THE EFFECTS OF CREDIT POLICY ON THE PERFORMANCE OF COMMERCIAL BANKS

CASE STUDY: KENYA COMMERCIAL BANK; MOI AVENUE BRANCH, KENYA

A RESEARCH PROJECT SUBMITTED TO THE SCHOOL OF BUSINESS AND MANAGEMENT IN PARTIAL FULFILMENT FOR THE AWARD OF A DEGREE OF BACHELORS OF BUSINESS ADMINISTRATION- FINANCE AND BANKING- OF KAMPALA INTERNATIONAL UNIVERSITY

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CHAPTER FIVE

DECLARATION

I, Maina Wanjiru Maina declare that this research project is my original work and has never been submitted to any university or institution of higher learning for purpose of any higher learning for purpose of any award. Where the works of others have been made, acknowledgement has been made.

Signature .... Date 18th April 09

Maina Joyce Wanjiru

APPROVAL

This research project has been submitted as a partial requirement for an award of Bachelor degree in Business Administration (Finance &Banking option) of Kampala International University with my approval as a supervisor.

Signature .... Date 28/4/2009

MR. ALEX OBOTH

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I acknowledge my parents Mr. and Mrs. Maina for their tireless effort to see me through my academic success and for the unlimited financial support that they gave me throughout my studies. Thank You

I would like to thank the Almighty God for His Grace and divine Favour throughout my studies.

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Abbreviations

CP –credit policy

NPA – Non-Performing Assets

KCB – Kenya Commercial Bank

CHAPTER ONE

1.0 INTRODUCTION

Client credit arises when there is a time lag between the delivery of goods and services and when payment is paid or received from the customer (Kakuru 2000). It's philosophy of lend now and receive payment later. Most commercial Banks offer loans to their customer and expect repayment on a future date (Atim, 1997)

There is risk associated with loan extension to clients. There is a likely hood that the loan extended to the bank client may not be recovered as expected and these poses a great risk to most commercial banks (Opio 2003). Therefore commercial banks must gain an acceptable level of confidence before extending credit to their clients. Different clients behave differently as regards loan repayments.

Recovery problems of loans by commercial banks create a lot of nonperforming assets (NPA) which greatly affects the profitability of commercial banks (Khoury 2004). The profitability of an organization determines its degree of survival (Ross & Westerd 1998). The organizations that fail to earn sufficient profits are normally unable to sustain their operations. Thus, profitability avails the organization with numerous advantages (Buckle, 2000). The object of commercial banks is to minimize costs associated with credit while maximize the benefits of client credit, ultimately profit (Pandey 1995). Credit management is therefore key in most Commercial banks. However many commercial banks continue to experience high default rates which have greatly affected their profitability.

1.1 BACKGROUND OF THE CASE STUDY

Kenya Commercial Bank (KCB) has been in business of lending its money to its customers since the time it was established in 1965 up to 2002 when it was sold off by its owners Government of Kenya. Being a state owned commercial bank, its credit policy was designed deliberately to lend to all Kenyans both in urban and in rural areas of the company major economic sector such as agriculture, industry commerce, tourism, and fishing and transport were specifically targeted. In essence KCB's credit system was intended to enhance financial resources availability in especially underdeveloped rural areas and economically empower their poor inhabitants. Consequently in the late 80's and early 90's the bank established a number of sector-oriented credit schemes to fulfill this broad objective. KCB has been the Kenya's largest commercial bank in terms of branch net work coverage which has extended to the neighboring East African Countries. Located in the city centre, there are already two branches in Uganda and one branch is about to be opened in Tanzania. Also in terms of employee asset base and other important aspects

1.2 STATEMENT OF THE PROBLEM

In the contemporary Kenyan economy, lending as a source of finance has been used by many organizations across various sectors including banking. In fact, the greatest asset for any bank are its debtors. However, it has been observed that lending has not improved most business organizations in the banking sector despite applications of the same credit policies and operating in similar environment. Lending process, therefore, affects the performance of the commercial banks. Due to failure to fulfill the lending criteria, Commercial Banks in Kenya are characterized by huge figures of nonperforming assets, increasing provision for bad debts, and registered reduced and high rate of increase in suspended interests. The researcher therefore focuses on investigating the effect of credit management policies on the performance of commercial banks

