

INFLUENCE OF CREDIT ASSESSMENT PROCESS ON REPAYMENT OF KENYA COMMERCIAL BANK LOANS IN SOUTH SUDAN

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ABSTRACT

The purpose of this research project was to assess the influence of credit assessment process on repayments of loans at Kenya Commercial Bank South Sudan Limited. KCB South Sudan Ltd non-performing loans increased beyond the allowed levels which as a result affected the overall group business performance. The study adopted a descriptive research design focusing on KCB South Sudan Limited. The study found out that in order to assess the credit risk of a loan advanced the lending institution needs to check the borrowers' economic and legal situation, assessing the environmental situation in which the borrower is operating in and in particular the environment in South Sudan. In addition, lending institution should have sound credit approval authorities, a prudent credit practice personnel ought to have customer relationship responsibility and there is need for credit monitoring so that the bank appreciates the borrower's current financial status and monitor the prevailing financial situation affecting the country like inflation. The study concluded that there existed a significant negative relationship between use of credit risk control and level of non-repayment of bank loans. The study recommends that KCB South Sudan Ltd should use credit risk identification practices in risk management due to its impact on reduction of level of bank loans repayment and enhance usage of credit risk analysis and appraisal in credit risk management.

Key Words: Credit assessment process, repayment, commercial banks loans, South Sudan, Credit risk identification, credit risk analysis, credit approvals, credit risk monitoring.

INTRODUCTION

The main role played by the commercial bank is financial intermediation whereby they collect surplus money from surplus households and extend to deficit households in the form of credit (Wondimagegnehu, 2012). Credit management is very crucial in maximizing the overall performance of financial institutions. Lending has been and still is the core business of financial institutions.

According to the Central Bank of South Sudan (CBSS) survey of 2013, non-performing loans (NPLs) increased from 10.5 billion to 19.7 billion South Sudanese pounds in 2013, an increase of 9.2 billion South Sudanese pounds from the previous year. In the year 2014, this amount increased to 73 billion South Sudanese pounds (SSP) (Siddiqui, 2008). The financial and banking sector in South Sudan is still at an infant stage and has a weak regulatory framework.

Kenya Commercial Bank South Sudan Limited, which is also referred to as KCB South Sudan, is a commercial bank registered in South Sudan and is one of the biggest commercial banks in South Sudan in regard to the number of customers it serves/ accounts it holds and branch network it has in the country and is one of the first foreign banks to commence its operations in Juba after the comprehensive peace agreement (CPA).

According to the 2012 annual banking report, KCB South Sudan Ltd currently has a market share of 42% serving 138,000 customers (Ngare, 2008). Although KCB South Sudan Ltd had a profit after tax of 41.5 Million South Sudanese Pounds (SSP) (around \$14 million) in 2012 from 25.4 Million SSP the previous year, KCB South Sudan Ltd has continuously become a risk factor to credit risks and management in the wake of 30 months armed conflict (civil war) that broke up on 15th December 2013.

KCB South Sudan Ltd non-performing loans increased beyond the allowed levels which as a result affected the overall group business performance. According to the CBK report (2014), the high non-performing loan ratio of 8.4% registered by KCB South Sudan Ltd was due to poor quality credit processes and management as well as the conflict which began in December 2013.

This study therefore seeks to assess if the repayment of bank loans in Kenya Commercial Bank in South Sudan is influenced by the credit assessment process.

Specific objectives of the Study

This paper therefore aims at addressing the following specific objectives:

- i. To determine the influence of credit risk identification on repayment of loans in KCB South Sudan Ltd.
- ii. To establish the influence of credit risk analysis and appraisal on repayment of loans in KCB South Sudan Ltd.
- iii. To establish the influence of credit approvals on repayment of loans in KCB South Sudan Ltd
- iv. To find out the influence of credit risk monitoring on repayment of loans in KCB South Sudan Ltd

Research Questions

This study sought to answer the following research questions:

- i. What determine the influence of credit risk identification on repayment of loans in KCB South Sudan Ltd?
- ii. What is the influence of credit risk analysis and appraisal on repayment of loans in KCB South Sudan Ltd?
- iii. How do credit approvals influence repayment of loans in KCB South Sudan Ltd?
- iv. To what extent does credit risk monitoring influence repayment of loans in KCB South Sudan Ltd? Significance of the Study

The study would contribute to scholarship as it would include the work of other researchers in this field and also make recommendations on areas that other researchers can closely monitor.

