THE EFFECT OF CREDIT POLICY ON THE PERFORMANCE OF COMMERCIAL BANKS IN KENYA

A CASE STUDY OF BARCLAYS BANK, GARISSA BRANCH-GARISSA DISTRICT NORTH-EASTERN PROVINCE OF KENYA

BY

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A RESEARCH DISSERTATION SUBMITTED TO THE SCHOOL OF BUSINESS AND MANAGEMENT IN PARTIAL FULFILMENT FOR THE AWARD OF A BACHELOR DEGREE IN BUSINESS ADMINISTRATION OF KAMPALA INTERNATIONAL UNIVERSITY

KAMPALA-UGANDA

MARCH, 2011.

DECLARATION

I Mohamed Abdisalam Salat, declare that this research is my original work and has never been produced based on my knowledge and ability and it had never been submitted ton any university for award of bachelor or any other qualification.

Signature..........................

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APPROVAL

I certify that the proposal submitted by this candidate has been under my supervision. His work is ready for submission, to be evaluated for the award of Bachelor of Business Administration of Kampala International University.

SIGNATURE..

Date....11/04/2011..........................

MRS.IRAU FLORENCE

DEDICATION

I dedicate this humble work to my Mum *Barey Adan* and my Dad Abdisalam Salat, who with their unreserved effort are responsible for what I am today and saw me throughout my education .

ACKNOWLEDGEMENT

The successful completion of this project was an uphill task. It had a number of hurdles that made it challengeable. Therefore, it was the support of various people effort that saw the success of this project to which I am grateful. I am highly indebted to them.

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MAY GOD BLESS YOU ALL

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ABSTRACT

The research study was undertaken on the effect of credit policy on performance of commercial banks.

The main objectives of the was to establish the relationship between credit policy and performance in commercial banks and also to determine the various credit policy variables that the bank can implement to manage its credit properly and worthiness of their customers used by Barclays bank, Garissa branch to examine the relationship between the two variables. Credit is a set of policy actions designed to minimize costs associated with credit while maximizing the benefit from it. The objective of this policy is to have optimal investors in debtors. An optimal investment where there is trade-off between the benefit and cost associated with it. In other words the optimal level of investment, both objectives of profitability and liquidity are realised.

The techniques used in the collection of the data were questionnaire and face to face to face interview. The data collected was coded, edited and tabulated with the help of tables and percentage that were essential techniques in presenting and analyzing the data.

The findings of the study were it was noted that the credit initiation process has a significant effect on the performance of the bank. This implies that if the credit initiation is effectively carried out, the performance of the commercial banks would be enhanced. Also noted in the finding are that the recovery rates of Barclays bank is high. This has been attributed by the credit evaluation procedures and close supervision of customers due to enough available credit officers.

It was however recommended that it's important for a commercial bank to determine its investment portfolio and know the risk implication of the portfolio. The bank should be aware of all factors that have impact on their investment decision and try to control those that are internal, that is within the bank. The bank should then be able to decide on its clients as well as their management in order to get a well performing portfolio.

Also recommended was in the assessment of a client, the banks should look at all the elements of the credit policy management and to ensure that they all were well done.

This may include proper customer's information, scrutinizing customer's performance, regular visit, follow laid down rules, extending proper loans and ensure close supervision. This will help improve performance of Barclays bank.

CHAPTER ONE

1.0 Introduction

This chapter starts with background of the study. The statement of the problem, purpose of the study, research objectives, research questions and significance of the study were provided in this chapter.

1.1 Background of the study

A country financial system includes its banking institutions and is the oil that greases the engine of its economic growth. Commercial banks provide the vital function of mobilizing savings from those who have it and allocate such saving to those who wish to borrow to invest in economy development. It is with this context that credit policy arises. The word policy can be a broad and frightening term while most banks will define them in similar manner. Therefore, credit policy is the general course of action developed for recurring situation designed to achieve established objectives based on how commercial banks facilitate their credit ability to dispose and retain back. The primary goal of credit policy is to avoid extending credit ability to dispose and retain back. The primary goal of credit policy is to avoid extending credit to customers who are unable to pay their accounts.

1.2 Statement of the problem

Some commercial banks in Kenya have closed due to poor management of loan portfolios. Economic conditions and banks credit policy are the chief influences on the level of bank account receivable. Economic conditions of course are largely beyond control of the financial manager; hence the central bank of Kenya has put in place some measures to improve the performance of the financial institutions by strengthening its supervisory role and ensuring compliance of all commercial banks to the financial regulations.

1.3 purpose of the study

The purpose of the study was to examine the effect of credit policy on the performance of Barclays bank, Garissa branch, Kenya.

1.4 Research objective

To determine the various credit policy variable that the bank can implement to manage its credit properly and worthiness of their customers.

Establish cost associated with credit policy management.

To establish the effect of credit policy on the performance of Barclays bank.

To establish the relationship between credit policy and performance in commercial banks.

1.5. Research question

How to determine the various credit policy variables that the banks can implement to manage its credit properly and worthiness of their customers

What is cost that associated with credit policy management?

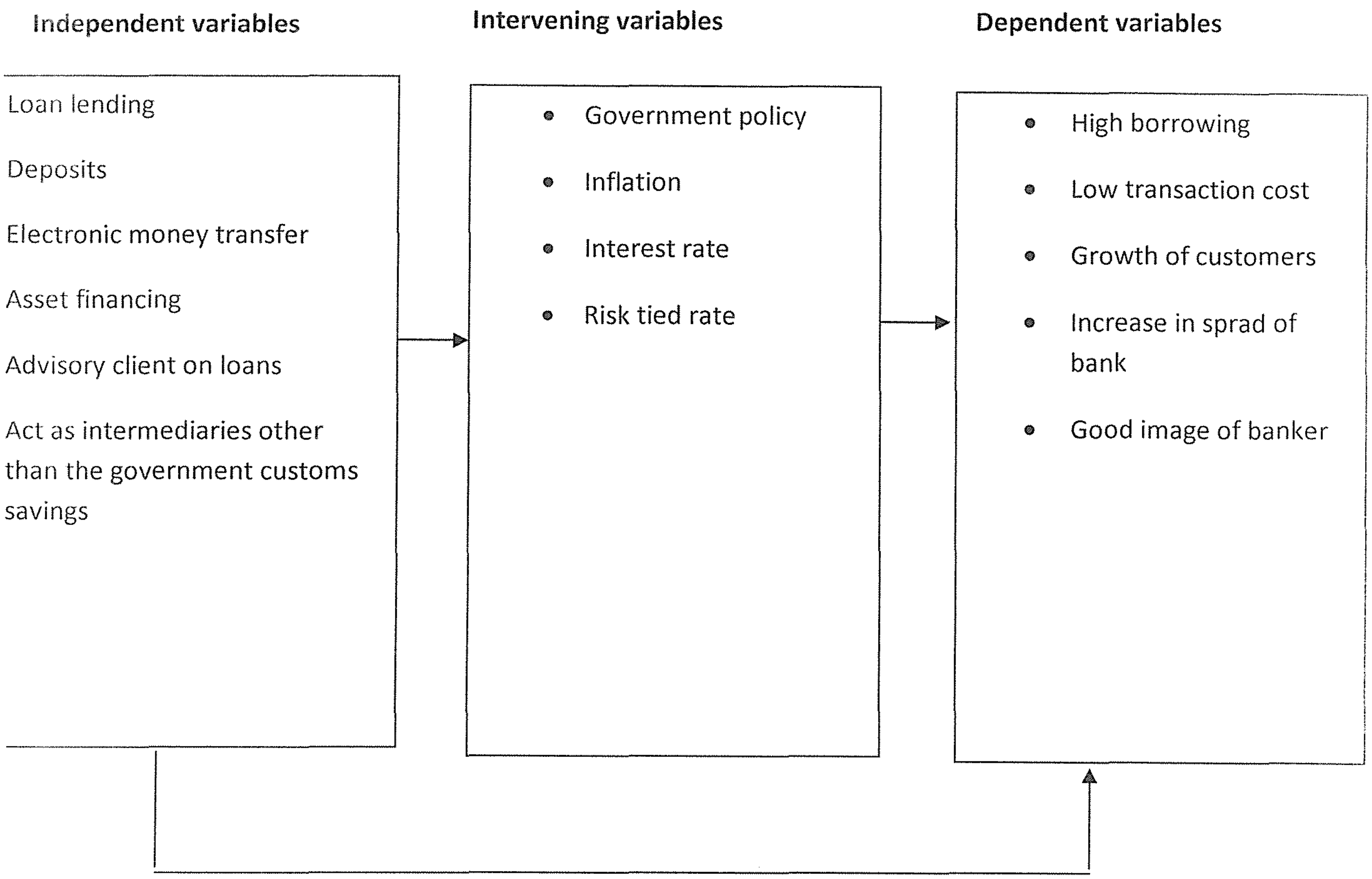
How to establish the effect of credit policy on the performance in commercial banks