1.3 OBJECTIVES OF THE STUDY

1.3.1 General Objectives

Objectives of commercial banks is to minimize costs of credit extension while maximize benefit of credit .however through credit creation and extension most commercial banks have accumulated extensive nonperforming assets and registered decreased profits (Winter 2005). Its not clear whether the decreased profitability is due to the effectiveness of the commercial banks. The researcher has therefore developed an interest in ascertaining the effects of credit management on the performance of commercial banks.

1.3.2 Specific Objectives

1. To establish the relationship between credit policy and the performance of financial institution

2. To establish the impacts of credit policy and the performance of financial institution
3. To establish credit policies used and their possible weaknesses and solutions to Weaknesses

1.4 RESEARCH QUESTIONS

1. What is the relationship between credit policy and the performance of financial institution?
2. What is the impacts of credit policy and the performance of financial institution?
3. What are the strength of credit policies used by commercial banks, their weaknesses and their possible solutions

1.5 SCOPE OF THE STUDY

The research focused on the aspects of credit policy of the performance of commercial banks in Kenya but it will be restricted to KCB Moi Avenue Branch in Nairobi for the period between 2006- 2008 due to limit time and scarcity of resources.

1.6 SIGNIFICANCE OF THE STUDY

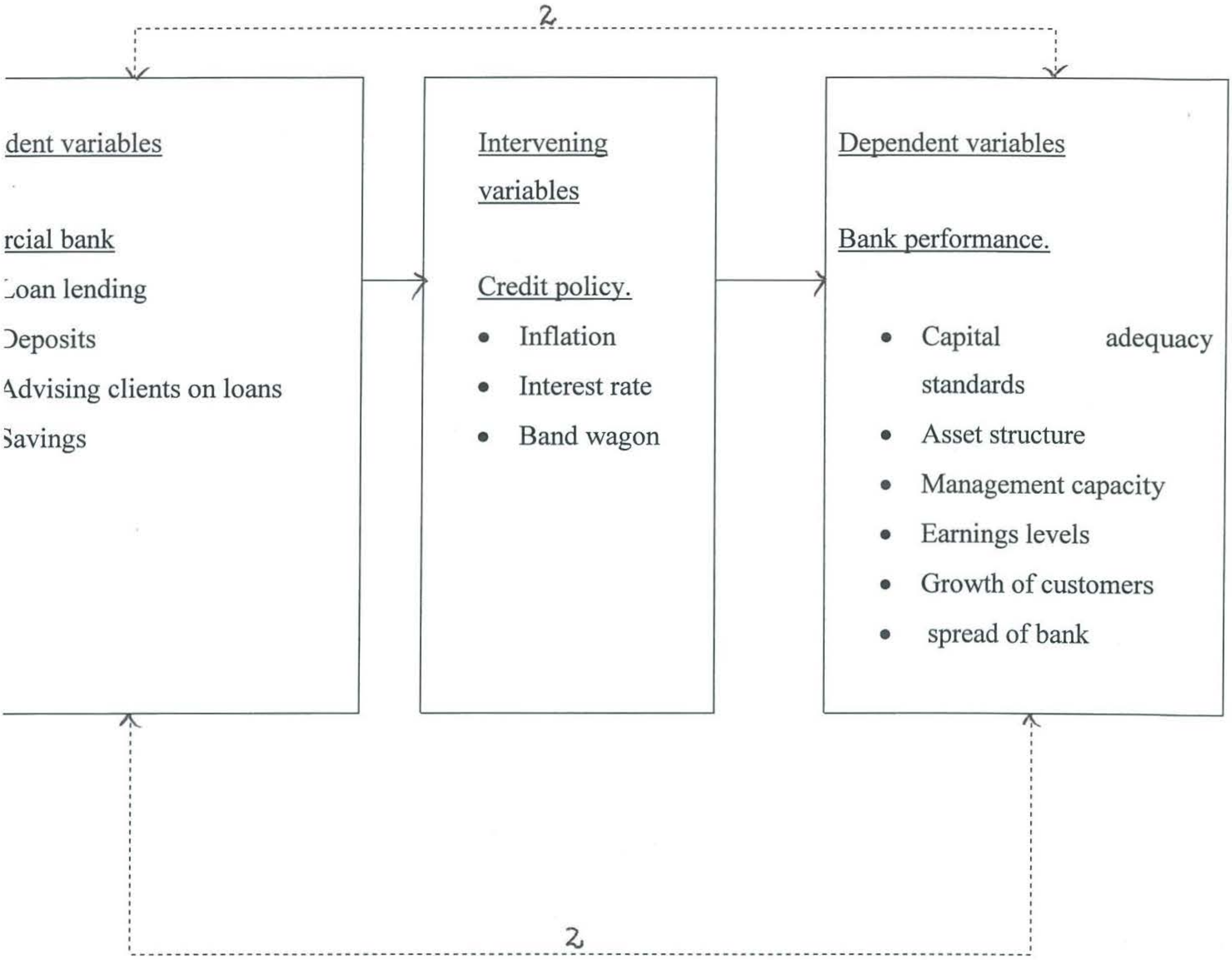
- Provide boundary between the theoretical and practical attributes of credit policies available and procedure of getting those policies
- If the findings are forwarded to commercial banks they will get to know the factors hindering their credit policy and therefore you formulate solutions to curb down on the factors hence boosting their financial performance in the competitive banking industry
- Will ascertain the effects of credit policy on the financial performance of commercial banks

