelines rests heavily on the managing director's decision (as indicated by Figure 4.1). This centralization could create weaknesses if policies are not thoroughly reviewed by the credit risk department before implementation. According to the Basel Committee on Banking Supervision (2006), robust credit risk management requires active participation from both directors and the credit risk department. These entities play a crucial role in maintaining adequate loan loss provisions and overseeing credit assessment processes. Therefore, incorporating their expertise in approving credit risk management strategies would likely strengthen the bank's overall risk management framework.

4.4.2. EFFECTIVENESS OF CURRENT CREDIT RISK MANAGEMENT POLICIES



According to the employees, the vast majority (90%) believe that credit risk management rules are effective in reducing credit risk, with only 10% believing that credit risk management policies are ineffective.

One of the respondents to the interview said that "credit risk management guidelines at FBC Bank are very efficient but it is of greatest significance to review the policies periodically to minimize possible loop holes to avoid credit risk completely”. The aforementioned statement suggests that FBC's credit risk management procedures are effective; but, as discussed in Chapter 2, credit risk monitoring and reporting ought to be undertaken on a constant basis to monitor disbursed loans and analyze credit exposure.

4.5. RECOMMENDED MEASURES IN MANAGING CREDIT RISK

Financial institutions in Zimbabwe had challenges primarily as a result of macroeconomic volatility; nonetheless, the primary cause of credit risk management issues remains inadequate credit risk management requirements for borrowers and counter-parties. According to the Basel Committee on Banking Supervision (2000), the board of directors shall be responsible for approving and assessing the financial institution's credit risk management strategy and important credit risk policies on a regular basis (at least yearly).

Senior management should be responsible for carrying out the board of directors' authorized credit risk plan, as well as creating strategies and methodologies for identifying, measuring, monitoring, and controlling credit risk. To improve the effectiveness of credit risk management procedures and practices, policies ought to tackle credit risk in all of the bank's activities, as well as at the individual credit and portfolio levels (Basel Committee on Banking Supervision 2000).

4.6. CHAPTER SUMMARY

The chapter presented and analyzed data collected from FBC Bank. The tough economic conditions generated by Zimbabwe's rising exchange rates following the introduction of bond notes in 2017 forced financial institutions into a deep pool of hazards, among which credit risk exists. Credit risk management policies have been undermined, compounded by poor credit risk management guidelines and noncompliance with credit risk management regulations. The next chapter focuses on the findings, conclusions, and recommendations.

CHAPTER 5

FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.0. INTRODUCTION

This chapter dives into the key takeaways from the research. By analyzing the findings, the chapter aims to establish conclusions that can be used to strengthen credit risk management policies. These conclusions will then serve as a springboard for developing recommendations for future research endeavors in the realm of credit risk management.

5.1. SUMMARY OF THE STUDY

The research evaluated the effectiveness of credit risk management in Banks, looking at a case study of FBC Bank. The study was motivated by the ever increasing concern in credit risk management by Banks and other financial institutions. Imprudent credit risk management policies has been causing a lot of nonperforming loans hence exposing Banks to credit risk.

The first chapter of this study establishes the context by outlining a historical overview of various challenges faced by banks, ultimately highlighting the vulnerability of the banking industry to credit risk. Chapter two then delves into a comprehensive literature review, exploring key concepts related to credit risk and its management strategies. Chapter 3 discussed the methodology used by the researcher to carry out the study, the researcher adopted a case study research design to conduct the research.

5.2. SUMMARY OF FINDINGS

The study identified several key sources of credit risk for FBC Bank which are macroeconomic instability, non-performing loans, and non-compliance with credit risk management policies. Macroeconomic instability is particularly the ongoing economic recession, significantly exposing the bank to credit risk. This instability hampered lending strategies and the effectiveness of credit risk management policies. The situation worsened in October 2018 with fluctuating exchange rates due to a foreign currency shortage. These fluctuations caused devaluation of the bond notes, a currency many FBC Bank clients relied on. As a civil servant-heavy bank, FBC was particularly affected by the rising cost of living caused by currency devaluation. This resulted in increased defaults among clients in this sector, as many struggled to meet their loan repayment schedules.

