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An Empirical Analysis of Management Attitude towards Risk and Credit Management

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Abstract

Purpose: The purpose of this paper was to evaluate the role of management towards risk and credit management in Ghana. Commercial banks play a critical role to emerging or developing economics like Ghana where borrowers have no or limited access to capital markets.

Design/methodology/approach: The study adopted both qualitative (case study) and quantitative methods respectively. Banks were selected to gather data, which was acquired from answers obtained from our administered questionnaire and also through interviews. The population of the survey constituted the management and non-management staff and customers of Ecobank (EBG), Ghana Commercial Bank (GCB) and Stanbic Bank.

Findings: Hypotheses of the study will be analyzed using correlation and regression. Results of the study show that there are high positive correlation between the constructs of credit risk management and management attitude.

Keywords: credit risk management, management attitude, and Ghanaian banking industry.

1. Introduction

The significant role played by banks in a developing economy like Ghana (where access to capital market is limited) cannot be overemphasized. In fact, well-functioning banks are known as catalyst for economic growth whereas poorly functioning ones do not only impede economic progree but also exacerbate poverty (Barth et al, 2004). However, banks are exposed to various risks such as credit, market and operational risk. Although all these risk militate against the performance of banks in several ways, Chijoriga (1997) argues that the size and the level of loss caused by credit risk as compared to others were severe to collapse a bank. Laxities of credit standards for borrowers and counterparties have caused serious banking problems, including loan losses, for many banks especially those in developing countries including Ghana.

In the commercial banking industry, it seems as if we really have not understood our borrowers or their industries as much as we should. Inevitably, this fundamental failure has produced significant credit problems. Most commercial banks have taken the main ingredient needed for quality assets for granted. Asset quality problems are therefore the consequence of ignoring the fundamentals of credit. In retrospect, most commercial banks are guilty of lending excesses that sourced and turned into credit problems. There should be a transition in the fundamental economies of lending precipitated by poor credit risk management habits and an obvious decline in credit underwriting standards. The tendency to disregard structuring, strong loan documentation, and diligent monitoring and servicing of credits have increased the credit impairment of most rural banks in Ghana thereby making them less profitable. The researchers complement and extend this stream of the literature by to evaluating the role of management towards in risk and credit management in Ghana.

The remainder of this paper is structured as follows. Section 2 will be present both the theoretical background and hypothesis to this study. Section 3 provides the research methodology of the study. In section 4, the researchers present the statistical results and discussions of finding. Finally, this study in section 5 discusses the conclusion of the study.

2. Theoretical Background and Hypothesis

2.1 Overview of Risk Management

Risk management as a discipline can be defined as "A management discipline whose goal is to protect and profits of an organization by reducing the potential for loss before it occurs, and financing, through insurance and other means, potential exposures to catastrophic loss such as acts of God, human error, or court judgments. In practice, the process consist of logical steps: risk or exposure identification; measurement and evaluation of exposures identified; control of those exposures through elimination and or reduction; and financing the remaining exposures so that the organization, in the event of a major loss, can continue to function without severe hardship to its financial stability" (Thornhill, 199)

According to Duffie and Singleton (2003), risk management is the process of adjusting both risk of large losses and the firm's vulnerability to them. This vulnerability depends on the portfolio of positions and on the amount of capital that is backing the firm's investment activities. Vaughan (1997) also defines risk management as a scientific approach to dealing with pure risks by anticipating possible accidental losses and designing and implementing procedures that minimize the occurrence of loss or the financial impact of the losses that do occur. The heart of bank financial management is the ability to manage the portfolio risk. To quote Walter Wriston of Citibank (the economist 10th April, 2003): "The fact is that bankers are in the business of managing risk. Pure and simple, that is the business of banking". Financial institutions are exposed to a different types of risk in carrying out their operations (Hitchins et al, 1996) identify nine types of risks namely credit, liquidity, interest, currency, market, operational, legal and regulatory, environmental, and health and safety risks. Heffernan (1996) further identifies other forms of risks apart from the nine risks identified above as settlement payment, gearing or leverage, political, and risks of global financing.