What are the relationships between credit policy and performance in commercial banks?

1.6. Scope of the study

Barclays bank, Garissa branch was established in the year 2005 in Garissa district, North Eastern Province of Kenya. The Barclays bank Garissa branch is situated along Niarobi-Wajir road, opposite Hidig plaza.

The research focused on the aspects of credit management policy of the performance of all commercial banks in Kenya but it was restricted to Barclays bank, Garissa for the period between august 2005- July 2008. The data collection is likely to take one month



Source: researcher, 2011

The conceptual framework helped the researcher to explain the topic of research by defining the variables in the topics. There is the independent variable which predicts controls, determines and influences the dependent variable. There is also intervening variables which works with dependent variable shown above.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter looks at the various credit policy variables that the bank can implement to manage its credit properly and worthiness of their customer, costs associated with credit policy management, effect of credit policies on the performance of commercial banks and the relationship between credit policy and performance in commercial banks.

2.1 Credit policy concepts

According to Kakuru (2007), credit policy is asset of policy action designed to minimize cost associated with credit while maximizing the benefit from it. The objective of this policy is to have optimal investment in debtors. An optimal investment is that level of investment where there is trade-off between the benefit and cost associated with it. In other word at optimal level of investment, both objective of profitability and liquidity are realized.

Brigham and Houston (2000) defines credit policy as the combination of three decisions variables namely credit standard, credit terms, and collection efforts that influence the amount of credit that is extended by commercial banks. Credit period, which is the length the customers are given to pay their dues. Credit standard; which refer to the required financial strength of acceptable credit customers. Collection policy, which is measured by its toughness or laxity in attempting to collect or slow paying accounts.

Similarly, Shekher (2007),credit policy is the conscious effort of the part of the bank to allocate their loan able funds among sectors according to priorities in terms of overalls national policies. This is the good omen especially because it may be remembered that a fruitful orientation of banking policy require accredit plan attuned to the target of investments and production laid down. The credit plan prepared by some of the lead bank contain development schemes in the various sector of the economy, which can be financed by the commercial and co-operative banks and other financial agencies operating in the district concerned.

2.1.1 Credit standards and analysis

According to Blocks and Hirt (2000),a credit standard refers to financial strength and credit worthiness. A customer must exhibit in order to qualify for credit. It's the basic stage for lending process. It's a process by which the financial institutions establish the credit worthiness of a customer. It involves the appraisal of a customer to identify possible risk in lending as well as establishing customer capacity to repay the loan. The successful credit standard and analysis would require the use of standard credit application form looking for characters, which indicates the possibility of risk and other relevant information for credit analysis.

Setting credit requires a measurement of credit quality which is defined in terms of the possibility of a customer default. The probability estimate for a given customer's for the most part, a subjective judgment.

Since the source of competition often leaves a bank with little discretion in setting credit terms, credit manager's focus on credit analysis along with collection and receivable monitoring. The process of deciding whether to expand credit to particular customers involves two steps that are gathering relevant information and determine credit worthiness.

Ross, Westerfield and Jeff (1996), suggest that different institution should use credit information to analyse credit thus bank will generally provide some assistance to their business customers in acquiring information of the credit worthiness of other firms. Customer payment history with the firm; this is the most obvious to obtain an estimate of customers probability of anon payment whether he or she has paid previous bill. Financial statement; a bank may ask the customer financial statements. This rule of thumbs based on the financial ratios can be calculated. Credit reports on the customer's payment history with other firms. In granting credit a bank determines how effort to expand to distinguish between customers who pay and those who do not. A bank uses a variety of device and procedure to determine the probability that a customer may not pay and put together.

According to Emery and Finnerty (1997),acredit standards are criteria used to grant credit. They depend on variables that determine Net present value, probability of payment, investment, required rate of return and payment period. A higher probability of default, delayed payments and the necessity of the expensive collection effort all reduce the net present value.

2.1.2 Credit terms

According to Kakuru (2007) these are stipulation under which a firm grants credit customers. The firm should try as much as possible to make terms more attractive to act as an incentive to clients without incurring unnecessary high levels of bad debts. Therefore the term offered should conform to the industrial terms.

Block and Hirt (2002), once the decision to extend credit to customers is made then a decision regarding the terms of credit follows. Credit term specify the duration of credit that is credit period and terms of payment in any commercial bank. He also articulated that credit period affect probability, liquidity and survival since increase in credit period increases the portfolios.

2.1.2.1 Determinants of credit terms in commercial banks

Greening and Bratonivic (1999), the world bank concluded that in determining the credit term of any customer, the following need to considered, credit policies and procedures, prior experiences, loan growth, quality and depth of management in the lending areas, loan collection like recovery procedures, changes in natural and local economic business conditions and general economic trends. Therefore many banks and regulations believe that an understanding of a bank's credit risk management provide a leading indicator of the quality of the bank's loan portfolio at a given period of time.

Henry (1994), pointed out that to consider when adopting credit terms which include credit application history with his or her banks viability of project to be financed, willingness to repay the principal and interest accrued, loan write off, purpose of the loan and the loan security documentation.

2.1.3 Collection policy

According to Kakuru (2007), collection policies are the efforts applied in order to accelerate from slow paying customers and reduce bad debts losses. Collection procedures should be defined for each credit customer. A programme of reminders should be worked out systematically to ensure customer retention as well as efficient and timely collection.

According to Eugene (1985), collection policy refers to the procedures the bank or firms use to collect past dues accounts or receivable. A collection policy is needed because all customers do not pay the firm bills in time. Some customers are slow payers while others are not payers. The collection effort should therefore aim at accelerating collection from slow pay and reducing bad debt losses. The firm's collection policy is measured by its toughness or laxity in following up slow paying accounts.

Attaining a high rate of loan collection is necessary condition for a commercial bank to become self-sustainable, losses have been the largest cost boom by banks and the principal causes of insolvency and in liquidity. This emphasize the fact that loans not paid decreases the funds available to lend, make it difficult to assure safe deposits and attract savings, absorb scarce marginal time, undermine the financial integrity of the lender and tarnish the intermediary's reputation. When an individual does not pay loan, the process of creating debt capacity is reserved and repayment capacity is destroyed.