Some borrowers defaulted entirely, leading to a rise in non-performing loans and the bank's inability to recover loaned principal amounts. The study identified positive aspects of FBC Bank's approach to credit risk management. Employees' strict adherence to the credit procedure manual helps minimize both operational and credit risks. Implemented credit risk management policies and strategies appear successful in preventing loan defaults. This success is reflected in the bank's prioritization of a borrower's income over collateral when evaluating loan applications. Collateral is considered a last resort. FBC Bank further strengthens its risk mitigation strategy by incorporating external credit ratings and utilizing automated deductions from employers, such as Salary Service Bureau (SSB) deductions, to ensure timely loan repayments.

The study identified non-performing loans (NPLs) as a significant source of credit risk for FBC Bank. NPLs arise when borrowers fail to meet their loan repayment obligations, effectively reducing the bank's available capital due to the non-payment of principal. While FBC Bank has implemented various strategies to minimize NPLs, the lack of loan protection insurance limits their ability to recover bad debts. This absence exposes the bank to credit risk in situations where borrowers default due to unforeseen circumstances, such as death. To mitigate this risk, the study recommends that FBC Bank consider acquiring loan loss provision insurance. This type of insurance would help cover unexpected defaults, such as those caused by a borrower's death in an accident.

The study also found that non-compliance with credit risk management policies can be a contributing factor to credit risk in banks. When employees fail to adhere to the strategies or policies established by management to mitigate credit risk, it can lead to weak and inadequate risk management practices. This lack of adherence makes it difficult for the bank to effectively improve its credit risk management framework, especially if employees are undermining established company policies.

The study revealed that FBC Bank doesn't utilize advnanced credit evaluation techniques like credit scoring, statistical models, or the Altman Z-score model. This appears to be due to a lack of personnel with the specialized skills needed to implement these models effectively. Instead, the bank relies primarily on current income/salary verification to assess the creditworthiness of new and infrequent clients. Additionally, the study found that the external risk rating method is underutilized. Potential explanations for this include limited employee training in credit risk management and model application, as well as the exclusion of credit officers from policy-making processes due to a centralized power structure that may not fully leverage the credit risk department's expertise. Furthermore, the study suggests that regulatory boards may lack sufficient resources to ensure proper bank management. While these boards are responsible for overseeing and improving existing credit risk management policies implemented by banks, resource limitations may hinder their ability to conduct thorough research on current industry challenges. This could prevent them from facilitating collaboration among banks to discuss and adopt best practices for mitigating credit risk.

5.3. CONCLUSIONS

The objectives of the study were to evaluate the credit risk management system at FBC Bank, to analyze FBC Bank's sources of credit risk, and to suggest suitable measures for managing credit risk. Based on the findings, it can be concluded that the main source to credit risk is the macro-economic instability stimulating the existence of non-performing loans, the other sources of credit risk included non-compliance with credit risk management policies. The study indicated that credit risk management policies at FBC Bank are effective therefore, one can conclude that the techniques used by the firm are effective in averting credit risk. The study revealed that the firm sorely depend on current net salary when assessing the credit worthiness of new and occasional clients. This exposed the firm to credit risk since one can use the same pay slip to conduct multiple borrowing practices. The research indicated that the firm does not carry out regular meetings and training on effective implementation of credit risk management policies targeted at reducing the implications of credit risk therefore, shunning out room for various ideas. The results from the study showed that the majority of the firm's clients have many years being in a business relationship with the firm therefore, it can be concluded that the majority of defaulting clients are those being granted loans because of relationship based lending. The study identified centralization of power at management level. This has posed severe harm to the organization since decision making is centralized leading to non-involvement of other departments in drafting credit risk management policies.