2.2 Credit Risk Management System of Banks

Numerous researchers have examined reasons behind bank problems and identified several factors (Chijoriga 1997, Santomera 1997, Brown, Bridge & Harvey, 1998). Problems in respect of credit especially, weakness in credit risk management have been identified to be the main part of the major reasons behind banking difficulties. Loans forms huge proportion of credit as they normally accounted for 10-15 times the equity of a bank (Kitua, 1996). In this way, the business of banking is potentially faced with difficulties where there is small deterioration in the quality of loans. Poor loan quality starts from the information processing mechanism (Liuksila, 1996) and then increases further at the loan approval, monitoring and controlling stages. This problem is magnified especially, when credit risk management guildelines, in terms of policy and strategies and procedure regarding credit processing do not exist or are weak or incomplete. Bridge (1998) observed that these problems are at their acute stage in developing countries. In order to minimize loan losses as well as credit risk, it is crucial for banks to have an effective credit risk management systems in place (Santomera 1997, Basel 1999). As a result of asymmetric information that exists between banks and borrowers, banks must have a system in place to ensure that they can do analysis and evaluate default risk that is hidden from them. Information asymmetry may make it impossible to differentiate good borrowers from bad ones (which may culminate in adverse selection and moral hazards) have led to huge accumulation of non-performing accounts in banks (Baster 1994). Credit risk management is very vital to measuring and optimizing the profitability of banks. The long term success of any banking institution depends on the effective system that ensures repayments of loans by borrowers, which were crucial in dealing with asymmetric information problems, thus, reduces the level of loan losses, (Basel, 1999).

2.3 Management attitude towards Risk and Credit Management

According to risk management guidelines for commercial banks issued by State Bank of Pakistan (2000), banks depending upon their size should constitute a Credit Risk Management Committee (CRMC), preferably comprising of head of Risk Management Department, Credit Department and Treasury. The committee should report to the banks risk management committee and should be empowered to oversee credit risk taking activities and overall credit risk management function. Effective credit risk management involves establishing an appropriate credit administration that involves monitoring process as well as adequate controls over credit risk.

It requires top management to ensure that there are proper and clear guidelines in managing credit risk, that is, all guidelines are properly communicated throughout the organization and that everybody involved in credit risk management understand them (Basel, 1999; Greuning and Bratanovic, 2003). Marphatia and Tiwari (2004) specified that risk management is primarily about people – how they think and how they interact with one another. They signified that CRMC should be mainly responsible for implementation of the credit risk policy or strategy approved by the Board ; monitoring credit risk on a bank-wide basis and ensure compliance with limits approved by the Board ; recommending to the Board, for its approval, clear policies on standards for presentation of credit proposals, financial covenants, rating standards and benchmarks; deciding delegation of credit approving power, prudential limits on large credit exposures , standards for loan collateral, portfolio management, loan review mechanism ,risk concentration, risk monitoring, and evaluation, pricing of loan, provisioning, regulatory or legal compliance.

According to Basel (1999), to maintain credit discipline and to enunciate credit risk management and control process there should be a separate function independent of loan origination function. Credit policy formulation, credit limit setting, monitoring of credit exceptions or exposure and review or monitoring of documentation are function that should be performed independently of the loan origination function. For small banks where it might not be feasible to establish such structural hierarchy, these should be adequate compensating measures to maintain credit discipline introduce adequate checks and balances and standards to address potential conflicts of interest. Ideally, commercial banks should institute a Credit Risk Management Department (CRMD). The function of the Credit Risk Management Department should include the following

A holistic approach in management of risk inherent in bank portfolio and ensure the risks remain within the boundaries established by the Board or Credit Risk Management Committee; ensuring that business line comply with risk parameters and prudential limits establish by the Board or CRMC; establishing systems and procedures relating to risk identification, Management Information System, monitoring of loan or investment portfolio quality and early warning. The department would work out remedial measure when deficiencies or problems are identified; undertaking portfolio evaluations and conduct comprehensive studies on the environment to test the resilience of the loan portfolio.

H1: The effective credit risk management by firms demonstrates an appropriate credit administration.

H2: The effective implementation of credit risk management by firms demonstrates management commitment in attaining corporate goals.

3. Research Methodology

3.1 Research Design

This study used the survey methods by employing quantitative instruments for data collection and analysis. The survey methods were used because the variables involved in the analysis were quantitative in nature. According to Trochin (1999), survey methods are used for non- experimental and descriptive research methods. He further indicated that, survey can be useful when a researcher wants to collect data on phenomena that cannot be directly observed. Based on Trochin‟s assertion, the researcher adopted the survey method for his study.

3.2 Case Selection

The process of selecting a suitable case is an essential step to build theories from case studies. This became important because when unsuitable cases are selected, the result obtained will be misleading and will not help us achieve our research objectives. Appropriate selection of case helps define the limit for generalizing the finding of the study and control waste (Eisenhardt, 1989). Considering the number of cases that can be studied at a particular time choosing a relevant case becomes an essential obligation (Pettigrew, 1998).