According to Ross, Westerfield, and Jeff (1996), after credit has been granted, the bank has potential problem of collecting the cash when it becomes due for which it must establish a collection policy. High percentage of nonperforming loans means that funds are not available loan to new borrowers and if loan are not repaid, they eventually affect the profitability of the bank.

2.1.4 Consumer bank credit

Henry (1976) defines credit policy as tool that provides framework for the entire credit management process. It's aimed at optimizing the efficiency of credit management of commercial bank and other related credit institution.The bank must gain an acceptance level of confidence to extend the loan facilities at the lowest possible risk of loss since the bank's funds are committed for returns.

According to Kakuru (2007), to estimate the probability of default, the financial manager considers the following aspect and attribute about the customers. There are generally termed as 5 C's which includes character, capacity collateral, capital, and conditions.

Capacity: this is the ability of customer to pay the credit advance to them in analyzing the capacity; one should look financial statement previous experience with the client trade reference, bank reference and the amount and purpose of the credit.

Character: this relates to willingness of a customer to settle his obligations. To ascertain this willingness, much consideration is accorded to moral factors. One should be able to determine whether the customer would make honest effort to meet his obligations.

Conditions: this include the assessment of prevailing economic and other factors like social and political, which may affect the customer's ability to pay. Economically under inflationary conditions, it is unsuitable to grant credit because of low returns expected.

Capital: this is contribution or interest of the customer in his business and is shown by; Capital = Assets- Liabilities. Therefore, considering capital you are determining the stake of the person in his/ her business. It's undesirable to grant credit to people who have got little capital. The reverse is true.

Collateral: this is the security against failure to pay. The person seeking to credit should offer this security before credit is granted. This should be safe and easily marketable. However, this collateral whether good or not, should be the last to consider. It cannot be the primary focus.

2.2 Effect of credit policy on performance of commercial banks

Credit policy provides a framework for the harmonization of the lending process which affects the performance of commercial. However, loans have carrying coast when unpaid in term as they constitute the credit risk factor with associated costs supporting the credit function since the cost of capital will increase in relation to added risk as capital is outstanding for long period in the events of today payments.

The dilemma of credit management of varying the level of consumer credit or loans the trade-off between profitability and liquidity or solvency of any commercial bank which affect its survival.

Kakuru (2007) asserts that credit can be useful in maintaining the market share in a declining market. On the hand, it can keep increasing the market share in growing market. Building customer goodwill, credit is extended so as to build long term relationships with the buyer or as a reward for their loyalty.

Similarly Elder(1996) notes that the influence of credit on performance is either way: first credit earns financial institution interest that contribute to its profitability and on the other hand, the borrowers benefit by way of achieving a financial boost in business but which depends on the commercial bank's innovativeness, exhibited or manifested on the credit policy as well as outreached by way of branch coverage.

As a major element in the struggle for the rural poor to achieve an economic breakthrough of the vicious of poverty , the provision of micro credit constitute the primary function of commercial banks and micro credit institution in Kenya.

However, a good credit policy which ignores saving mobilization affects negatively the financial viable of the financial institution or intermediary. It is beneficial to focus on what the policy does to the performance of the finical system and therefore performance in the commercial banks should be measured by number of people who have regular access to finical service, cost of finical transaction quality of service provided, and proxy being the repayment rate and saving mobilization.

It is therefore true that the success of commercial banks depends on financial self-sustainability and substantial outreach to the targeted population rather than credit policy since self-sustainability is achieved when the returns on equity, net of any subsidiary received equals to or exceeds the opportunity cost of funds.

2.2.1 Importance of credit

According to Horne (1971), the principle function of credit in commercial bank is to transfer the property from those who own it to those wish to use it, as in granting loans by the bank to individuals who plan to initiate or expand their business venture. The transfer is temporary and is made for a price known as interest which varies with the risk involved and also with the demand for and supply of credit.

2.2.3Costs associated with credit policy

According to Kakuru(2007),as much as extending credit is beneficial it accrues costs which are inevitable to the banks and link to the process of credit lending.

Collection costs- these are incurred at the time of collection of receivable. These could be inform of sending reminding letter , meeting telephone charges, and making reminders through the press is some cases.

Bad debt losses: these are associated with the collection costs. Some client may fail to honour their credit obligation, which leads so some receivable becoming uncollected. This will ultimately leads to the debt being written off.

Administration cost: these are normally incurred in supervising and investigating the receivable accounts. These cost arise inform of processing costs, costs of application analysis and the clerical work in checking the applicants and the accounts.

Opportunity cost: for banks investing in receivables, it's very clear that funds will be tied up debts. Some business opportunities such as expansion are therefore forgone during the fund are tied up. This is aggravated where banks goes ahead to finance its business opportunities by seeking borrowed funds that involve credit.

Production and selling cost: these increase with expansion insale which arise from investing in receivables. When bank credit policy is loosened so as to expand sales, then incremental sales revenue, production and cost increased. The difference between increment sales revenue, production and selling cost is the incremental contribution of the change in the credit policy.

2.3 The relationship between credit policy and performance in commercial banks

2.3.1 Reducing the rate of defaulters

According to Halter (1991), all debt instruments carry some degree of risk; risk management is an integral part of investment portfolio management and of the overall management of funds. Banks must take great care in evaluating what types of risk are inherent in the various assets they acquire and the liability they assume. They must make sure that they are compensated with earning proportionate to the risk they accept and they must balance the level of risk that existing within and among the various portfolios. Risk is much more to measure, however, because its key character is uncertain. Thus credit risk and interest rate risk are the basic type of risk in bank investment and loans.

Credit risk is the possibility that the borrower of a loan or the issuer of a security may be unable to meet interest and principle payment when they fail due. The failure of borrower to carryout there financial obligation to their lenders are pledged by contracts called default. A borrower may be unable to perform up to expectations for a variety of reasons, many of which are not always predictable. Hence anything that affects the borrower's financial position may to credit risk.

According to Kohn (1999), defaulting is a fail to pay off the amount owed when the loan matures. There is a risk of loss that adheres to generals in general. The lending bank cannot tell in advance which loan will turn bad or will cause trouble, but know from experience that loans of difference classes offer varying possibilities for risk. Credit management policy helps to reduce this risk by reducing the rate of defaulters through monitoring loan given. A good credit policy enables that loaned amount is paid back by all clients in the right time.

2.3.2 Maintaining liquidity

According to Srivistava (2000), liquidity is the word that the banker uses to describe his ability to satisfy demand for cash in exchange for deposits. The banker should attach great significance to his obligation to his depositor's money, on demand, because his inability to do so, may lead to the public losing confidence in the bank.

Halter (1991), liquidity is the ability to obtain needed cash quickly and at a reasonable cost since funds may be unpredictable and controllable, banks must maintain adequate liquidity to ensure that cash or access to it, can be obtained on short notice and with little or no loss of transactions, to emergency needs of funds, to satisfy the customers' demand for loans, and provide flexibility It taking advantage especially favourable investment opportunities. A bank with no little liquidity is able to fix and rearrange its mix of assets and liabilities to respond to changing business conditions. A bank with too little liquidity may be forced to obtain needed funds at high cost or may find it difficult to obtain needed funds at reasonable cost. A bank with excess liquidity also pays a penalty for failing to manage its liquidity position efficiently because the cost of liquidity is usually lower earnings.

2.3.3 Maintains a favourable spread

According to Brigham and Houston, spread income comes when the cost of funds does not exceed the interest rate earned on the loan portfolio. When loan is given to a client, he/she pays it back with interest and the institution earns interest income. Credit policy enables the bank to acquire interest income greater than interest expense thus making profit.