5.4. RECOMMANDATIONS

5.4.1. REGULAR REVIEW OF CREDIT RISK MANAGEMENT POLICIES

To ensure effective credit risk management, the board of directors should conduct regular reviews of the bank's credit risk policies. These reviews should assess the organization's risk tolerance (risk appetite) and align credit risk management strategies accordingly. Regularly evaluating and updating policies helps maintain an appropriate credit risk environment. Additionally, these reviews should verify that credit officers are adhering to the established policies, fostering a culture of compliance.

5.4.2. ENGAGING EXTERNAL CONSULTANT CREDIT ANALYST

The study recommends that FBC Bank consider engaging external credit risk consultants. These specialists possess the necessary skills to implement advanced credit evaluation models, such as statistical models and credit scoring. Their expertise could significantly contribute to mitigating credit risk. Furthermore, incorporating external consultants for periodic credit risk management training programs for employees would strengthen the bank's overall risk management framework. This approach would equip employees with the knowledge and skills necessary to effectively implement credit risk management policies.

5.4.3. STRENGTHENING CLIENT COMMUNICATION

The study emphasizes the importance of fostering strong client relationships. Improved communication can be achieved through a more thorough loan screening process prior to disbursement. Additionally, the bank should hold regular meetings with its stakeholders, which include clients. These meetings provide an opportunity to inform clients about any changes to lending procedures and to address their concerns. Open communication allows clients to voice any potential difficulties they foresee in repaying their loans. This proactive approach can help identify potential issues early on and may lead to alternative solutions or loan modifications that benefit both the bank and the borrower.

5.4.4. MANTAINING CREDIT LIMITS

The study recommends that FBC Bank implement ongoing credit risk assessments for all clients. This proactive approach can help identify potential problems early on and prevent future loan defaults. It's crucial for credit officers to adhere to established credit limits, even in situations where clients may express dissatisfaction or request additional loan amounts (top-up loans). While relationship lending can be valuable, it should not come at the expense of sound credit risk management practices. Upholding the company's credit procedure manual ensures consistent and responsible lending decisions.

5.4.5. RISK MITIGATION STRATEGIES

The study recommends that FBC Bank explore additional risk mitigation techniques beyond traditional risk reduction methods. One approach would be to incorporate loan protection insurance as a risk financing tool. This type of insurance would provide the bank with a financial safeguard in the event of a client's death or complete default (insolvency) as declared by a court. If such an event occurs, the insurance company would reimburse the bank for the outstanding loan balance, including accrued interest and penalties.

5.4.6. OFFERING SHORT-TERM AND INSTANT LOANS

The study acknowledges the benefits of FBC Bank providing short-term and instant loans. These loan options address clients' immediate needs and generate revenue for the bank in a relatively short time frame. For borrowers, these loans can be instrumental in managing unexpected events such as accidents, medical emergencies, or funeral expenses.

5.5. FUTURE RESEARCH

While this study focused on evaluating the effectiveness of credit risk management policies within banks, it also highlights the potential value of further research in a related area. Specifically, examining the effectiveness of regulatory boards in overcoming credit risk and non-performing loans (NPLs) could provide valuable insights.

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APPENDIX 1: COVER LETTER

I am a student at Bindura University of Science Education studying toward a Bachelor's of Commerce honors Degree in Banking and Finance. I have designed this questionnaire sorely for seeking information for a research study in partial fulfillment for the award of a Bachelor's of Commerce honors Degree in Banking and Finance.

I am kindly requesting for your contribution in this research study on the topic entitled "Examining the effectiveness of credit risk management on banks: . A case study of FBC Bank". The objective of this research study is to evaluate the sources of credit risk in Banks leading to high delinquency rate and non-performing loans. The study also attempts to evaluate the credit risk management systems at FBC Bank and recommend appropriate measures for managing credit risk.

