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Credit Risk Management and Profitability of Lending Institutions in Panabo City

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Abstract: This study aims to determine the relationship between credit risk management and the profitability of lending institutions in Panabo City. This study used a quantitative descriptive correlational research method to know the relationship between the two variables by sampling fourty-six lending institutions in Panabo City. The study administered research questionnaires of both variables, which were interpreted using weighted mean and Pearson-r statistical tool. The level of credit risk management of lending institutions with an indicator of credit risk identification, control, assessment, and mitigation has gathered an overall mean of 4.86, with the descriptive equivalent of very high, while the level of profitability of lending institutions with an indicator return on asset and return of equity with an overall mean of 4.91 which both has a descriptive equivalent of very high. Therefore, the finding shows that there is a significant relationship between credit risk management and the profitability of lending institutions in Panabo City.

Keywords: *Credit risk management, profitability, return on asset, return on equity, Philippines*

I. INTRODUCTION

Due to today's pandemic's impact, lending institutions have difficulty sustaining their profitability. An institution's profitability must be kept at an optimal level, suggesting that its financial activities are well-managed. In a lending institution, profitability risk is unavoidable. Therefore, it is only reasonable for the institution to have a systematic process that can maintain a high profitability ratio. That allows the institution to track the recovery of the granted credits to customers (Tupaz, Eroy& Espinosa, 2021, p.1).

In Slovakia, four out of ten lending institutions have seen a considerable drop in profitability due to inadequate management of credit payment retrieval timeliness. These issues resulted in debt defaults due to clients' inability to meet their credit obligations on time, causing the institutions to go bankrupt due to low profitability (Boris, 2015, p330). Profitability is the best source of finance/capital to invest in expanding the business; additional funds from investors attracted by the prospect of high returns on their investment. A business without profitability cannot survive, whereas a highly profitable business can fully reward shareholders with a significant investment return. Increasing profitability is the most important task of business managers that will assist in providing input for management decisions and benefit the company's long-term success; without it, the company would cease to exist (Król, 2018, p.279).

The link between credit risk management and profitability is that the management of the risk related to that credit affects the profitability of the banks. Credit risk management is one of the most significant risks that banks face, considering that granting credit is one of the main sources of income in commercial banks. Therefore, the importance of credit risk management in banks is due to its ability in affecting the banks' profitability, existence and growth. It is observed that the bank credit depends upon the economic activities in an economy. As economy grows bank credit accelerates while the slow growth of the economic activity or the decline in economic activity results decline in bank credit (Dash & Kabra, 2010).

Numerous studies have been found regarding the credit risk management, but the researchers have not come across a study on credit risk management and profitability of lending institution. As a result, the managers needed to determine the long-term and short-term results. They were unaware of the environmental condition affecting the lending institution's profitability (Ashenafi2022, p. 36). Thus, this interests the researchers in conducting the study to

determine the relationship between credit risk management and profitability among the lending institution in Panabo City.

Furthermore, this study mainly focuses on the credit risk management and profitability of lending institutions in Panabo City. The primary reason for conducting this study is to assess the level of profitability of lending institutions depending on managing the credit risk. The lending manager will use the result of this study as a guide to help and analyze their business strategies to boost or increase the profitability of the company.

Therefore, this motivates the researchers to conduct this study to determine the level of credit risk management and profitability of lending institutions in Panabo City.

Globally, the importance of profitability should be in line with what the investor can obtain in the market plus a risk premium as a shareholder. However, profitability continues to be a return referred to the company and not to the shareholder. Upon narrowing the problem, this study would contribute to the lending institution by implementing an intervention.

A more profound comprehension of the significance of this study will be beneficial and knowledgeable to Lending Institutions. The study's findings will enlighten them on what influences credit risk management concerning their institution's profitability. This study's respondents are those whose work substantially impacts the financial institution's growth. Clients of the lending institution the study's findings are helpful for the clients of the lending institution. It would impart additional knowledge to them on how they can be wiser in investing and gaining profit. Students of this study will help them understand the importance of credit risk management control to institutions' profitability. Not only has that sense, but also the methods in this research may be helpful to their finances. Future Researcher's findings can be used as a reference by the future Researcher to put more weight on their prospective study.