1.7 LIMITATIONS OF THE STUDY

1. The greatest constraint was the inadequate resources in terms of time, fund, and assessing the appropriate data.
2. Respondents were reluctant to give information concerning the topic under Study due to the sensitivity of the matter on the concerned bank
. 3 There was an increase in costs in cases of call backs.
4. Time framework within which the research proposal was to be completed was not Enough yet good proposal work takes time

1.8 CONCEPTUAL FRAMEWORK

A conceptual framework defines the topic of research through the explanation of variables within the topic. Independent variable determines, predict and influence the dependent variable. Dependent variable is prone to control by independent variable to influence the dependent variable. For the purpose of this research the conceptual framework can be illustrated with the help of conceptual model below:



The above model has two routes through which credit management policy is likely to influence financial performance. Route one is where there might be intervening variables working hand in hand with the influences of credit management policy. Route two is where the credit management policy might affect financial performance directly which is indicated with the dotted line.

CHAPTER TWO

LITERATURE REVIEW

2.0 INTRODUCTION

This chapter contains salient issues in existing literature on the credit management of commercial banks that have been explored and studied by different scholars. The chapter provided an empirical platform for use in the investigation of how credit policy impacts on the profitability of commercial banks. The literature review was drawn from empirical survey of credit management practices, journals and textbooks dealing with credit policy.

2.1 DEFINITION OF CREDIT POLICY

According to (***halpen et al, 1993***), Credit management involves the collection compilation storage, analysis and retrieval of information regarding trading on credit. Credit policies are guidelines set by the lending Institution to establish the features and rules for the types of credit product that it offers.

And according to **Frederics Mishkin, (*1*992),** credit policy is the activity of:

- Deciding whether a firm should grant credit to a customer and how much credit (that is, for what amount of money and the length of time) should be granted.
- Ensuring that customers who have been granted credit are paying on time.

Many policies are written to safeguard the lenders' assets by limiting the risk on the loan.

2.2 CREDIT POLICY AND ITS IMPORTANCE

According to ***Pandey, 1995)*** in granting credit to a customer, Credit policies save time by ensuring that the same issues are not discussed over and over again each time the decision to grant credit is to be made. They also ensure that decisions are consistent and fair and that people in the same circumstances get treated in the same manner. ***(Van Horne 1995)*** urges that a firm needs an optimal credit policy, which equates benefits derived from increase in revenue and costs incurred when maintaining receivables.

