

Research Article

Assessment of Credit Management Practices and Loan Default Factors: Evidence from Cooperative Bank of Oromia Share Company, Ethiopia

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Abstract

Credit management is a fundamental banking function that influences loan portfolio quality, profitability, and financial sustainability. In Ethiopia, the expansion of banking services and lending activities has increased the importance of effective credit management practices. However, non-performing loans continue to pose significant challenges to the banking sector, largely due to weaknesses in credit appraisal, monitoring, and recovery mechanisms. This study aimed to assess the credit management practices of Cooperative Bank of Oromia S.c., Ethiopia, with particular emphasis on credit granting procedures, collection strategies, factors affecting credit performance, and the causes of borrower default. A descriptive research design was employed using both quantitative and qualitative approaches. Primary data were collected through structured questionnaires and interviews administered to employees involved in credit-related operations, while secondary data were obtained from reports, policy manuals, and relevant literature. Out of 150 questionnaires distributed, 98 valid responses were returned and analyzed using descriptive statistical tools, including frequencies, percentages, mean scores, and standard deviations. The findings revealed that the bank follows formal credit management procedures such as customer screening, financial analysis, collateral evaluation, and loan monitoring. Nevertheless, weaknesses were identified in monitoring and follow-up mechanisms. The results further indicated that macroeconomic factors, including inflation, high interest rates, unemployment, and economic instability, negatively affect credit performance. In addition, poor loan appraisal, delayed loan disbursement, unrealistic repayment schedules, inadequate supervision, and weak monitoring systems were found to be the major causes of borrower default. The study concludes that strengthening credit appraisal systems, enhancing loan monitoring and supervision, improving staff capacity, and adopting technology-based credit management tools are essential for reducing non-performing loans and improving the financial performance and sustainability of Cooperative Bank of Oromia S.c.

Keywords

Credit Management, Loan Default, Non-Performing Loans, Credit Risk, Cooperative Bank of Oromia

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1. Introduction

1.1. Background and Importance of Credit Management in the Banking Sector

The banking sector is crucial for economic growth through financial intermediation and credit allocation [1]. Commercial banks mobilize resources from savers and channel them to investors and productive sectors via loans and advances, which constitute a primary revenue source [2]. The sustainability and profitability of banks largely depend on robust credit management systems that minimize credit risk [3]. Effective credit management covering borrower evaluation, loan approval, monitoring, and recovery enhance asset quality, profitability, and financial stability. Conversely, weak practices can lead to loan delinquency, non-performing loans, and declining financial performance [5]. Globally, crises like the Asian and global financial crises have highlighted the detrimental effects of poor loan appraisal, inadequate supervision, and weak monitoring systems, underscoring the importance of prudent credit risk management [4].

1.2. Context of the Ethiopian Banking Industry and Cooperative Bank of Oromia

In Ethiopia, the banking industry has experienced significant growth following financial sector liberalization and increased demand for financial services. Banks have expanded their branch networks and lending across various sectors such as agriculture, trade, manufacturing, and construction. Despite this expansion, non-performing loans remain a persistent challenge, affecting operational efficiency and financial health [5]. Contributing factors include weak credit management practices, ineffective loan monitoring, and adverse macroeconomic conditions. Cooperative Bank of Oromia S.C., established in 2004, is among the fastest-growing banks in Ethiopia. It has expanded nationwide and supports diverse sectors but continues to face challenges related to delayed repayments and loan delinquency [6], highlighting the need for a thorough assessment of its credit management and loan recovery procedures.

1.3. Research Gaps and Study Objectives

Previous studies in Ethiopia and other developing countries have primarily focused on determinants of non-performing loans and the relationship between credit risk and profitability. However, there is a lack of comprehensive empirical research specifically examining the practical credit management procedures of specific banks [3, 7]. Including loan appraisal systems, monitoring mechanisms, collection strategies, and borrower default causes. Additionally, earlier research often overlooked institutional weaknesses and borrower-related factors impacting loan performance in developing economies [11]. This study aims to fill these gaps by providing empirical insights into the credit management practices of the bank, assessing its procedures, identifying factors influencing credit

performance, and analyzing the major causes of borrower default. The findings are intended to guide improvements in credit systems and reduce non-performing loans, benefiting bank management, policymakers, and financial institutions.