Credit risk management is a systematic strategy for managing uncertainties, including assessing risks, developing risk management strategies, and mitigating risk. The organizational resources and accepting some or all of the risk's repercussions are among the methods (Afriyie & Akotey, 2012). Since the unpredictable nature of macroeconomic and microeconomic variables are unique to the banking business. Credit risk management is a challenging and complex undertaking in the financial industry (Garr, 2013). Moreover, (Nikolaidou & Vogiazas, 2014) stated that practical management is described as coordinated duties and activities for controlling and directing credit risks, which the company faces by including essential risk management techniques and processes concerning the business's goal.

Operationally, to have solid and effective credit risk management practices for guaranteeing consistent recoveries from customers. He underscored that credit management could limit the chances of unpredictable records receivable; leading to high finance costs (Frank, 2014). Also, Getaingi (2012, p1) claims that credit risk management has an indicator of credit risk identification, control, assessment, and mitigation. It plays a vital role in sustaining the profitability of lending institutions as this would minimize the risk of lending activities. It is a structured way to manage uncertainties through risk assessment, devising risk management strategies, and risk mitigation. It employs organizational resources that influence the lending institution's profitability. Financial security is more than monetary conditions, which included saving and utilization yet in addition incorporates abundance that to some extent represents assumption toward life fulfilment. Financial security is likewise engaged with terms of living plans and additionally monetary sources (Poblacion & Manigo, 2022, p.269).

Credit risk identification. Finding risk requires good information and a complete understanding of the microfinance institution and its internal and external settings. These are essential to identifying the risk, which is the first step in the risk management process (Khizer et al., 2011, cited by Ewool & Quartey, 2021). Furthermore, historical data on the institution and comparable institutions can be more advantageous. It can result in educated predictions on present and evolving difficulties that the institution has not yet addressed (Kenny et al., 2014). Credit risk control. Controlling credit risk has changed to using a temporary advance charge as the tool, with cash estimates moving gradually toward establishing marker work, local credit, and assessing expansion weight and financial prospects. According to confident national investors and scholars today, cash and credit should again be considered a significant economic component (Bloor, 2008, referenced by Conise, Desoyo & Vallesser, 2020, p13).

Credit risk assessment. According to Greening & Bratanovic (2003, cited by Irawati et al. 2019, p23), the credit portfolio is managed; that is, how loans are originated, appraised, supervised, and collected, is the foundation of sound credit risk management practices. Furthermore, a business credit risk index assessment system was developed by integrating dynamic and static data. It's built using enterprise identification, behavior, and external data (Abastante et al., 2019). Credit risk mitigation. Banks evaluate the purpose of a client loan application and the use of the loan to ensure banks fund a less risky venture. They also assess the credit quality of a client loan portfolio regularly and take measures to mitigate risks as a non-performing loan mitigation measure to a large extent (Getaingi 2012).

Lending institutions are concerned with more than just providing service to an individual or organization; they are also worried about making a profit and ensuring financial stability. Profitability is an action that generates a profit or financial gain by which a company's revenue exceeds a certain threshold of relevant expenses. Profitability ratios assess management's capacity to produce income from the organization's payment-generating sources (Duffie & Singleton 2012, p53). In terms of lending institutions, this entails a sustainable debt recovery rate from borrowers. Low profitability indicates ineffective management, which signifies a risk to the institution's profitability (Nwafili, 2017, p153).

Return on asset. It is a standard metric that assesses a company's capacity to profit from asset exploitation. It also tells if management is effective or bad at implementing cost control and how the administration uses its property or assets. It demonstrates an institution's efficiency based on its total assets and how it manages them to generate profit over time (Prastowo, 2002, cited by Tupaz, Eroy, & Espinosa, 2021). *Return on Equity*. When composing an institution, it is critical to understand how to keep track of a company's financial activities, particularly its profitability. It is a valuable indicator for finding companies that can provide positive returns over time and a technique for determining whether a company has the potential to make a lot of money (Calamar, 2016).