2.3 RELATIONSHIP BETWEEN CREDIT POLICY AND FINANCIAL PERFORMANCES

According to encyclodictional 2006, financial performance is a company's ability to generate new resources from day to day operations over a given period of time. The financial performance of commercial banks is judged by net income and cash flow operations.

Credit advanced to customers and bank investments are prominent sources of income to a bank. In fact, lending is the main business of all banks. Hence banks require use of effective credit policy to avoid NPA. This will help them to not only stay in business but realize profit as well. The credit advanced to customers is one of the biggest and most proportion of a bank's income and call for ethical credit policies if a bank is to sustain a sound financial performance

Bank CP does not only result into only improvement in performance of commercial bank loans but also the general improvement in performance and soundness of commercial banks. This also improves shareholders' value

2.4 CREDIT RISK

According to ***Gerald O. Halter,(1991), page 55*** Credit risk is the possibility that the borrower of a loan or issue of security may be unable to meet interest and payments when they fall due. This failure of borrowers to carry out their financial obligations to their lenders as pledged by contract is known as defaults. A borrower may be unable to perform up to expectations for variety of reasons many of which are not always predictable, thus anything that affects the borrower's financial position may contribute to credit risk. Credit risk always encompasses the possibility that a borrower may choose not to or may attempt to defraud its creditors. Credit risk therefore can change during the term of a debt and the successful handling of problems by the borrower may improve an investor's claim.

According to the journal for the capital markets industry, Uganda volume 11 No. 3 July-September 2007; Credit rating is the assessment of both qualitative and quantitative information which may impact on an entities ability to repay its loans. Quantitative factors may include financial information on liquidity and debt while qualitative information may include financial information on liquidity and debt while qualitative information may include management depth and lately corporate governance structure of the bank. Credit risk evaluation is the core competence of the commercial banks. However credit risk evaluation (credit rating model) focuses narrowly on the likelihood of default on a loan.

2.5 CREDIT EVALUATION

Muelle P. Henry (1976) defines credit policy as a tool that provides framework for the entire credit management process. A credit policy or credit management system (CMS) is aimed at optimizing the efficiency of credit management of commercial banks and other related credit institutions. The banks must gain an acceptable level of confidence to extend the loans facilities at the lowest possible risk of loss since the bank's funds are committed for returns.

Credit evaluation according to (Van Horne,1995) is the process of assessing the information about the applicant, his intentions, and base on the findings to approve or decline the loan proposal. For a firm to have an effective credit policy, it must have clear cut guidelines to reduce the possibility of default. According *to* ***Lawrence D. Schall and Charles W. Haley page 518***; Credit managers base their evaluations on the risk in extending credit on assessments of the attributes of particular customers. This can be seen in 5 C's' that is Character, capacity, collateral, capital and conditions.

Character: this is a customer own desire to pay off debts hence this is the most important attribute.

Capacity: this is the ability to pay debt as reflected in the cash flows of the individual of firm.

Conditions: these are general economic circumstances of the firm's industry or the individual employment.

Capital: this refers to financial strength of customer which depends primarily on the customer's net worth relatively to outstanding debt obligations.

Collateral: this is asset that the customer has available to pledge against the debt.

2.6 CREDIT STANDARDS AND ANALYSIS.

Credit standards refer to financial strength and creditworthiness a customer must exhibit in order to qualify for credit. It is a basic stage in lending process. It's a process by which the financial institutions establish the credit worthiness of a customer. It involves the appraisal of customers to identify possible risks in lending as well as establishing the customers capacity to repay the loan. The successful credit standards and analysis would require the use of the standard credit application form looking for characters, which indicate the possibility of risk and other relevant information for credit analysis.

Setting credit standards require a measurement of credit quality, which is defined in terms of the probability of a customer's default. The probability estimate for a given customer is, for the most part, a subjective judgment. ***Stanley B. Block and Geoffrey A. Hirt, (2002) page 186-190;***

According to, ***Douglas R. Emery, John D. Finnerty 1997 page 635;*** Credit 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 efforts all reduce the net present value.