According to Halter (1991), spread management focuses on maintaining an adequate spread between a bank's interest expense on liabilities and its interest income on assets to ensure an acceptable profit margin regardless of interest rate fluctuation. Thus, spread management attempt to reduce the banks' exposure to cyclical rates and mobilize earning over the long term.

2.3.4 Enhances customer growth

A good a client policy enables the institution to get more clients. This is because the loan policies will be appropriate to every customer making the loan cheap. Cheap, loans attract more clients hence improving on the number of customers.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0. Introduction

For this research to be effective, research design, data collection and analysis were used to arrange the information in such a way that it enabled the researcher to come up with the reliable recommendations and conclusions. The following are the methodologies to be employed starting with the research design, study population, sampling design, research instruments and analysis of data.

3.1 Research design

Consistent with the research objectives and research questions, the researcher used descriptive random sampling design to carry the study on the effect of credit policy on the performance of Barclays bank.

3.2 The study population

Due to poor performance of some indigenous banks in Kenya, Response was received from Barclays bank management staffs, managers, accounts and sale executives and customers.

3.3 Sampling design

In order to ensure representatives of the samples from study population of credit and loan officers, sampling was grouped according to chain of command. Random sampling technique was used in picking the employees on which the data was collected. Thus respondents were randomly selected as 10 respondents from each department like ICT department, Finance department, sales and marketing department, loan departments, top managements and clients of the banks to come up with the total of 60 respondents.

3.4 Data source, collection and analysis

3.4.1 Data source

To achieve the research objective both primary and secondary data was used on the study. The main primary data was in depth from interviews which was conducted on the staff and questionnaires administered to Barclays banks staffs. Secondary sources were obtained from monographs (textbooks), annual reports of commercial banks director's report and audited accounts, credit registers, journal and other publications to provide a yardstick against responses from primary data gathered in order to deliver meaningful objective interpretation of the efficiency of the existing credit policy on the performance of the bank.

3.4.2 Data collection methods and instruments

3.4.2.1 Interview method

The personal interview was carried out by researcher as a follow up of the questionnaires designed by the researcher. The questionnaires were sent to the department heads, staff and other subordinate staff. The technique was used because all the respondents are literate. The major advantage of this method includes; free of bias information and enough time for the respondent to consider his/her points carefully than in an interview.

3. 5 Data processing and analysis

The data collected was analyzed in the form of descriptive statistical method which included tables, bar graphs, histograms, pie charts and percentages. Data processing and analysis involved the following.

3.5.1 Editing

The completed structured questionnaire was scrutinized in order to reduce errors and omission. Each questionnaire underwent through study on the responses given in order to establish their eligibility and accuracy. Where data was quantitative, it was organized in such a way that meaningful interpretation could be deduced from such data during analysis stage.

3.5.2 Coding

Where questions were open ended, data and responses were further coded so as to categorize the responses exhaustively. This enabled the researcher to easily depict the finding of the study and to interpret them appropriately so as to come up with adequate conclusions from the data collected.

3.5.3 Tabulation

The data was then analyzed using the computer statistical package to show the numerical scores and percentage.

3.6 Limitation of the study

The researcher is bound to face the following limitation in the process of this research; Banker's information and business finance sources are very sensitive issues in most organizations. Some of the respondents might be unwilling to answer the questionnaires thus leading to the delay in data collection. The researcher used his introductory letter from the university to show that the information got was kept with utmost confidentiality.

There might be the problem of information access by the researcher. The management of Kenya commercial bank –invokes confidentiality and internal use only clauses and regulation and thus the researcher is bound to follow the necessary clauses and regulations.

Respondents might not act in time due to unfavourable timing, especially during times they are busy with the office work thus this might lead to delay of data and therefore the researcher availed himself to them during usually their free time.

Financial constraints greatly hindered the scope of the study. This was due to the fact that the researcher had to finance other academic programme and such cost like word processing, secretarial typing, transport cost, telephone calls can be felt practically. Bound with this, the researcher used the small finance available to him to enable the study successful.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND DISCCUSION OF FINDINGS

4.0 INTRODUCTION

This chapter presents the results and analysis of the findings of data collected from the questionnaire and interview schedule in order to provide possible explanation for the findings of the study.

4.1 Bio Data

4.1.1 Respondents designations

In this study the researcher ought to understand who the respondents were by designation. Table one below presents this information and the figure one presents diagrammatic presentation of the same. In the category of others, it includes people working in the finance, accounting, administration, legal departments in the Barclays bank.

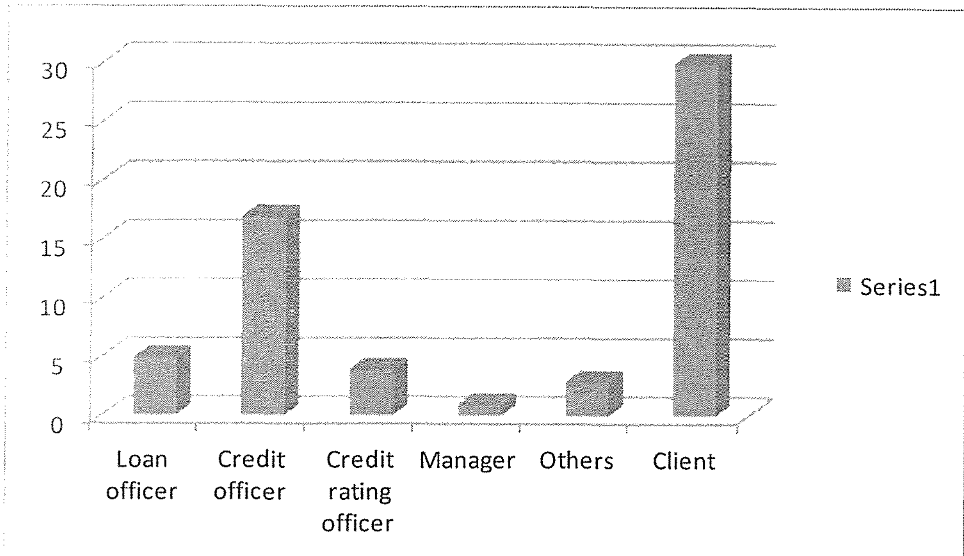
From the above analysis, it is easily deduced that the highest number of respondents classified with the occupation where clients constituting 50% of the respondents and minority of the respondents classified with the occupation were managers who were 2% of the respondents.

Table 15: classification of the respondents by designation

Designation	**Frequency**	**Percentage**
Loan officer	5	8%
Credit officer	17	28%
Credit rating officer	4	7%
Manager	1	2%
Others	3	5%
Client	30	50%
Total	**60**	**100%**

Source; primary data

Figure 6: graphical presentation of the respondents by designation



Source; primary data

4.1.2 Respondents by Age, Sex and educational level

The researcher ought to analyse the respondents by age, sex and education as in the table below;

Table 16. Respondents by sex categories

Sex	Frequency	Percentage
Male	23	55%
Female	27	45%
Total	**60**	**100%**

Source; primary data

From the above table, the majority of the respondents were men, who were 55% of the respondents unlike the females who were minority of the respondents.

Table 17. Respondents by age groups

Age group	Frequency	Percentage
18-25 years	13	22%
26-33years	27	45%
34-41years	8	13%
42-49 years	7	12%
Over 50 years	5	7%
Total	**60**	**100%**

Source; primary data

For the analysis of the above table, majority of the respondents represents, respondents aged 26-33 years comprising 45% of the respondents. Respondents aged over 50 years were the minority comprising 7%.