Credit risk management of a business includes managing the consequences of every action taken by the company. Thus, profitability is unique in a company’s ability to use its assets efficiently to generate profits and positive cash flow that will enable the business to remain in operation over the long term. Understanding the impact of every result will play an advantage for future references in decision-making. It gives the business the resources to operate profitably and eventually grow in the market, (Girsch-Bock, 2022, p. 2). Credit risk management allows banks to charge high-interest rates to account for the risk and therefore it improves profitability (Kutum 2017).

Moreover, Credit risk management is going to be crucial for profitability. Despite the variety of risks that banks encounter, credit risk management is by far the most significant (Poudel, 2012). Higher profitability has shown to result in fewer non-performing loans for banks since they can afford to implement proper credit risk management procedures (Rachman et al., 2018).

This is anchored in the study of Afriyie & Akotey (2012, p4), which states that credit risk management has become more significant not just because of the present global financial crisis in banks. But also as a critical concept that defines banks' survival, expansion, and profitability. It supports the theory of Anthonia (2012, p5), according to which an institution must carefully maintain its profitability. It must indicate healthy management with a return on investment and asset returns. As a result, efficient credit risk management should be performed promptly. In addition, according to the Agency Theory by Shapiro (2005, as cited by Olobo et al., 2021), investors maximize their earnings by lowering risk. It argues that diversifying a portfolio's uncorrelated assets lower risks and maximizes returns.

Credit risk management has an indicator of credit risk identification, control, assessment, and mitigation. It plays a vital role in sustaining the profitability of lending institutions as this would minimize the risk of lending activities. Credit risk He explained that credit risk management manages through risk assessment, devising risk management strategies, and risk mitigation employing organizational resources that influence the lending institution's profitability (Getaingi, 2012).

Our study will fill the research gap on the influence of credit risk management to the profitability in lending institution. And under the condition that derivative market now is getting increasing popularity. Banks are using diversified derivatives to hedge counterparty default risks (Jones & Perignon, 2013, p. 373). Consequently, we can provide more comprehensive knowledge to the readers. Another contribution will be that this research will supply the foundation for other researchers who wish to dig into further study.

This study aimed to determine the level of credit risk management and profitability of lending institutions in Panabo City. It sought to answer the following objectives: (1) To describe the level of credit risk management of lending institutions in Panabo City in terms of (1.1) credit risk identification; (1.2) credit risk control; (1.3) credit risk assessment; and (1.4) credit risk mitigation. (2) To describe the level of profitability of lending institutions in Panabo City in terms of (2.1) return on asset and (2.2) return on equity. (3) To determine the significant relationship between credit risk management and profitability of lending institutions in Panabo City.

The null hypothesis of this study was tested at a 0.05 level of significance, which states that there is no significant relationship between credit risk management and the profitability of lending institutions in Panabo City.

II. METHOD

This chapter presents the methodology used to conduct this study. This includes the research design, research respondents, research instruments, and research procedure with statistical data treatment.

Participants

The researchers targeted 46 lending managers/owners or credit staff out of 52 Lending institutions located in Panabo City that can only participate in the study. There is only one manager/owner in every lending institution and

less than five credit staff. Aside from this, there is no other employee who can participate in the study. The researchers used the random sampling technique where each sample has an equal probability of being chosen and there may be implications to the availability of the respondents because of the current situation caused by the pandemic.

Materials/Instruments

The researchers provided a research questionnaire adopted from the study of Getaingi (2012, p52-60) specifically the indicator of the independent variable: credit risk identification, credit risk assessment, credit risk control, and credit risk mitigation. The questionnaire for the dependent variable adopted from the study of Charol and Delator (2020, p3), and the indicator of the dependent variable are the return on asset and return on equity.