2. Review of Related Literature

2.1. Concepts of Credit Management and Credit Analysis

Credit management is a vital aspect of banking operations, encompassing the formulation and implementation of policies and procedures aimed at minimizing credit risk while maximizing returns from lending. It involves key processes such as borrower evaluation, loan approval, disbursement, monitoring, collection, and recovery [3]. Effective credit management ensures the maintenance of asset quality, enhances profitability, and supports operational sustainability [7, 15]. Each stage plays a crucial role in shaping the quality of the bank's loan portfolio; weaknesses in credit appraisal and monitoring can lead to increased loan delinquency and defaults [11].

2.2. Theories: The Five Cs of Credit

The most widely accepted framework in credit analysis is the Five Cs of Credit which assists financial institutions in assessing borrower creditworthiness [4]. Character refers to the borrower's honesty and willingness to fulfill their repayment obligations. Capacity measures the borrower's ability to generate sufficient cash flow to service the loan, reflecting their repayment capacity. Capital represents the borrower's financial strength and the level of their investment contribution, indicating their commitment and ability to withstand financial setbacks. Collateral involves assets pledged against the loan as security, providing a form of protection for the lender in case of default. Lastly, Conditions encompass the economic and industry-specific factors that may affect the borrower's ability to repay, such as market stability or regulatory environment. By applying these principles, banks and financial institutions can evaluate risks more effectively, minimizing lending exposure and reducing the likelihood of borrower default.

2.3. Macro and Micro Factors Influencing Credit Performance

Credit performance is affected by both macroeconomic and internal institutional factors:

Macroeconomic factors: Inflation, unemployment, economic instability, and interest rate fluctuations significantly impact borrowers' repayment capacity [2]. For example, high inflation erodes purchasing power, reducing business profita-

bility, while high interest rates increase borrowing costs. Macroeconomic stability plays a significant role in shaping banking sector performance and credit repayment behavior [12]. Institutional factors: Internal weaknesses such as poor credit policies, weak managerial efficiency, inadequate supervision, and ineffective monitoring systems can undermine credit performance [8, 9]. Studies in Kenya, Nigeria, and India have shown that poor loan appraisal and weak supervision are major contributors to loan delinquency [1].

2.4. Causes of Borrower Default

Research has identified several key causes of borrower default. One significant factor is improper loan appraisal, where an inadequate assessment of the borrower's repayment capacity leads to higher risk of default [1, 10]. Additionally, the diversion of loan funds occurs when borrowers use the funds for purposes other than those originally intended, which can impair their ability to meet repayment obligations [1, 11]. Inadequate supervision also plays a critical role, as weak follow-up and monitoring allow default risks to escalate unchecked [8, 17]. Delayed disbursement of loans can further disrupt planned repayment schedules, making it difficult for borrowers to adhere to their commitments [14]. Unrealistic repayment schedules that do not align with the borrowers' actual cash flows increase the likelihood of default [3, 14]. Lastly, external factors such as legal and regulatory constraints can hinder the enforcement of repayment, further contributing to borrower default [13]. Effective loan recovery strategies, including structured follow-up and enforcement mechanisms, are critical for minimizing default rates in banking institutions [16].

2.5. Summary of Empirical Studies Relevant to the Context

Empirical research highlights the importance of prudent credit analysis and sound credit management practices. Ahmad (1997) identified improper appraisal, diversion of funds, and inadequate supervision as primary causes of default [1]. Balogun and Alimi (1988) emphasized that delayed disbursement, high interest rates, and weak supervision significantly affects repayment performance [13]. Berger and DeYoung (1995) pointed out that unrealistic repayment schedules and poor follow-up systems further exacerbate non-performing loans [7]. In the Ethiopian context, studies have shown that macroeconomic instability, institutional weaknesses, and borrower-related factors substantially influence credit performance [2, 5, 11]. However, limited research has extensively examined the practical credit management procedures of specific banks like Cooperative Bank of Oromia, highlighting the need for context-specific analysis [3, 6].