Ross Westerfield Jeff of Corporate finance 4th Edition, 1996 page 758; Suggests that different institutions should use credit information to analyze credit thus banks will generally provide some assistance to their business customers in acquiring information of the creditworthiness of other firms. **Customer's payment history with the firm:** this is the most obvious way to obtain an estimate of a customer's probability of a non-payment whether he or she has paid previous bills. **Financial statements:** a bank may ask the customer to supply financial statements. This rule of thumbs based on financial ratios can be calculated. **Credit reports on customer's payment history with other firms:** many organization sell information on the credit strength.

2.7 CREDIT TERMS

According to ***Stanley B. Block, and Geoffrey A. Hirt, 2002 page 186-90;*** Once the decision to extend credit to customer is made then a decision regarding the terms of credit follows. Credit terms specify the duration of credit that is credit period and terms of payment in any commercial bank. He also articulated that credit period affects profitability, liquidity and survival since increase in credit period increases the loan portfolios.

2.7.1 DETERMINANTS OF CREDIT TERMS IN COMMERCIAL BANKS.

The world bank Washington D.C concluded that in determining the credit terms of any customer, the following need to be considered: credit policies and procedures, prior loss experiences, loan growth, quality and depth of management in the landing 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 provides a leading indicator of the quality of the bank's loans portfolio at a given period of time.

2.8 COLLECTION POLICY

According to ***Brigham F. Eugene, 1985*** Collection policy refers to the procedures the banks 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 fail to make payments. The collection efforts should therefore aim at accelerating collection from slow pay and reducing bad debt losses. The tough credit policy of KCB bank leads to more profit.

Attaining a high rate of loan collection is a necessary condition for a commercial bank to become self sustainable, losses have been the largest cost borne by the bank 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 to 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 destroyed.

According to ***Ross Westerfield Jaff 1996,*** high percentage of nonperforming loans means that funds are not available to provide loan to new borrowers and if loans are not repaid, they eventually affect the profitability of the bank.

2.9 IMPACTS 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 the commercial bank. However loans have carrying costs when unpaid in time as they constitute the credit risk factor with associated costs of supporting the credit functions 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 policy of varying the level of consumer credit or loans the tradeoff between profitability and liquidity or solvency of any commercial bank, affects its survival.

Kansiime Elderd (1996), the influence of credit on performance is either way: first credit earns financial institution interests that contributes 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.

As a major element in the struggle for the rural poor to achieve an economic break-through of the vicious of poverty, the provision of micro credit constitutes the primary function of commercial banks and micro credit institutions in Kenya.

It is beneficial to focus on what the policy does to the performance of the financial system and therefore performance in the commercial bank should be measured by number of people who have regular access to financial services, costs of financial transactions quality of services provided, the repayment rates and saving mobilization.

Bank credit management does not only result into improvement in performance of commercial bank loans but also the general improvement in performance and soundness of commercial banks. This also increases the shareholders value

CHAPTER THREE

RESEARCH METHODOLOGY

This chapter gave methods that the researcher used to collect, analyze and present data from the field of study. The information enabled the researcher to come up with the reliable recommendations and conclusions.

3.1 RESEARCH DESIGN

The researcher used co-relational method when conducting his research. The reasons for proposing this method is because the title of the study has two variables that is credit policies and performance commercial banks. The method helped find out the relationship between the two variables without complications.

3.2 POPULATION AND SAMPLE

Due to poor performance of some indigenous banks in Kenya, a survey was used to carry out with loans and credit officers of KCB bank to relate their views with the credit policy and the performance of the bank. The study was conducted only in Nairobi's Moi Avenue branch area. Also KCB bank management staffs in various departments were be interviewed.

3.3 SAMPLING DESIGN AND SIZE

3.3.1 SAMPLING DESIGN

In order to ensure representatives of the samples from study population of credit and loan officers, sampling was be grouped according to chain of command. Random sampling technique was used in picking the employees on which the data was be collected. Thus respondents were randomly selected from staff in KCB bank Moi Avenue branch. Sampling design was preferred to minimize bias in sampling process to achieve maximum precision which was expected to give the research constraints of the study, senior management and other staff members of the bank were also be interviewed.