The respondents can answer the questionnaire by checking their answer choice. The Likert Scale requires the subject to check their choice, with 5 as the highest and 1 as the lowest. The questionnaire was divided into two parts; the first was about lending institutions' credit management, and the second focused on lending institutions' profitability in Panabo City.

Moreover, the following scale for interpretation was used to determine the level of credit risk management of lending institutions in Panabo City. The scale of 4.21 – 5.00 is considered very high, which means that credit risk management is highly observed. The scale of 3.41 – 4.20 is considered high, which means that credit risk management is often observed. The scale of 2.61 - 3.40 is considered moderate, which means that credit risk management is observed. The scale of 1.81 – 2.60 is considered low, which means that credit risk management is less observed. The scale of 1.00 – 1.80 is considered very low, which means that credit risk management is not observed.

Furthermore, to determine the level of profitability of lending institutions in Panabo City, the following scales for interpretation were used. The scale of 4.21– 5.00 is considered very high, meaning that profitability is highly satisfactory. The scale of 3.41 – 4.20 is considered high; this means that profitability is often satisfactory. The scale of 2.61 - 3.40 is considered moderate, meaning that profitability is satisfactory. The scale of 1.81 – 2.60 is considered low, meaning that profitability is less satisfactory. The scale of 1.00 – 1.80 which considered very low, meaning that profitability is not satisfactory **Design and Procedure**

This study used a quantitative research methodology, precisely the descriptive-correlational research method, to determine the relationship between credit risk management and the profitability of lending institutions in Panabo City. Sousa (2007, p504) claims that descriptive-correlational design helps describe variables and determine natural relationships. The researchers used this method to determine the amount of each variable: credit management as the independent variable and profitability as the dependent variable, before examining the significant association between credit management and profitability of Panabo City's lending institutions.

The researchers took the following steps in gathering data: The researchers prepared the questionnaires and sent them to the panel members and adviser to be checked along with the permission letter to conduct the study, which was sent to the adviser. Consequently, the researchers made a letter of request for the list of the exact population of lending institutions in Panabo City.

The researchers asked for the signature of the respective advisor to officially conduct the study. The proponent can guarantee that any subsequent actions have been validated and approved.

The research questionnaires were distributed after the proponents received the approved permission letter from the Research Panel. The researchers were personally going to their company. After doing so, the researchers gave the questionnaires to the respondents; the questionnaires were given personally. Following health protocols, the researchers wore masks and face shields before making personal contact with the respondents and adhered to the mandatory contact tracing. After that, questionnaires given personally were retrieved the same day as the questionnaires were administered since the respondents advised the researchers to wait. The responses were collected, tallied, and submitted for statistical interpretation. The results were analysed and interpreted based on the significance of the study.

The researchers utilized the following statistical tools: Mean, it was used to determine the level of credit management and profitability of Lending institutions in Panabo City, and Pearson-r, it was used to determine the relationship between credit risk management and the profitability of Lending institutions in Panabo City.

III. RESULTS AND DISCUSSION

This chapter is composed of the interpretation and analysis of data relevant to the queries in the problem statement. The data are presented in tabular and textual format with a profound description of the result. The sequence of topics in the study is as follows: the level of credit risk management, the level of profitability, and the significant relationship between credit risk management and profitability among selected lending institutions in Panabo City.

Level of Credit Risk Management

Table 1 shows the level of credit risk management measured in terms of credit risk identification, credit risk control, credit risk assessment, and credit risk mitigation. The evaluation is based on the questions of each indicator relating to credit risk management among selected lending institutions in Panabo City.

Table 1.
Level of Credit Risk Management of Lending Institution in Panabo City.