LITERATURE REVIEW

This section describes the theories on which the study is anchored. It specifically presents two theories namely the theory of credit scoring and competitive pricing of default risk and the Modern Portfolio Theory as discussed below;

Credit scoring entails the study of David Durand in the area of consumer installment financing published in 1941 by a firm engaged in knowledge diffusion of how the economy works. The study was made to order in 1937 after observing that consumer financing faced the Great Depression better and registered relatively small losses compared to other credit markets (Durand, 1941). The study pioneered the use of statistics in analyzing credit risk factors in consumer financing. Credit scores are used in lending institutions to award an applicant based on the information supplied in the application form and maybe a few records and information about the borrower to determine the amount of credit to be advanced. Based on the scoring results, the loan appraisers form a decision which could be either issue credit or decline issuance altogether.

The Modern Portfolio theory is known to have been published by Harry Markowitz in 1952 in his journal of Finance. Although Markowitz was the publisher of this theory, he was not the first one to appreciate the power of diversification. The theory was the first system used to help to quantify the best method of constructing a portfolio. The theory states that all the potential investors should select the lowest risk allocation in regards to specific returns (Francis & Kim, 2013). The Modern Portfolio theory is a very useful process during the credit assessment process in banking system (Saunders & Allen, 2010). This is a process aims at establishing the credit risk of an individual through measuring it.

Empirical Literature Review

This section covers studies presented by other scholars and researchers relevant to the topic. The section is arranged in line with the research objectives to inform the formulation of research instrument questions.

In order to take mitigation steps in risk management, it is important the risks present in a given process are identified, profiled to come up with appropriate measures of mitigating it. Risk identification is vital to any financial institution that gives credit to its customers; it helps in effective risk management within the institution.

In the study by Moti et al., 2012, it was found that institutions involved in lending, including commercial banks, mortgages, SACCOs and micro-finance institution carefully assess credit risk and potential changes that may make the borrower not to be in a position to make periodic payment of principal and interest rate as agreed upon during the extension of credit.

The process of credit risk analysis and appraisal enables the extension of credit facilities to a given applicant. Mwangangi (2014) in a study found out that the use of credit scoring of a particular borrower positively and significantly influenced the repayment performance in AFC.

The process of credit approvals ensures that all the due process of loan assessment has been adhered to before the loan is advanced to the borrower. Zimbalchew (2015) journal of Assessment of Loan Recovery Performance in Construction and Business Bank stated that proper disbursement process will also help the bank to have appropriate resources to take legal action in case the borrower fails to pay, thus reducing incidences of bad loans.

Commercial banks need to pay close attention to the progress with which loan beneficiaries service their loans to be able to detect any signs of difficulty in repayment in good time. This process of paying close attention is referred to as credit risk monitoring. Siddiqui (2008) in studying the risks present in financial contracts among Islamic banking found out that banks need to ensure that they have full information concerning the present status of a borrower.