3.3.2 SAMPLE SIZE

Considering time and other constraints of the study, the researcher selected 50 respondents randomly. This was considered representation of the study population consistent with the research questions.

3.3.3 DATA SOURCE, COLLECTION AND ANALYSIS

3.3.3.1 DATA SOURCE

Both primary and secondary data were be used on the study to help achieve the objective of the research. The main primary data source was from an interview and questionnaires which was administered on the staffs. Secondary data sources was obtained from text book, annual reports of commercial bank of Kenya and quarterly reports, KCB Director's reports 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.

3.3.3.2. DATA COLLECTION METHODS AND INSTRUMENTS

3.3.3.2.1 INTERVIEWING METHOD

The personal interviews was carried out by the researcher as a follow up of the questionnaires so that the interviewee was aided in the areas of difficulty and seek an in depth discussion and explanation on matters missed on the questionnaires.

3.3.3.2.2 QUESTIONNAIRES METHOD

Data was collected by the use of structured questionnaires designed by the researcher. The questionnaires were sent to the department heads, staff and other subordinate staff. This technique was used because all the respondents are literate. The major advantage of this method included; free of biased information and enough time for the respondent to consider his/her points carefully than in an interview.

3.3.4 DATA PROCESSING AND ANALYSIS

Data collected was analyzed using percentages, tables and graphs and simple statistical modules like the central tendency, frequency distribution to assess the effects of credit policy function on the performance of commercial banks. Quantitative data analysis was performed in relation to research question.

Statistical findings were interpreted in light of the objectives of study and conclusion made based on the literature review to attach more meaning.

CHAPTER FOUR

PRESENTATION, ANALYSIS AND DISCUSSION OF FINDINGS

4.0 INTRODUCTION

This chapter discusses the research questions in view of the research objectives to assess the roles of credit policy in the performance of commercial banks so as to improve our understanding of the salient issues of the subject matter in line with survey findings and literature reviewed. In the presentation of findings, tables and figures have been used; frequencies/ percentages have also been used to describe findings

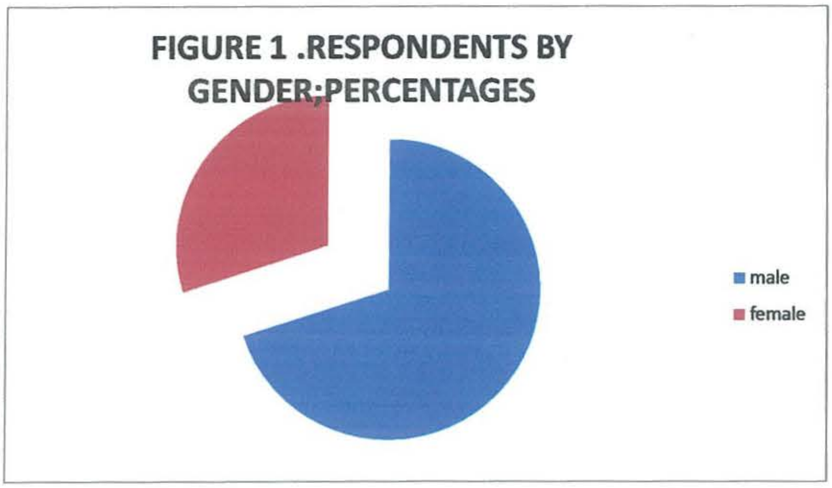
4.1 RESPONDENTS BY SEX

The researcher sought to know the sex of the respondents. Out of the 50, 35 were male while 15 only were female. This is illustrated by the table below in percentages

Table 1. RESPONDENTS BY GENDER

Sex	**Frequency**	**Percentages**
Male	35	70%
Female	15	30%
Total	**50**	**100%**

Source: primary data



Source: primary data

There were 35 male representing 70% and 15 female representing 30 % of the respondents. This according to the study shows that there are more male employees in the KCB bank than there are female. The researcher noted that this affects the bank negatively due to certain factors contributed by male than by female. Men are characterized with unproductive activities such as excessive taking of alcohol. Getting children out of wedlock whom they have to finance among other activities may affect their finances and consequently delay paying back the loan or worse still not being able to pay at all.