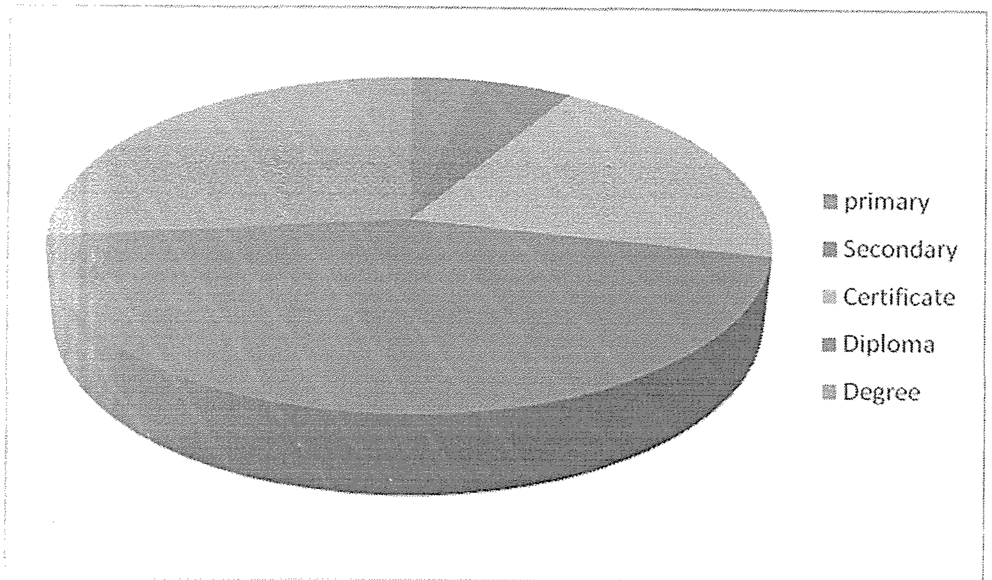
Table 18. Respondents by educational level

Educational level	Frequency	Percentage
primary	2	3%
Secondary	3	5%
Certificate	12	20%
Diploma	27	45%
Degree	16	27%
total	**60**	**100%**

Source; primary data

It was also noted that only 45% of respondents were diploma holders. In addition, minority of respondents were primary level comprising 3% of the respondents.

Figure 7. Respondents by education level



Source; primary data

4.1.3 Length of Service

The researcher was also interested to find out, how much time the respondents had spent working with Barclays bank to effectively interpret their views in relation to the performance of the bank.

Table 19. Respondent's length of service

Period in service	**Frequency**	**Percentage**
Less than 2 years	10	17%
2-5 years	25	41%
5-8 years	14	23%
Over 8 years	11	19%
Total	**60**	**100%**

Source; primary data

From the above illustration, it is evident that the largest portion of the respondents had 2-5 years which is 41%. This therefore, proves that their views are largely based on past personal experience with the bank. And less than 2 years represents the minority of the respondents which has 17% of the respondents. Thus this shows that the respondents of 41% have a fairly sound knowledge of the operations of the bank.

4.2 Existence and use of Credit Policy in Barclays bank

The performance of any commercial bank depends on its existing credit policy at any given period of time. The elements of credit risk management which include market definition, credit initiation, credit documentation and credit culture are discussed below.

4.2.1 Market Definition

This is the first element of credit risk management process. The bank defined target market should be ensured with the use of the bank's drawn up credit policies, procedures and directives. The bank's credit policy should be able to comprehensively guide the entire bank's act in relating to credit.

By knowing the market that is defined, the bank employees will then know the type of risk that is involved to the bank and then constrain themselves within the acceptable limits.

The questions of finding the extent of applicability of the bank's target market and the performance of loans portfolio is discussed below. This is in respect to whether the bank has written credit policies, drawing up of credit policies and the use of the credit policies in making credit decisions.

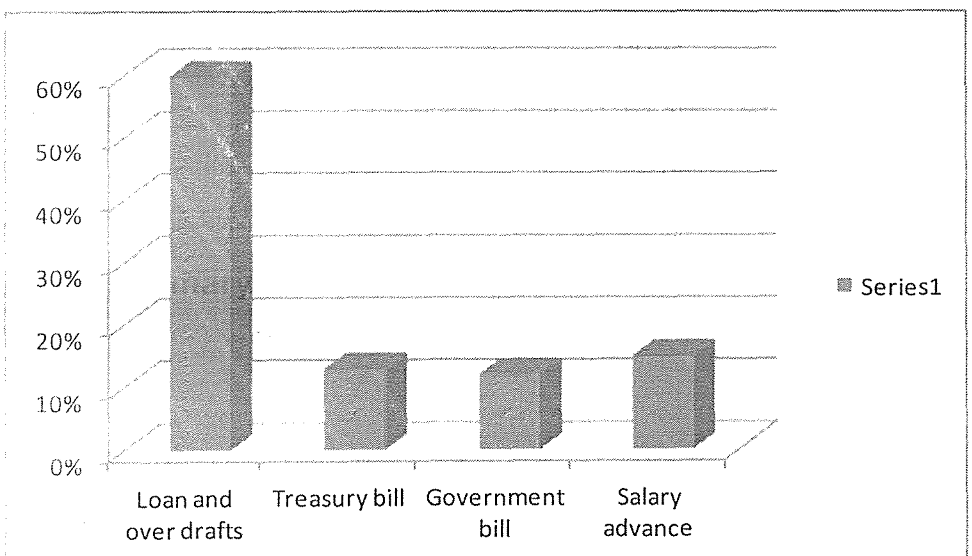
4.2.1.1 Barclays bank investment portfolio as defined by the market

Table 20: showing investment portfolio

Items	**Percentage**
Loan and over drafts	60%
Treasury bill	13%
Government bill	12%
Salary advance	15%

Source; primary data

Figure 8.a graphical presentation of investment portfolio



From the above, loans and overdrafts are the most significant investments of Kenya commercial bank at 60% of the bank's total investments. Despite this, the bank has also invested in treasury bills, government bonds, and salary schemes hence all the respondents agreed that their resulting loan portfolio was good.

4.2.1.2 Existence of written credit policy and its review

Kenya commercial bank has written credit policies, procedures and directives that are guided by the banks mission and strategies plan. These are used to guide credit decision made and define the target markets of the bank. The respondents had varying perception of their banks credited policy as regard to what it comprises and how clear it is in guiding their credit decisions. 95% of all the respondents said that their credit policy clearly guide them on issues like guidelines for loans, setting geographical limits as well as lending authorities by committee and individuals. It also guide them on appraisal policies, acceptable loans, loan maturity, loan pricing policy and the information needed for credit assessment. The guidelines also cover loan to directors, shareholders, interested parties and credit officers, loan portfolio objectives, collection procedures and duties of credit officer, the credit committee and credit supervisor.

Despite the above 95 % of the respondents in table 6 strongly agreed that Kenya commercial bank has written policy guidelines that guided them in their credit decisions unlike the minority of the respondents strongly disagree with the use of credit policy in the bank.

Table 21. Credit policy respondents

Response	Frequency	Percentage
Strongly agree	95	95%
Agree	3	3%
Neither agree or disagree	2	2%
Strongly disagree	0	0%
Disagree	0	0%
Total	100	100%

Source; primary data

The management in Kenya commercial bank reviews the credit policy, procedures and directives as shown in table 7 above;

Table 22 management's review of the bank's credit policy

Response	**Respondents**			
	Strongly agree	**%-age**	**Strongly disagree**	**%-age**
Review policies	60	100%	0	0%
Changing market condition	42	70%	18	30%
Increasing risk of credit	46	76%	14	24%
Central bank directives	6	10%	54	90%
Legal consideration	0	0%	60	100%
Increased competition	12	20%	48	80%
Review every				
By annually	21	35%	39	65%
Year	24	40%	36	60%
2 years	36	60%	24	40%
3 years	5	8%	55	92%
Never	0	0%	0	0%

Source; primary data

4.2.2 Credit initiation

This is the second element of credit risk management. The credit initiation management involves credit organization, credit evaluation, negotiation and approval. All the aspects of credit initiation process are based on collection of information that should be timely wholesome and reliable.