Summary and Research gap

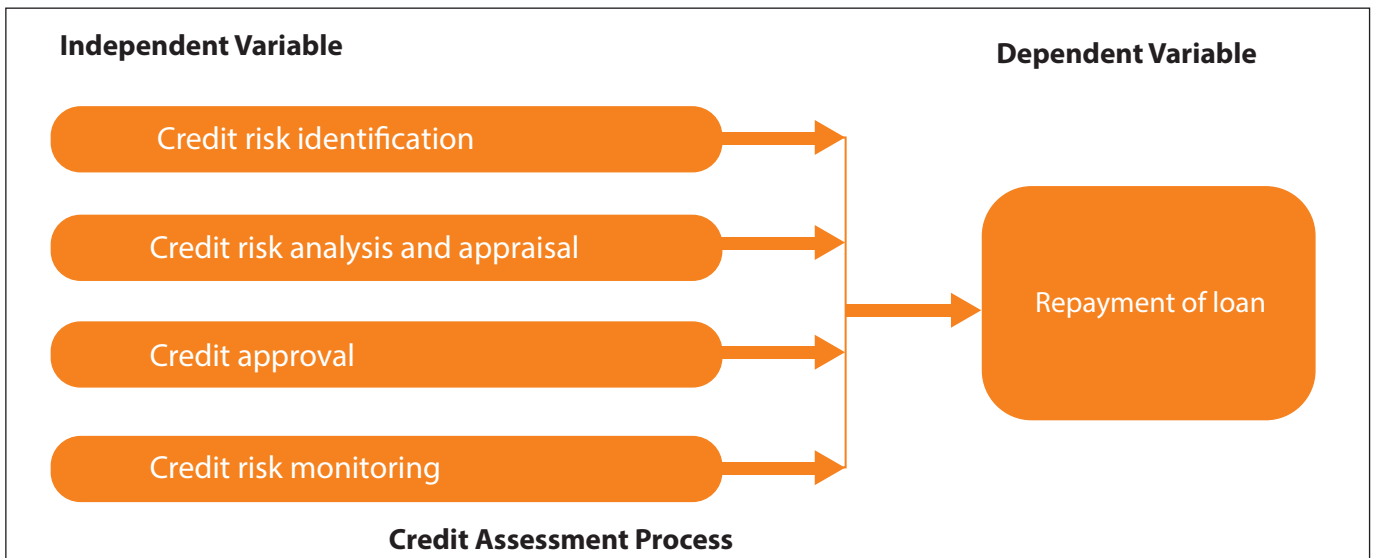
The theoretical and empirical analysis found Credit assessment process (credit risk identification, credit analysis and appraisal, credit approval and credit risk monitoring) to be very vital in the management of Banks. The theories analyzed (the theory of credit scoring and competitive pricing of default risk and modern portfolio theory) have shown the importance of various methods of credit assessment process and how they are used in financial institutions.

All studies indicated above on credit assessment have attempted to analyze the different sections of credit assessment process and concentrated more on the different methods used by various financial institutions in different countries but none has attempted to analyze the entire credit assessment process and its influence on repayment of bank loans in a South Sudan context.

From the above literature review, the influence of credit assessment process on repayment of bank loans in South Sudan and mainly credit risk identification, credit risk analysis and appraisal, credit approval and credit risk monitoring is identified as a gap and thus necessitating the study.

Conceptual Framework

The conceptual framework shows the relationship between the independent variables (credit risk identification, credit risk analysis and appraisal, credit approval and credit risk monitoring) and the dependent variable in this study which is repayment of loan.



METHODOLOGY

The study adopted a descriptive research design focusing on KCB South Sudan Limited to achieve the study objectives. Primary data from the respondents by the use of a questionnaire was obtained from the target population as indicated below. The secondary data were obtained from reviewing textbooks, publications, financial statements, internal records and operating manual of Kenya Commercial Bank South Sudan Ltd.

Target Population

Target Group	Target Population
Branch Managers	16
Operation Managers	16
Credit Officers	32
Credit Analyst	32
Personal Bankers	80
TOTAL	176

This study employed a survey of 16 branches of KCB South Sudan and forty percent (40%) of the target population of branch managers, operations managers, credit officers, credit analysts and personal bankers. A total of 72 respondents were selected using simple random sampling method. The seven branches considered for this study out of the sixteen available branches of KCB South Sudan were selected using simple random sampling method. Munuki branch was considered for the pilot study where 5 credit officers and 5 credit analyst were selected for pre-testing the research instrument.

The data gathered were analyzed, and the descriptive statistics were done by the use of percentages, frequencies, means and standard deviations. Inferential statistics were computed with the aid of regression analysis that established the relationship between the independent and the dependent variable.

The multiple regression model was as follows: $Y = a_1 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon$

Where Y= Repayment of loans which is the dependent variable measured by loan default rate (loan repayment rate), a_1 = Constant whereas $\beta_1, \beta_2, \beta_3$ and β_4 are Coefficients of the determinants the effects of credit assessment process on repayment of bank loans in South Sudan using a case of Kenya Commercial Bank South Sudan Limited. ϵ = error term; X_1 = Credit Risk Identification; X_2 = Credit Risk Analysis and Appraisal; X_3 =Credit Risk Monitoring; X_4 = Credit Approval.

RESEARCH FINDINGS AND DISCUSSION

The study administered 72 questionnaires to the target respondents out of whom 51 were filled in and returned. This translated to a response rate of 71% which is good enough and representative of the population and conformed to Mugenda and Mugenda (2003) requirement that a response rate of 70% and above is excellent.