3. Methodology

This study employed a descriptive research design to assess the credit management practices of Cooperative Bank of Oromia S.C. The descriptive design was considered appropriate because it enabled the researcher to examine existing lending procedures, evaluate credit management systems, and identify factors influencing loan performance within the bank.

The study adopted both quantitative and qualitative research approaches. The quantitative approach facilitated statistical analysis of respondent opinions regarding credit management practices, while the qualitative approach provided explanatory information through interviews and document analysis.

Both primary and secondary data sources were utilized in the study. Primary data were collected using structured questionnaires and interviews administered to employees involved in credit-related operations. Secondary data were obtained from annual reports, operational manuals, bank policy documents, journals, books, and previously conducted studies related to credit management and loan default.

The target population consisted of employees working in credit departments, loan administration sections, and recovery units of Cooperative Bank of Oromia. These employees were selected because they possessed adequate knowledge regarding loan appraisal, credit monitoring, and recovery procedures. Judgmental sampling technique was employed to select respondents based on their involvement in credit management activities. A total of 150 questionnaires were distributed to selected respondents, and 98 completed questionnaires were returned, representing a response rate of 65.3 percent.

Table 1. Questionnaire Distribution and Response Rate.

Description	Frequency	Percentage
Distributed Questionnaires	150	100%
Returned Questionnaires	98	65.3%
Unreturned Questionnaires	52	34.7%

Source: Researcher Own Computation

Structured questionnaires containing both closed-ended and open-ended questions were used to collect primary data. Interviews were conducted with managers and senior credit officers to obtain additional information regarding credit management practices and loan recovery systems. The collected data were coded, classified, tabulated, and analyzed using descriptive statistical methods including frequencies, percentages, means, and standard deviations. Tables were used to present the findings clearly and systematically.

Table 2. *Research Variables and Measurement Techniques.*

Variables	Indicators	Measurement Technique
Credit Granting Practices	Appraisal, collateral, screening	Mean and percentage
Collection Strategies	Monitoring, reminders, recovery	Frequency and mean
Factors Affecting Credit Management	Inflation, interest rate, unemployment	Descriptive analysis
Causes of Loan Default	Delayed disbursement, poor supervision	Mean score

Source: Researcher Own Computation

The reliability and validity of the data collection instruments were maintained through pre-testing and consultation with banking professionals and academic advisors. Ethical considerations were also maintained throughout the study. Respondents were informed about the purpose of the research, and confidentiality of information was assured.

4. Results and Discussion

The findings revealed that Cooperative Bank of Oromia follows formal credit granting procedures that include customer screening, financial analysis, collateral evaluation, approval, documentation, and disbursement. Most respondents indicated that collateral security and borrower financial performance are major criteria used in loan approval decisions.

Table 3. *Evaluation of Credit Granting Practices.*

Credit Granting Practices	Mean Score
Customer Screening	4.12
Financial Analysis	4.08
Collateral Evaluation	4.26
Loan Monitoring	3.21
Follow-up Mechanism	3.05

Source: Researcher Own Computation

The results indicate that the bank performs relatively well in customer screening and collateral evaluation. However, weaknesses were observed in loan monitoring and follow-up systems, which contributed to increasing loan delinquency and repayment problems.

The study further revealed that the bank employs different collection strategies including repayment monitoring, reminder notices, loan restructuring, and legal enforcement measures against defaulters. Despite these efforts, delayed repayment and weak enforcement mechanisms continue to affect loan recovery performance.

Macroeconomic factors were identified as major challenges affecting credit management practices. Respondents indicated that inflation and high interest rates significantly reduce borrower repayment capacity. Economic instability and unemployment were also found to increase loan delinquency by weakening business performance and reducing household income levels.