3.3 Data Collection

The population of the survey constituted the management and non-management staff and customers of Ecobank (EBG), Ghana Commercial Bank (GCB) and Stanbic Bank in Ghana. The researchers used the purposive sampling technique and accidental technique. The study used a sample size of five hundred and fifty (570) respondents, of which the researchers divided it equally among customers and management staff and non-management staff of the three banks. Due to adequate time the researchers devoted for the data collection, the researchers were able to get five hundred and Sixty-one (511) questionnaires that were administer.

3.4 Measurement of Variables

3.4.1 Management Attitude

For purpose of this research, questions on how management behave were asked and placed on a 5- point scale ranging from strongly agree (5), Agree (4), Undecided (3), Disagree (2), and strongly disagree (1) in form of statement. This scale is adopted from Deshpande et al. (1993); Jaworski and Kohli (1993); and Samiee and Roth (1992).The respondents were asked to indicate their level of agreement with each statement in relation to the management attitude of their banking institutions.

3.4.2 Credit Risk Management

Questionnaire on credit risk management was designed to measure the role adverting plays in selecting choosing a brand. All of these questions were measured from “strongly disagree” to “strongly agree”. This scale is adopted from Deshpande et al. (1993); Jaworski and Kohli (1993); and Samiee and Roth (1992).

3.5 Validity and Reliability of Data

The reliability of data used for empirical analysis and hypothesis testing was assessed. The reliability of the data was assured by the use of Cronbach’s alpha (numerical value of 0.5 is considered appropriate to show consistency). For this research data, the alpha value for management attitude is 0.83 and credit risk management at 0.87. The hypothesis formulated for the study was tested by cross-sectional data with the use of statistical software SPSS 20.0. Descriptive statistics and Pearson correlation were generated between variables.

4.Data Analysis

4.1 Statistical Population and Statistical Samples

After collecting data, we should evaluate the role of management towards risk and credit management in Ghanaian banking industry. Management attitude was treated as predicator and risk and credit management is a criterion variable. Based on analysis of the collected data and using description statistics for demography, it was found that most respondents were male at 60.4% and the most of the research participants (49.7%) are aged

between 25 and 40. Additionally, most people (48.2%) have some undergraduate education level and most respondents are married (58.9%).

4.2 Credit Risk Management

This section reports the statistical analysis of our data on credit risk management. Table 1 show a summary of descriptive statistics and correlation between all variable used. The dependent variable used is effective credit risk management (ECRM). The independent variables include effective risk identification (ERI), Credit risk measurement (CRME), credit risk assessment (CRA), and credit risk monitoring (CRM).

4.2.1 Descriptive Statistics

Table 1 Descriptive Statistics and Pearson Correlation of Credit Risk Management Variable

Variables	N	Mean	SD	2	3	4	5
1.ECRM	511	3.19	1.152	.529**	.624**	.514**	. 839**
2.ERI	511	3.67	1.152		.690**	.939**	.099
3.CRME	511	3.37	1.474			.251**	.525**
4.CRA	511	3.26	1.320				.291**
5.CRM	511	3.47	1.038				

** Correlation is significant at 0.01 level (2-tailed).

The Pearson correlation above shows that credit risk management had the highest correlation coefficient with the dependent variable at 0.84 at p< 0.01 (2- tailed) and credit risk identification at 0.529 at p< 0.001(2-tailed). Also variables such as credit risk measurement (CRME) and credit risk assessment (CRA) had a correlation coefficient of 0.624 at p < 0.01 (2-tailed), 0.514 at p < 0.01(2-tailed) respectively. Inferences that can be made from this statistical figures above despite they all had a significant correlation with the dependent variable is credit risk measurement is really high.

In the study the researchers found out that the respondents agree that the banks have appropriate credit administration that supervise the day to day credit and risk associated with their work. Since the focus was on whether the effective credit risk management is as a result of the appropriate credit administration. This finding satisfies the hypothesis (H1) that states that the effective credit risk management by firms demonstrates an appropriate credit administration.