In order to understand the suitability of the respondents to provide data for the study, they were requested to indicate their general information. In regard to gender, 73% of the respondents were male while 27% were female which indicates that all genders were represented hence giving a good representation of the study. 31.4% of the respondents had diploma, 43.1% had bachelor degree while 25.5% had master's degree meaning that the respondents had relevant knowledge thus they had ease in addressing the questions and provided the correct responses. 41.2% of the respondents had been working for a period of 1-4 years, 39.2% for a period of 5-8 years and 19.6% for a period of 9-12 years which indicates that the respondents had been working in the bank long enough thus had experience on credit assessment process. 11.8% of the respondents were branch managers, 13.7% were operation managers, 23.5% were credit officers, 29.4% were credit analyst and 21.6% were personal bankers. This indicates that the study involved participants from across all cadres thus the information provided were appropriate and reliable for the study.

Bank Loan Repayment

In this study the Bank loan repayment is the dependent variable. The respondents were asked to indicate the degree to which they agree or disagree with statements on repayment of loans at KCB South Sudan Ltd. The findings are as follows;

Statements	Mean	Std. Dev
The loan approved should be enough for the intended purpose as per the client's request.	3.92	1.074
The loan repayment duration should be convenient to the client's business	3.78	1.025
Credit policy, credit monitoring and other internal factors within KCB South Sudan Ltd are the causes of clients defaulting on repayment of loans	4	1.077
Environmental problems such as country's economic crisis are the main factors that cause clients to default on repayment of loans.	4.01	1.067
Only the well deserved and able customers are issued loans as per the bank's credit policy	3.78	1.331

Influence of Credit Risk Identification on bank loan repayment

In this study, Credit risk identification is taken as an independent variable. Several statements on credit risk identification and its influence on repayment of loans at KCB South Sudan Ltd were identified, and the respondents were required to indicate the degree to which they agree or disagree with the following statements.

Statements	Mean	Std. Dev
In order to assess the credit risk of a loan advanced the lending institution needs to check the borrowers' economic and legal situation	3.78	1.171
Assessing the environmental situation (economic growth, political stability and factors affecting the industry will help identify the credit risks	3.47	1.316
Lending institutions like banks etc carefully assess credit risk and the potential chances that borrower fail to pay their loan obligations as scheduled	3.68	1.288
Identifying credit risks affect the incidence of delinquency and default in loan repayment	3.84	1.155
To assess credit risk, lenders gather information like financial situation and collateral of the borrower	3.6	1.281
The main predictors of the credit appraisal process are financial ratios, personal or corporate profile and the adequacy in staffing.	4.03	1.232
There are weaknesses in structure of the credit appraisal like bank staff colluding to award loans to non-qualifying applicants.	3.56	1.3
Banks must identify and score all the risks that are involved with advancing credits to customers and their effect on profitability	3.66	1.259

Coefficient for Credit Risk Identification

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	4.720	2.450		1.926	.000
Credit Risk Identification	.262	.071	.467	3.698	.001

The established regression equation becomes;

$$Y = 4.72 + 0.262X_1 + \epsilon$$

The equation above reveals 4.72 % rate of the repayment of loans with a coefficient of 0.262 for the credit risk identification with the influence of credit assessment process on repayment of bank loan in South Sudan using a case of KCB South Sudan Limited.

Where: Y= Bank Loan Repayment, X₁= Credit Risk Identification and ε = Error Term.

The above findings are in agreement with the study of Ang and Longstaff, 2013 which states that in order to evaluate the credit risk associated with a loan advanced to a borrower, it is necessary for the lending institution to take a close look at the borrowers' economic and legal situation as well as the relevant environmental situation.

Influence of Credit Risk Analysis and Appraisal on bank loan repayment

In this study, Credit risk analysis and appraisal is taken as an independent variable. Several statements on credit risk analysis and appraisal and its influence on repayment of loans at KCB South Sudan Ltd were identified, and the respondents were required to indicate the degree to which they agree or disagree with the following statements.