Indicators	SD	Mean	Descriptive Equivalent
Credit risk identification	0.39	4.82	Very High
Credit risk control	0.33	4.87	Very High
Credit risk assessment	0.32	4.89	Very High
Credit risk mitigation	0.36	4.85	Very High
Overall result	**0.36**	**4.86**	**Very High**

The first indicator credit risk identification gained an overall mean result of 4.82 with an overall standard deviation of 0.39. The indicator credit risk control gained an overall mean result of 4.87 with a broad standard deviation of 0.33. The indicator credit risk assessment gained an overall mean result of 4.87 with an overall standard deviation of 0.32. Lastly, the indicator credit risk mitigation earned an overall mean result 4.85 with a broad standard deviation of 0.36. In summary, the data demonstrate that credit risk management is highly observed by gaining an overall result of 4.86, which is very high.

The first indicator, credit risk identification with an overall mean result of 4.82, has a descriptive equivalent of very high. Therefore, it is highly observed in a lending institution. This showed lending evaluates loan applicants' long-term objectives to identify potential business concerns in the future. Considers whether the clients are highly qualified professionals in their field. The lending institution analyzes clients' records of repaying credit and checks business proposals. Business plans to identify credit risks to which the bank is exposed and evaluates the net worth of the client's business. The institution also significantly analyzes the clients' character, including loan applicants' credit histories.

The second indicator of credit risk control with an overall mean result 4.87, has a descriptive equivalent of very high. Therefore, it was highly observed in lending institutions. This demonstrated that lending institutions use credit securitization to protect clients' credit facilities and reduce their credit loss. They audit their business operations internally and externally to determine how to manage lending risks. Thoroughly check clients before approving credit facilities to minimize credit risk and use legal department checks like signing binding contracts to reduce credit defaults substantially.

The third indicator of credit risk assessment with an overall mean result of 4.89, has a descriptive equivalent of very high. Therefore, it was highly observed in lending institutions. It indicates that lending institutions were using credit risk assessment practices to a great extent to mitigate the occurrence of non-performing credit. The study results showed that lending institutions create credit evaluation committees to significantly reduce risks associated with client business activities and analyze the profitability, efficiency, and leverage of a client's business. Before granting credit, update borrower credit files for purposes of client rating to be used for approval or sanctions to minimize lending risks. The lending was discovered to evaluate credit performance monthly. To determine the impact of risks on clients' businesses and credit repayment, classify risks according to the Degree of damage. Take corrective action to manage banks' risks, and adopt credit recovery techniques to lower non-performing loans.

The fourth indicator credit risk mitigation with an overall mean result of 4.85, has a descriptive equivalent of very high. Therefore, it indicates a high peaked distribution in a lending institution. Lending institutions diversify their credit facilities to clients in different sectors to minimize credit risks from financing limited business activities. The institution also ensures the credit portfolio mitigates risk. The client defaults are to reduce non-performing loans and price credit depending on the level of risk of the client's business. The study discovered that banks frequently assess the credit quality of a client's credit portfolio. It takes steps to reduce risks as a mitigation measure against non-performing loans and the purpose of credit requested by the client. The utilization of credit to ensure bank funds are a less risky venture.

The following indicators: credit risk identification, credit risk control, credit risk assessment, and credit risk mitigation were all in very extent distribution and highly observed by the management; this was all supported by the study of Getaingi (2012). They indicated that using credit risk management practices has significantly reduced the amount of non-performing loans in Kenyan commercial banks. According to the study, following capital requirements

will substantially impact credit risk management, proving that commercial banks with appropriate capital will successfully implement credit risk management practices.

Moreover, while integrating the business requirements with controls, credit risk management as a structural necessity needs to be improved (Olobo et al. 2012, p312). The findings of this study were in line with those of other studies by Yousfi (2015 as cited by Taiwo et al., 2017), all of which stressed the benefits of risk management techniques for improving transparency. Studies highlighting the balance between risk management and corporate growth (Bushman & Williams, 2015) disagreed, claiming that rigorous risk management practices would impede business growth.

Level of Profitability

Table 2 shows the level of profitability of lending institutions in Panabo City have gathered an overall result of 4.91 with an overall standard deviation. It has a descriptive equivalent of very high. Therefore, it implies that profitability is highly satisfactory. This indicates that lending institutions have effectively sustained their profitability by balancing the allocation of assets and equity. This result is supported by Johnson (2019), who stated that it is empirical for the institutions to sustain their profitability as this would be the indicator of their success.