4.2.2 Regression Analysis

Table 2 Regression Analysis of Credit Risk Management Variables

Models	R-square	Unstandardized coefficients.		Standardized coefficient	t-value	Sig.
		Beta	Standard Error	Beta		
1. ERI	.543	.320	.083	.621	3.872	.000
2.ERI, CRME	.670	-.027	.116	.581	3.566	.000
3.ERI,CRME, CRA	.733	-.183	.097	.611	-2.060	.001
4.ERI, CRME,CRA,CRM	.881	.007	.035	.511	3.023	.010

The regression model was established using the equation: $Y= \alpha + \beta 1X_1 + \beta 2X_2 + \beta 3X_3 + \ldots + \beta nXn$ where: Y is the dependent variable, "α" is a regression constant; β1, β2,β3 and βn are the beta coefficients; and X_1, X_2, X_3, and Xn are the independent (predicator) variables. Standardized beta coefficients were put in the regression equation. This revealed that corporate social responsibility awareness can be predicated as: $Y= \alpha + 0.62\ X_1 + .58\ X_2 + .61\ X_3 + \ldots + \beta nXn$ where: *Y* is (ECRM) ; X_1, is (ERI) ; X_2, is (CRME); X_3 is (CRA), and Xn is the nth predicator.

4.3 Management Attitude

WEV means well-established vision and is the dependent variable, EAE means establishing an appropriate credit risk environment, OUGP means operating under a sound credit granting process, MCA means maintaining an appropriate credit administration, measurement and monitoring process, EAC means ensuring adequate controls over credit risk and RS means role of supervisors are independent variables.

4.3.1 Descriptive Statistics

Table 3: Descriptive Statistics and Pearson Correlation of Management Attitude Variable.

Variables	N	Mean	SD	2	3	4	5	6
1.WEV	511	3.20	1.137	.411**	.859**	.321**	.844**	.718**
2. EAE	511	3.27	1.066		.101**	.918**	.148**	.099**
3.OUGP	511	3.71	1.176			.227**	.955**	.843**
4.MCA	511	3.41	1.123				.034**	.189**
5.EAC	511	3.12	1.099					.875**
6.RS	511	3.23	.918					

** Correlation is significant at 0.01 level (2-tailed).

From the table 3, it shows , OUGP, EAC and RS had a significant correlation with the dependent variable at 0.86 at $p < 0.01$(2-tailed), 0.84 at $p < 0.001$(2-tailed) and 0.72 at $p < 0.01$(2-tailed) respectively. Inferences that can be made from this statistical figures above despite they all had a significant correlation with the dependent variable is that maintaining an appropriate credit administration for a long time was a challenge to the banks.

The researchers investigated further to know whether the effective implementation have any bearing with management commitment and attitude. The finding showed that the firms effective implementation of credit risk management is as a result of the management commitment and attitude.. This finding satisfies our hypothesis (H2) that states that the effective implementation of credit risk management by firms demonstrates management commitment in attaining corporate goals.

4.3.2 Regression Analysis

Table 4 Regression Analysis of Management Attitude Variables

Model	R-square	Unstandardized coefficients.		Standardized coefficient	t-value	Sig.
		Beta	Standard Error	Beta		
EAE	.611	.350	.063	.401	5.580	.000
EAE,OUGP	.721	.503	.041	.520	12.228	.000
EAE,OUGP,MCA	.784	-.179	.031	.633	-5.789	.000
EAE,OUGP,MCA,EAC	.831	.629	.062	.608	10.076	.000
EAE,OUGP,MCA,EAC,RS	.911	.524	.033	.502	4.323	.010

The study also used correlation and regression analysis in testing H2. The model of analysis was based on the regression analysis: $Y= \alpha + \beta 1X_4 + \beta 2X_5 + \beta 3X_6 + \ldots + \beta nXn$ Where: Y is the dependent variable (management attitude) , "α" is a regression constant; $\beta 1$, $\beta 2$,$\beta 3$ and βn are the beta coefficients and (X_4, X_5, $X_6 \ldots X_n$) are the independent variables. The dependent variable can be predicted as: $Y= \alpha +0.40 X_4+.52 X_5 + 63 X_6 + \ldots + \beta nXn$ where X_4, X_5, and X_6 are EAE, OUGP and MCA respectively.

5. Conclusion

The study was conducted to evaluate the role of management towards risk and credit management in Ghana. The study adopted both qualitative (case study) and quantitative methods respectively. Banks were selected to gather data, which was acquired from answers obtained from our administered questionnaire and also through interviews

The statistical findings showed significantly that the effective credit risk management by firms demonstrates an appropriate credit administration. And also the effective implementation of credit risk management by firms demonstrates management commitment in attaining corporate goals the relationship between credit risk management and management attitude were positive. The hypothesis established for this study was supported by the researcher findings.

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