The question of the extend of applicability of the credit initiation process in Kenya commercial bank as well as the question on the relationship between the credit initiation process and the performance of the loan port folios is answered below.

4.2.2.1 Credit origination in Barclays bank

Credit origination involves the initiation assessment of credit application. This is done with the guidelines of the bank's credit policy, if a client does not conform to the guidelines, they are immediately eliminated. These guidelines include business sector, industry client profession, amount of credit facility and type of market which it involved in.

4.2.2.2 Credit evaluation in Barclays bank

Credit evaluation looks at the in depth analysis in a client application. Table 8 shows the responses on how long it takes a client to access the funds from the time an application on credit facility is tendered in. according to the table below 76% of the respondents agreed that for a big loan it takes a month for a loan to be approved.

Table 23. Response on approval of loan facilities

Response	**Frequency**	**%-age**
Less than 15 days	**2**	**3%**
15-30 days	**46**	**77%**
One and a half months	**12**	**20%**
Two months	**0**	**0%**
More than two months	**0**	**0%**
Total	**60**	**100%**

Source; primary data

77% of majority of the respondents agreed it takes 15-30 days for one to access the funds from the bank while 3% of minority of the respondents agreed that it only takes less than 15 days for loan application to be approved. All the respondents mentioned that the following are important factors in evaluation of a client credit application, credit limits summery, security documentation, credit approval memo, collateral evaluation, customer visit, basic information, customer profitability, competitive analysis report, financial spread sheet, cash flow projections, management assessment and the investigation summery, press report and quarterly risk classification.

In the assignment of rates, the factors considered include the cash flow of the business, management, quality of the asset of the company and collateral. Other factors include liquidity of the business, profit margins, and owner's level of dependence on the business, cycle trends, industry conditions, leverage levels, type of business and type of the company. However, all supervisors agreed that cash projection were not important in assessment of client for credit.

Table 24: Important Factors Used In Assessment of Credit

	VI		I		FI		HI		NI		total
	F	%	F	%	F	%	F	%	F	%	
limit ary	27	45	24	40%	3	5%	4	7%	2	3%	60
se of the	36	60	18	30	4	7	2	3	3	0	60
eral/security	42	70	18	30	0	0	0	0	0	0	60
ity to pay	36	60	24	40	0	0	0	0	0	0	60
jements' ter	9	15	18	30	15	25	6	10	12	20	60
ial assets	27	45	6	10	12	20	12	20	3	5	60
ial tions	24	40	12	20	6	10	16	27	2	3	60
of dence	26	43	27	45	3	5	2	3	2	4	60

Source; primary data

Key: VI- very important, I- Important, FI- fairly important, HI- Hardly important, NI- Not Important, F- Frequency

From the above, the majority of the respondents agreed that it is very important to use factors like credit limits, collateral, security in the assessments of credit worthiness of the clients. Minority of them agreed that it's not important to use the factors in the assessment of credits.

4.3.2.3 Credit Negotiation Process in Barclays Bank

In the process, the terms of the agreed credit product are agreed. These terms may include pricing collateral covenants of loans agreements. Pricing of the credit product is considered critical. It is important for the credit officer to know acceptable price of the credit product as well as the upper and lower limits of the same. The respondents pointed out that the factors which influenced the price of the credit products are mainly going market rates, past set interest rates, central bank directives, expenses and cost of the bank inflation rate, marginal cost of funds, demand for credit products, risk of the individual and market risk.

4.3.2.4 Credit Approval in Barclays bank

In Barclays bank, credit and management committee in the bank do the approval of credit policies. For each of the proposal, the credit staffs assign a rating and forward the recommendations to the higher level of credit selection process. The proposed risk rating is either reaffirmed or recalibrated at the time of final approval and sanction. All respondents indicated that the aspects of credit approval included document witnessing, payment administration, notes validity, company assessment and risks classification.

4.3.3 Credit Documentation and Disbursement

The credit documentation and disbursement process is the third element of credit risk management. It is important because it ensures that proper documentation is in place before the disbursement is done and that any modification is approved before disbursement. It also ensures that timely disbursement of funds after approval.

Extend of the applicability of the credit documentation and disbursement processes as well as the relationship between the credit documentation and disbursement process and performance of loan portfolio were reviewed as follows;

All the respondents agreed that the bank has standard and formal loan agreements. The covenant may be included in the bank has standard maintenance of minimum level of working capital, limitation of changes in ownership and disposal of fixed assets and limitation of level of leverage. When the conditions of the loan agreement are violated, the clients always pay a penalty fees, the credit facility may be increased, outright cancellation of the credit facility, acceleration of payments, being put under receivership and forcing new management on the company.

4.3.4 Portfolio Management in Barclays bank

Portfolio management is the fourth element of the credit risk management which focuses on the measuring individual's credit worthiness and trying to contain individual credit risk within set strategic guidelines. Once the credit worthiness of a client has been established, the portfolio management process tries to ensure through monitoring that it is maintained. When it deteriorates or lost, portfolio management process tries to correct problem before it becomes a bad debt. The extent of applicability of the portfolio management process as well as the relationship between the portfolio management process and performance of loan portfolio had been analyzed thus all the respondents agreed that management reviews the loan portfolio periodically. Table 10 shows management's involvement in the credit function.

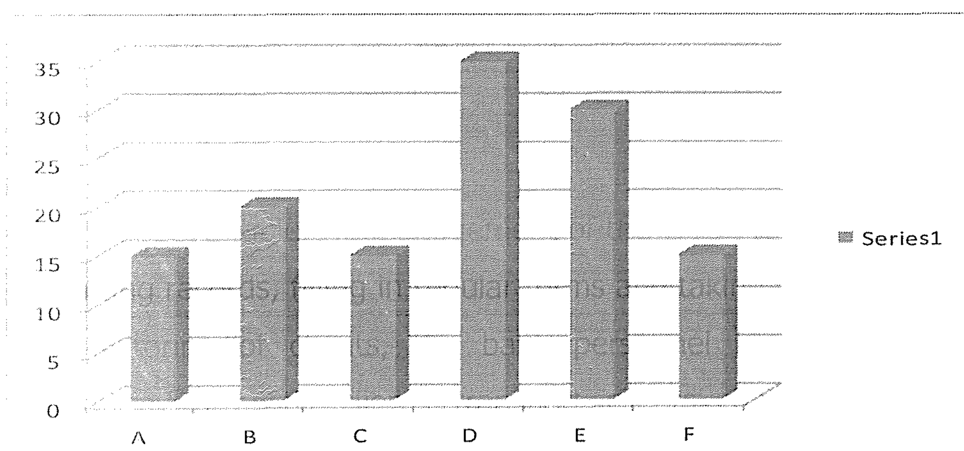
Table 25: management of credit function

Action of credit function	Frequency	Percentage
Monitoring	12	20
Scrutinizing records	27	45
Regular form filling	15	25
Course in credit management	6	10
Total	60	100

Source; primary data

From the above table the management of the credit function involves credit monitoring, scrutinizing records, filling in regular forms and taking courses in credit management. In the monitoring of clients, the bank personnel face several challenges like: poor communication, hostile clients, transport, clients' change of premises, and accessibility of clients and large portfolio of clients.