Table 2.
Level of Profitability of Lending Institution in Panabo City.

Indicators	SD	Mean	Descriptive Equivalent
Return on asset	0.27	4.92	Very High
Return on equity	0.29	4.90	Very High
Overall result	**0.28**	**4.91**	**Very High**

In addition, by maintaining profitability at an optimum level, lending institutions can attract more investors, indicating security in investment returns.

Additionally, the degree of profitability in return assets has amassed an overall mean result of 4.92 with a descriptor equivalent of very high. Therefore, the profitability of lending institutions based on their asset return is very satisfying. Since assets are crucial to keeping a business operating, lending institutions have found that using return on investments as a measure of profitability has been successful. This is corroborated by Leybag's (2017) assertion that assets are essential to every business's ability to profit and maintain its worth.

The level of profitability measured by return on equity is shown to be very high, with an overall mean result of 4.90. Therefore, the profitability of lending institutions based on the return on equity is also very satisfying. This indicates that the lending institutions are successfully producing income from the investors' investments, which is a highly acceptable result. This suggests that the institutions have kept up their effectiveness in making money. Pileggi (2021) elaborated that keeping the return on equity at its ideal level indicates that the institution is good at making money. This would help keep the investors interested in investing as investors use return on equity as their basis for supporting to ensure the security of investment returns. Pileggi argues that this would help maintain the institution's ability to make money.

Significant Relationship between Credit Management and Profitability among Selected Lending Institutions in Panabo City

Table 3 shows the significant relationship between credit management and profitability among selected lending institutions in Panabo City. The computation of P-value is 0.000 presents that it is less than the 0.05 level of significance. Thus, the null hypothesis (H0) is rejected. Therefore, there is a significant relationship between credit management and profitability among selected lending Institutions in Panabo City.

Table 3.
Significant Relationship between Credit Risk Management and Profitability of Lending Institution in Panabo City.

Pair	Variables	Correlation Coefficient	p-value	Decision on Ho
IV and DV	Credit Risk Management and Profitability	.580**	0.000	Rejected

There is a statistically significant relationship between credit risk management and profitability, credit risk management impacts the profitability of banks. The study shows that credit risk management significantly improves bank profitability as assessed by the independent factors (Kurawa & Garba 2014). In addition, Gizaw, Kebede & Selvaraj (2015) studied how credit risk management affects profitability. The study aimed to investigate how credit risk affects banks' bottom line experimentally.

Credit risk management should be at the core of bank operations to ensure profitability. The system, process, and controls that a business has in payment are all included in credit risk management. Banks should effectively manage their assets, liabilities, and capital to maximize shareholders' wealth (Chhetri, 2021, p28).

IV. CONCLUSION AND RECOMMENDATIONS

Conclusion

Based on the following findings of the study, the following conclusions were drawn by the researchers:

The level of credit risk management of lending institutions in Panabo City is very high. At the same time, the level of profitability of lending institutions in Panabo City is very high. Therefore, there is a significant relationship between credit risk management and the profitability of Lending Institutions in Panabo City.

Recommendation

Based on the findings and conclusions of the study, the following recommendations are drawn:

The lending institutions can sustain or maintain their efforts on their credit risk management regarding accepting and allowing credit to customers with solid creditworthiness and financial base. The borrowers' credit files should update for client rating to be utilized for approval or consent to reduce lending risks and analyze the profitability, efficiency, and leverage of a client's business before granting credits. But they can improve their service and avoid credit risk from the institution by practicing credit risk management.

The lending institutions must improve their credit risk management by identifying, controlling, assessing, and mitigating the institution's credit risk. In addition, they must also enhance their activities using the client's investments to increase their income by securing it in stocks with high returns. With these, they can improve their capacity to exceed their investment return goals and secure more investments from investors.

The future Researcher may enhance this study and serve as related literature in the future and further study credit risk management and profitability of lending institutions in Panabo City

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