Table 4. *Factors Affecting Credit Management.*

Factors	Mean Score
Inflation	4.31
Interest Rate	4.28
Unemployment	4.10
Economic Instability	4.22
Managerial Efficiency	3.96

Source: Researcher Own Computation

The findings demonstrate that both external economic conditions and internal institutional weaknesses negatively affect loan portfolio quality and credit management performance.

The study also identified major causes of borrower default. Poor loan appraisal emerged as one of the leading causes because inadequate borrower assessment increased exposure to risky borrowers. Delayed loan disbursement was another significant factor affecting repayment performance because borrowers often failed to use loans for intended business purposes.

Table 5. *Causes of Borrower Default.*

Causes of Default	Mean Score
Poor Loan Appraisal	4.35
Delayed Loan Disbursement	4.12
Unrealistic Repayment Schedule	4.08
Weak Monitoring System	4.21

Causes of Default	Mean Score
Legal and Regulatory Problems	3.98

Source: Researcher Own Computation

The findings further showed that weak follow-up systems and inadequate supervision contributed significantly to non-performing loans. Insufficient monitoring allowed borrowers to divert loan funds away from intended activities, thereby increasing repayment difficulties.

Overall, the findings indicate that although Cooperative Bank of Oromia has established formal credit management systems, substantial improvements are required in appraisal, monitoring, supervision, and recovery mechanisms to minimize loan default and improve operational performance.

5. Summary

This study critically examines the credit management practices of Cooperative Bank of Oromia S.C., highlighting key procedures such as credit appraisal, collection strategies, and borrower default causes. The research reveals that macroeconomic factors including inflation, high interest rates, unemployment, and economic instability adversely impact credit performance. Internally, weaknesses such as poor loan appraisal and inadequate monitoring significantly contribute to rising NPLs. Empirical findings point to delayed disbursement, unrealistic repayment schedules, and insufficient supervision as primary causes of borrower default. Despite existing formal credit management systems, the bank faces considerable challenges in controlling loan default and maintaining asset quality, underscoring the need for comprehensive improvements.

6. Conclusion

The findings underscore that effective credit management is vital for the financial stability and operational efficiency of CBO. While the bank has established basic credit procedures, deficiencies in loan appraisal, monitoring, and supervision exacerbate default risks and impair asset quality. Macroeconomic volatility further complicates credit performance, emphasizing the importance of robust internal controls and risk mitigation strategies. Addressing these weaknesses is essential to reduce NPLs, improve profitability, and foster sustainable growth within the bank and the broader Ethiopian banking sector.

7. Recommendations

Strengthen Credit Appraisal Systems: The bank should enhance its borrower assessment processes by integrating comprehensive financial analysis and credit scoring models to ensure that loans are granted only to creditworthy borrowers

with sound repayment capacity.

Improve Loan Monitoring and Supervision: Establish rigorous monitoring mechanisms and regular follow-up routines to detect early signs of repayment difficulties, enabling timely corrective actions.

Revise Repayment Schedules: Develop realistic repayment plans aligned with borrowers' cash flows and economic realities, reducing the likelihood of default.

Capacity Building and Training: Provide continuous training for credit officers and staff on risk assessment, loan evaluation, and monitoring techniques to improve their competence and decision-making.

Enhance Internal Controls: Strengthen internal audit and control systems to ensure accountability, transparency, and adherence to credit policies.

Mitigate Macroeconomic Risks: Engage with policymakers to foster macroeconomic stability, which will indirectly support borrowers' repayment capacities and reduce external shocks.

Leverage Technology: Invest in credit management software and data analytics tools to improve decision accuracy, streamline processes, and facilitate real-time monitoring.

Abbreviations

NPLs	Non-Performing Loans
CBO	Cooperative Bank of Oromia

Author Contributions

Loko Mathewos Nigatu: Conceptualization, Methodology, Data Curation, Formal Analysis, Investigation, Resources, Validation, Visualization, Supervision, Project Administration, Writing – original draft, Writing – review & editing

Conflicts of Interest

The author declares that there is no conflict of interest regarding the publication of this article. The research was conducted independently without any financial, personal, or institutional influence that could have affected the study design, data collection, analysis, interpretation, or reporting of the findings.

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