Figure 4; showing challenges in monitoring respondents



Source; primary data

KEY:

- A- **poor communication**
- B- **large portfolio of clients**
- C- **clients change of premises**
- D- **hostile clients**
- E- **transport**
- F- **accessibility of clients**

4. 3.4.1 loan loss reserve account

The respondents considered several factors as the cause of bad debts namely; improper appraisal, conmen, poor supervision, political influence, weak legal systems, diversion of funds noncompliance and poor payments.

Under the portfolio administration function, the bank maintains loans reserves account so that in case any losses are incurred in credit, this allowance may cover the loss of that period.

4.3.5 Credit culture

Table 26: response of the clients on the banks

Response	Frequency	Percentage
The policy encourages clients to borrow	24	40
The policy discourages clients from borrowing	0	0
High repayments rates due to the structure of the guidelines in the policy	27	45
Low repayment rates due to some weakness in the policy	9	15
Total	**60**	**100**

Source; primary data

4.4.2 Barclays bank's recovery rates

The study findings confirm that the recovery rate of Barclays bank is high. This has been attributed to the credit evaluation procedures and close supervision of customers due to enough available credit officers. Thus in table 12, the average recovery rate of Barclays bank as a whole for the periods 2006-2007 is 70.5%.

That is average recovery rate= total recovery rate/3 years.

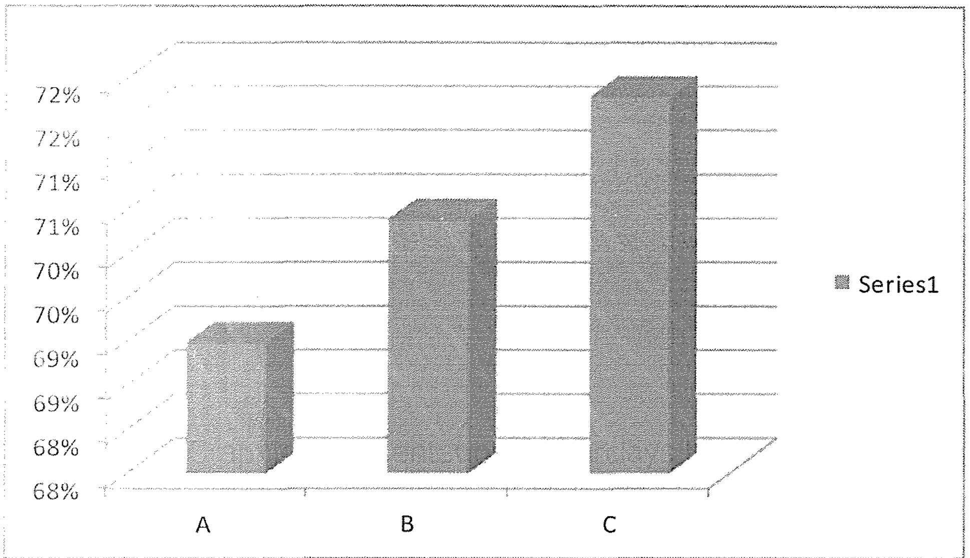
Table 27. Barclays bank performance as at 31st December 2008

Year	2006	2007	2008
Application received	**10332**	**23700**	**29870**
Application approved	**9200**	**18900**	**21090**
Application disbursed	**7012**	**12232**	**18670**
Application approved (KShs)	**300m**	**453m**	**1200m**
Volume disbursed (KShs)	**220m**	**346m**	**1020m**
Volume recovered (KShs)	**120m**	**304m**	**900m**
Volume matured	**198m**	**339m**	**988m**
Recovered rate (%)	**69%**	**70.4%**	**71.8%**
Default rate	**27%**	**29.8%**	**29.9%**

Source; bank documents

From table 12, the average recovery rate of Barclays bank from the periods 2006-2008 is 70.4%. This is good enough to reflect that the bank is mismanaged. The high recovery rates are due to close supervision of all loan clients

Figure 10. Graphical presentation of Barclays bank recovery rates at different years



Source; primary data

From the above graphical analysis it is evident that the high proportions of loan clients meet their financial obligation.

Table 14 below presents a summary of how they rated the approaches using;

High effective (HE), fairly effective (FE), Not effective (NE), Non response (NR), Frequency (F)

Table 28: Effectiveness of credit recovery approach

	HE		FE		NE		NR		total
	F	%	F	%	F	%	F	%	
uous supervision to : purposeful use of the	18	30	18	30	24	40	0	0	60
ɹous customer zation about their al obligation	30	50	24	40	5	8	1	2	60
der on phone, letters physical customer t	42	70	18	30	0	0	0	0	60
of court bailiffs and ıge of collateral	36	60	24	40	0	0	0	0	60
] clients property	33	55	24	40	2	4	1	1	60
ıing clients property	40	66	19	32	1	2	0	0	60
es to guarantors	29	48	29	48	1	2	1	2	60
ıg to the customer	39	65	21	35	0	0	0	0	60

Source; primary data

Judging from the above analysis it is clearly evident that the majority of the respondents find the approaches highly effective, whereas very few of the respondents find the approaches fairly effective. In the reinforcement of the above, results revealed that none of the respondents found the recovery approaches inefficient as they always realize an overwhelmingly high repayment rates.

CHAPTER FIVE

SUMMARY OF THE FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.0 INTRODUCTION

This chapter presents the summary of findings, conclusion, recommendation and suggestion for future research in line with study objectives and research question.

5.1 SUMMARIES OF MAIN FINDINGS OF THE STUDY

5.1.2 Various credit policy variables undertaken by the bank

The various credit policy variables that the bank can implement to manage its credit properly and witness their customers, it was noted that the credit initiation process is carried out in commercial bank. Using the credit rating to assess the clients' credit worthness, credit officers, credit supervisors, and head of departments do the assessment of credit rates (figure 4). It was noted that the credit initiation process has a significant effect on the performance of the bank. This implies that if the credit initiation is effectively carried out, the performance of commercial banks would be enhanced. This was basically based on the variables of credit policies which are credit standards, credit terms and the credit collections.

5.1.3 Establishing the effect of credit policy on the performance of commercial banks

To establish the effect of credit policies on the performance of Barclays bank, the study finding confirms that the recovery rate is high. This has been attributed by the credit evaluation procedure and close supervision of customers due to enough available credit officers. Thus in table 12, the average recovery rate of Barclays bank as a whole for the periods of 2006-2008 is 70.5%.

The bank maintains a loan loss reserve and actual losses for the period. It was also noted that portfolio management has a significant effect on the performance of commercial banks. If the portfolio management of the credit management process is ignored then a deterioration of good credit may occur and ultimately bad debts. Hence it should be managed effectively so that the performance of commercial banks is enhanced.

5.1.4 The relationship between credit policy and performance of commercial banks

When the bank defines its market and constrains itself within the set target, the risk arising from credit will be maintained. This will however lead to less bad debts and thus good portfolio. This was noted in table 7. Using the credit rating system to assess the clients' credit worth, credit officers, credit supervisors and head of departments do assessment of credit rates (figure 4). It was noted that the credit initiation process has a significant effects on the performance of the bank. This implies that if the credit initiation is effectively carried out, the performance of commercial banks would be enhanced.

Barclays bank considers documentation critical in the drawing up of loan agreement. Covenants may be included in case of defaults thus various measures are initiated against the client. In the study, it was noted that there is a relationship between credit documentation and disbursement and the performance of the loan portfolio.