Statements	Mean	Std. Dev
The use of credit scoring of a particular borrower positively and significantly influenced the repayment performance	3.94	1.138
Lending institutions should work with each other especially in sharing borrowers' information this will reduce chances of giving loans to risky customers	3.86	1.113
The lending institutions should have short and effective credit scoring processes.	3.8	1.149
For credit risk analysis, the lenders check for past financial circumstances and loan collateral	3.56	1.237
Credit scoring tool based on credit history and other pertinent data helps in facilitating the assessment of credit risk	3.96	1.076
Credit-scoring models use information like financial condition, prior payment history, public filings and industry comparative data for credit assessment	3.66	1.259
Loan approval is based majorly through computer analysis that rates the borrower	3.72	1.15
Credit Scoring is a statistical method used to predict the probability that a loan applicant or existing borrower will default in repaying the loan amount	3.76	1.209
Credit scoring can be used to price loans basing it on the degree of risks attached to that loan.	3.64	1.246

Coefficient for Credit Approval

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	4.337	2.026		2.1417	.037
Credit Risk Identification	.447	.058	.739	.682	.000

$$Y = 4.337 + 0.447X_1 + \varepsilon$$

The equation above reveals 4.337% rate of the repayment of loans with a coefficient of 0.447 for the credit approval with the influence of credit assessment process on repayment of bank loan in South Sudan using a case of KCB South Sudan Limited.

Where: Y= Bank Loan Repayment, X₁= Credit Risk Analysis and Appraisal and ε = Error Term.

The above findings are in line with that of Hotz *et al.*, 2011 stated that all banks and other credit institutions are guided by their own credit policies which are used in the evaluation process of all applicants either individual or corporate.

Influence of Credit Risk Monitoring on bank loan repayment

In this study, Credit risk monitoring is taken as an independent variable. Several statements on credit risk monitoring and its influence on repayment of loans at KCB South Sudan Ltd were identified and the respondents were asked to indicate the extent to which they agree or disagree with the statements.

Statements	Mean	Std. Dev
There is need for credit monitoring so that the bank understands the current financial conditions of the borrower	4.21	0.965
Lending institution also monitor the prevailing financial situation affecting the county like inflation	4.07	1.092
All banks monitored all the loans that were advanced to customers in an effort to ensure proper and timely loan repayment	4.17	1.108
The problem of credit risk often begins at the loan application stage and increased throughout monitoring, controlling and the loan approval stages.	4.05	1.12
Collaterals, securing loans and guarantors are some strategies in debt recovery for loans.	4.15	0.902
Lending institutions provide adequate training to relationship officers and other bank staff in enhancing loan repayment	4.29	0.965
Banks asks customers to visit their branches and convince them to pay up or will be listed in CRB	4.22	0.901

Coefficient for Credit Risk Monitoring

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	4.955	3.468		1.4282	.003
Credit Risk Identification	.257	.102	.337	.509	.015

$$Y = 4.955 + 0.257X_1 + \epsilon$$

The equation above reveals 4.955% rate of the repayment of loans with a coefficient of 0.257 for the credit risk monitoring with the influence of credit assessment process on repayment of bank loan in South Sudan using a case of KCB South Sudan Limited.

Where: Y= Bank Loan Repayment, X₁= Credit Risk Monitoring and ε= Error Term.

The above findings are in agreement with the study of Siddiqui (2008) which found out that in order to have an effective credit monitoring system, it must include ways to ensure that the financial institutions appreciate the borrower's financial ability.

Regression Analysis and Hypothesis Testing

The study carried out a multiple regression analysis to assess the influence of credit assessment process on repayment of bank loans at Kenya Commercial Bank South Sudan Limited. The findings are indicated below.

Model Summary

Model	RR	Square	Adjusted R Square	Std. Error of the Estimate
1.	.789 ^a	.622	.590	.03045

From the above table, R was 0.789 meaning that there was a positive relationship between all the four factors influencing on the repayment of loans. R² was 0.622 implying that 62.2% of the dependent variable was explained by the independent variables while only 37.8% of the variations were due to other factors. This implies that, there was a significant variation of 62.2% of level of repayment of loans varied with variation in credit assessment process on repayment of bank loans in South Sudan with confidence level of 95% , P = 0.0021 < 0.05 using a case of Kenya Commercial Bank South Sudan Limited.