Please note the scholar guarantees that;

- ✓ Information gathered will be kept private, confidential and anonymous.
- ✓ The researcher values both your organizational and personal views.

NB Please only tick once where appropriate

APPENDIX 2: QUESTIONNAIRE

SECTION A: Demographic information

1. Kindly indicate by ticking in the box your gender?

☐ Male ☐ Female

2. Which age group do you belong to?

☐ Below 25 years ☐ 25-40 years ☐ 40-60 years ☐ above 60 years

3. Kindly indicate your level of education by ticking in the box?

☐ High school or equivalent ☐ Bachelor's degree

☐ Master's degree ☐ PHD

4. How long have you been within FBC Bank?

☐ Less than one year ☐ (1 – 2 years) ☐ (3 – 4 years) ☐ (5 years and above)

5. What is your current position at FBC Bank?

☐ Managing Director ☐ Credit Officer ☐ Supervisor

☐ Other…………………………………………………………………. (Specify)

SECTION B; CREDIT RISK MANAGEMENT AND IDENTIFICATION. (PLEASE TICK ONCE)

1. What is the main source of credit risk at FBC Bank?

☐ Macro-economic instability

☐ Weak credit risk management policies

☐ Non –performing loans

☐ Non-compliance with credit risk management policies

☐ Insider lending

☐ Inadequacy of collateral security

2. Credit risk management policies used at FBC Bank are effective and efficient in combating credit risk. To what extent do you agree?

☐ Strongly disagree ☐ Disagree ☐ Agree ☐ Strongly Agree

3. What type of technique is used in determining credit worthiness of new and occasional clients?

☐ Credit Scoring ☐ Current income / salary

☐ External risk rating ☐ Statistical system model

4. What measures does FBC Bank impose when defaults arise?

☐ Attach Collateral ☐ Law Suits ☐ Bank Stop Orders ☐ Conduct next of kin

☐ Others………………………………………………………………… (Specify)

5. Who is responsible for approving credit risk management strategies and policy implementation at FBC Bank?

☐ Credit committee ☐ Directors ☐ Credit risk department

☐ Managing Director

6. Employees of FBC Bank adhere to the credit policy procedure manual. To what extent do you agree?

☐ Agree ☐ Strongly Agree ☐ Disagree

☐ Strongly Disagree

7. Overally how effective are the credit risk management policies at FBC Bank?

☐ Not Effective ☐ Effective ☐ Very Effective

6. What do you think should be done to improve credit risk management policies within FBC Bank so as to totally combat credit risk?

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APPENDIX 3: INTERVIEW QUESTIONS.

RESEARCH TOPIC; Examining the effectiveness of credit risk management on banks: A case study of FBC Bank.

QUESTIONS

1) What do you think are the sources of credit risk at FBC Bank?
2) What is the typical time-frame for loan approval and what documentation is typically required?
3) How long have you been working at FBC Bank and What is the maximum loan amount offered by FBC Bank?
4) How do you evaluate credit risk management policies used at FBC Bank in combating credit risk?
5) What type of technique is used in determining credit worthiness of new and occasional clients at FBC Bank?
6) What measures does FBC Bank impose when defaults arise?
7) What items does FBC Banks require as collateral security?
8) Who is responsible for approving credit risk management strategies and policy implementation at FBC Bank?
9) Employees of FBC Bank adhere to the credit policy procedure manual. To what extent do you agree?
10) What measures are used by FBC Bank to recover back their money in times of default?

11) What do you think should be done to improve credit risk management policies within FBC Bank so as to totally combat credit risk?

12) What do you think should be done to those defaulting payment so as to minimize loan defaults at FBC Bank?

13) Do you have any queries relating to the credit procedures at FBC Bank?

14) What recommendations do you suggest to FBC Bank regarding

its lending procedures?

THANK YOU VERY MUCH.

B201294B - TAFADZWA JARAVAZA - DISSERTATION

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