5.2 CONCLUSION

Elderd (1996), the influence of credit on performance is either way: first credit earns financial institution interests that contribute to its profitability and on the other hand, the borrowers benefits by way of achieving a financial boost in business but which depends on the commercial bank's innovativeness, exhibited or manifested on the credit policy as well as outreach by way of branch coverage.

The good performance of Barclays bank was mainly contributed by the credit control measures as a result of well-established credit risk screening mechanism in place before credit is extended to clients. It's evident from this study that indigenous commercial banks in Kenya use all the elements of credit risk management process, but are not comprehensively using the aspects of the various elements of the process in the management of their credit function.

There is a significant and positive relationship between the elements of credit policy management and the performance of Barclays bank thus these findings reveal that the credit policy management in the bank has a strong impact on the quality of the bank's loan portfolio and thus the performance of the bank.

It is clear that all credit collection methods are used such as reminder letters, personal visits, collection agencies and telephoning although collection agencies and legal action are specifically employed to accelerate payment of outstanding debts.

Basing on the objectives of the study, it was concluded that the bank has undertaken all variables of credit policy to ensure that it can meets its obligations. However, it was also noted that the credit policy has effect on the performance of commercial banks, this can be seen from loans having carrying costs when unpaid in term as they constitute the credit risk factor with associated costs supporting the credit functions since the costs of capital will increase in relation to added risks as capital is outstanding for long period in the events of today's payments.

5.3 RECOMMENDATIONS

It's important for a commercial bank to determine its investment portfolio and know the risk implication of the portfolio. The bank should be aware of all factors that have impact on their investment decision and try to control those that are internal, that's within the bank. The bank should then be able to decide on its clients as well as their management in order to get a well performing portfolio.

In the assessment of a client, the banks should look at the elements of the credit policy managements and to ensure that they all are well done. This may include proper customers' information, scrutinizing customer's performance, regular visits, follow laid down rules, extending proper loans and ensure close supervision. This will help improve the performance of Barclays bank.

The bank should always provide timely and reliable information about provisions made, institute active commercial sections in the bank, ensure better security and ensure viable project funding.

Banks should discourage political loans, insist on the client regular visits and institute a monitoring unit in the bank.

It's critical for the banks to ensure proper file keeping as well as full documentation before disbursement. This will ensure that the interest of the bank is taken care of especially in case of customer default. The documentation relation to loan agreements as well as security registration and liens should also be kept at par. These files should be periodically up-dated with new and relevant information relating to a client when it comes to light. The bank should ensure that all credit funds are disbursed after set formalities are in place, and that the funds when disbursed are managed actively and well to ensure that the credit facility does not deteriorate.

5.4 ISSUES FOR FURTHER RESEARCH

There is still need for research to be done on other functions in the bank outside the credit policy like internal control on debtors in Barclays bank in Kenya.

Further research could be the role of commercial banks in the society.

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APPENDICES

APPENDIX 1: QUESTIONNAIRES TO MANAGEMENT

I *Mohamed Abdisalam Salat,* a student of Kampala International University pursuing a Bachelor of Business Administration (accounting option), Registration number BBA/17485/72/DF, I am conducting a research on "The effect of credit policy on the performance of commercial bank in Kenya, a case study on Barclays bank in Kenya, Garissa branch". You have been selected as one of the respondents in this research study. The information being gathered will be purely for academic purposes and will be treated with the high degree of confidentiality.

Instruction: Please help by answering the following question as honest as possible. Please tick where appropriate on the space provided.

Personal Background.

Section A:

1.Sex.

Male ( ) Female ( )

2. Age group.

21-30years ( ) 31-40 years ()41-50years ( )Over 50 years ( )

3 Marital status.

Single ( ) Married ( )

4. Education background

Secondary level ( ) Certificate level ( ) Diploma level ( )

Degree level ( ) others ( )

5. Occupation

Credit officer ( ) Loan officer ( ) credit rating officer ( )

Manager( ) Clients ( )

6. Duration taken in working in that department?

Less than 2 years ( ) 2-5 years ( ) 5-10 years ( ) 10-15 years ( )

Over 15 years ( )

7. Who is responsible for credit rating?

Credit officer/credit supervisor ( ) head of credit department ( )

Section B

Question	**Agree**	**Strongly agree**	**Neither agree nor disagree**	**Strongly disagree**	**Disagree**
Credit policy					
8. Does your organization have a written credit policy					
9. Are credit policies, procedure and directive realistic to the performance of Barclays bank?					
10. Do you use procedures and directives for all loan applicants?					
11. Are borrowers					
12. Does the credit policy encourage					

clients to borrow?					
13. Does Barclays bank Conduct review on its credit policy?					
Credit rating					
14. Does your bank use a system of credit rating in evaluation of client's application for credit facility?					
15. Are credit rating of clients often reviewed?					
16. Has the performance of Barclays bank been between the periods of 2003-2007 been effective?					
17. Are there some factors that led to non-payments/bad debts in Barclays bank?					

Section c

How clear are the policies, procedures and directives in the following areas?

Questions	Very clear	Clear	Fairly Clear	Not Clear	Not included
Credit terms					
18. In defining duties and responsibilities of credit officers, credit supervisors and credit committees					
19. In defining acceptable types of loans?					
20. In setting guidelines for categorizing loans					
21. In establishing maximum financial information required at the inception of credit					
22. Establishing leading authority of committees, individuals or officers					
23. Credit analysis and credit information					
24. Establishing limit and guidelines for loans to bank officers and directors					
25. Establishing maximum maturities for the various loans					
26. Establishing geographical limits for loans					
27. Establishing limits and guidelines for loans to any related interests					
28. IN submission and processing of credit application					

Section D

In evaluation an application for a credit facility, how important are the following?

Criteria	Very important	important	Fairly important	Hardly important	Not important
29. Purpose of the credit					
30. Collateral/ security					
31. Capacity of customer to pay					
32. Character of management					
33. Financial assets of the company					
34. Credit limit summary					
35. Credit approval memo					
36. Financial projection					
37. owner level of dependence					

Section E

In evaluating credit recovery approaches, how effectiveness are the following, high effective (**HE**), Fairly Effective **(FE)**, Not Effective **(NE)**, Non response **(NR)**, Frequently**(F)**

Response	**HE**	**FE**	**NE**	**NR**
38. Continuous supervision to ensure purposeful use of the loan				
39. continuous customer sensitization about their financial obligations				
40. Reminder on phone, letters and physical customer contact				
41. use of court bailiffs and mortgage of collateral				
42. visiting clients whenever they need				
43. Auctioning clients property				
44. Referees to guarantors				
45. Warning to the customers				

APPENDIX 2: TIME FRAME

NO.	Activity	Time frame
1	Collection of data	December
2	Analysis and interpretation of data	January
3	Writing the proposal	January
4	Supervisor read through the book	February
5	Making corrections and binding the proposal	February
6	Writing the research report	March
7	Binding and submission of the final report	March

APPENDIX 3: THE RESEARCH BUDGET

ACTIVITY BUDGET			
CORE ACTIVITY	**ITEMS/PARTICIPANS**	**Cost in UGshs**	**Sub-total Cost (UGsh)**
Consolidated of iterature Assigning and developing research nstruments	Library search Typing and photocopying of research instruments	7,600 16,000	23,600
Finalizing research nstrument	75 questionnaires @200 UGshs	15,000	15,000
Data processing and eport writing	Researcher	80,000	80,000
.0% contingency and nstitutional costs	10,000	10,000	10,000
Total		**128,600**	**128,600**