ANOVA

Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	696.298	4	174.074	18.955	.000 ^b
Residual	422.448	4	9.184		
Total	1118.745	650			

From the above table, the significance value is 0.000 which is less than 0.05 thus the model is statistically significant in predicting how credit risk identification, credit risk analysis and appraisal, credit approval and credit risk monitoring influence the repayment of loans. The results indicate that the model has an F- ratio of 9.184, P= 0.000< 0.005. The F critical at 5% level of significance was 2.56. Since F calculated (value = 18.955) is greater than the F critical (2.56), this illustrates that the overall model was significant.

Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	2.434	3.019		0.806	0.424
Credit Risk Identification	-0.052	0.094	-0.093	-0.551	0.004
Credit Risk Analysis and Appraisal	-0.131	0.093	-0.237	-1.402	0.016
Credit Approval	0.579	0.094	0.958	6.132	0
Credit Risk Monitoring	0.123	0.072	0.162	1.7	0.006

The established regression equation becomes;

$$Y = 2.434 - 0.052X_1 - 0.131X_2 + 0.579X_3 + 0.123X_4 + \epsilon$$

The general model above reveals 2.434% rate of the repayment of loans with a coefficient of(-0.052) for Credit Risk Identification, (- 0.131) for Credit Risk Analysis and Appraisal, (0.579) for the credit risk monitoring and (0.123) for Credit Approval with the influence of credit assessment process on repayment of bank loan in South Sudan using a case of KCB South Sudan Limited, where : Y= Bank Loan Repayment, X₁= Credit Risk Identification, X₂=Credit Risk Analysis and Appraisal, X₃= Credit Approval, X₄=Credit Risk Monitoring and ε= Error Term.

From the above findings of the regression analysis if all factors were held constant, bank loan repayment would be at 2.434. Credit risk approval had the highest influence on bank loan repayment followed by Credit Risk Identification and then Credit Risk Monitoring while Credit Risk Analysis and Appraisal had the least influence. All the variables were significant as the P-values were less than 0.05, an indication that all the factors were statistically significant. The study's compliance with credit risk identification led to significant negative influence on repayment of loan as r=-0.052, P=0.004, t=- 0.551. This clearly indicates that commercial banks in South Sudan have inadequate capital that would influence effectiveness in use of credit risk identification.

The study found that the use of credit risk analysis and appraisal practice led to significant decrease in level of Nonperforming loans in commercial banks as r= -0.131, P=0.16, t=-1.402.

This clearly indicated that the use of credit risk analysis and appraisal would lower the level of non-performing loans to a very great extent. The study found that the use of credit approval to a very great extent led to significant increase in non-performing loans as r= 0.579, P= 0.000, t=6.132. This clearly indicates that use of credit approval to a very great extent led to an increase in the level of non-performing loans in commercial banks in South Sudan. The study found that use of credit risk monitoring practices to a very great extent led to significant decrease in non-performing loans as r=0.123, P=.0.006, t=1.700. This clearly indicates that use of credit risk monitoring practices to a very great extent led to a significant decrease in level of non-performing loans in commercial banks in South Sudan.

CONCLUSIONS AND RECOMMENDATIONS

The study concluded that KCB bank use credit risk identification practices in risk management to a very great extent which resulted to significant reduction in level of non-performing loans. In addition, there existed a significant negative relationship between use of credit risk control and level of non-repayment of bank loans. Moreover, KCB bank engaged in credit approval to ensure client loan facilities are secure to minimize credit loss. Finally, the study concludes that there existed a significant relationship between use of credit risk monitoring practices and level of bank loans repayment.

The study recommends that KCB South Sudan Ltd should use credit risk identification practices in risk management due to its impact on the reduction of the level of non-repayment of bank loans. KCB South Sudan Ltd should enhance usage of credit risk analysis and appraisal in credit risk management through engaging in loan securitization. Credit approval of loan is made depending on the level of risk of the clients' business and diversifies its credit facilities to various clients in the different sector. KCB South Sudan Ltd should monitor borrowers' credit files for purposes of client rating to be used for approval or sanctions to minimize risks facing the bank.

Recommendation for Further Research

The study could be replicated through the addition of more aspects of the credit assessment process and to further evaluate the influence of studied variables on the repayment of the loan in addition to the current findings. The study recommends that additional studies should be done to assess the influence of credit assessment process on repayment of bank loans in financial institution including deposit taking microfinance institutions in South Sudan.

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