4.1.1 RESPONDENTS' AREA OF SPECIALIZATION

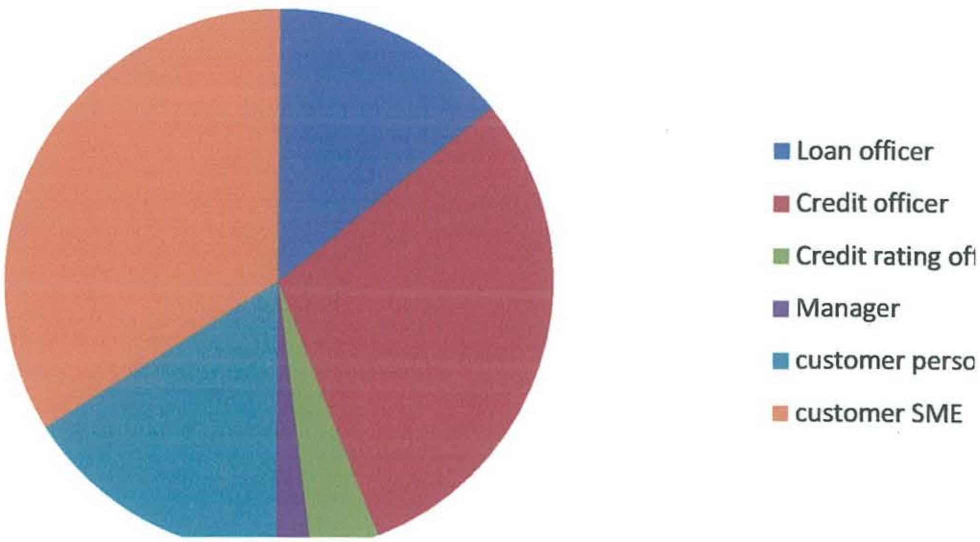
The researcher sought to understand who the respondents were by designation. This information is provided on the table below followed by figure 3, a diagrammatic presentation of the same

Table 3.classification of respondents by area of specialization

Designation	Frequency	% of frequency
Loan officer	7	14%
Credit officer	15	30%
Credit rating officer	2	4%
Manager	1	1%
Customer personnel	8	16%
Customer SME	17	34%
Total	**50**	**100%**

Source: Primary data

figure 3. classification of respondents by their area of specialization



Source: Primary data

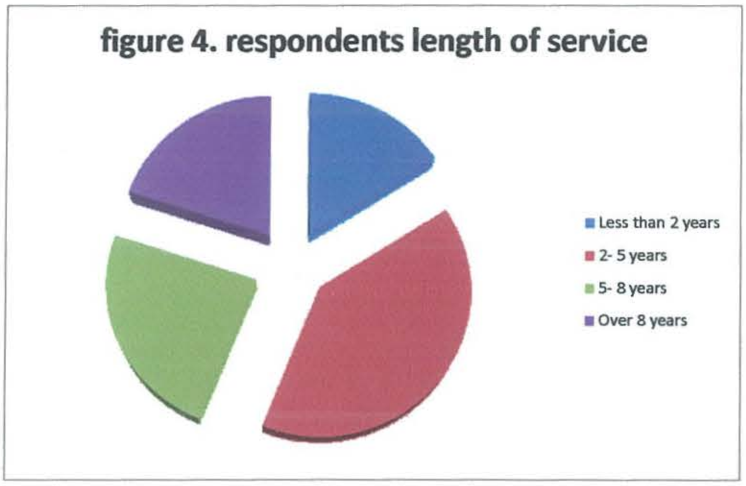
4.1.2 LENGTH OF SERVICE

The researcher was also interested to find out how much time the respondents have spent working with the KCB bank so as to effectively interpret their views in relation to the performance of the KCB bank.

Table 4. Respondents' length of service

Period in service	Frequency	Percentage
Less than 2 years	8	17%
2- 5 years	20	41%
5- 8 years	12	23%
Over 8 years	10	19%
Total	**50**	**100%**

Source: primary data



Source: primary data

4.2 REVIEW OF CREDIT POLICY

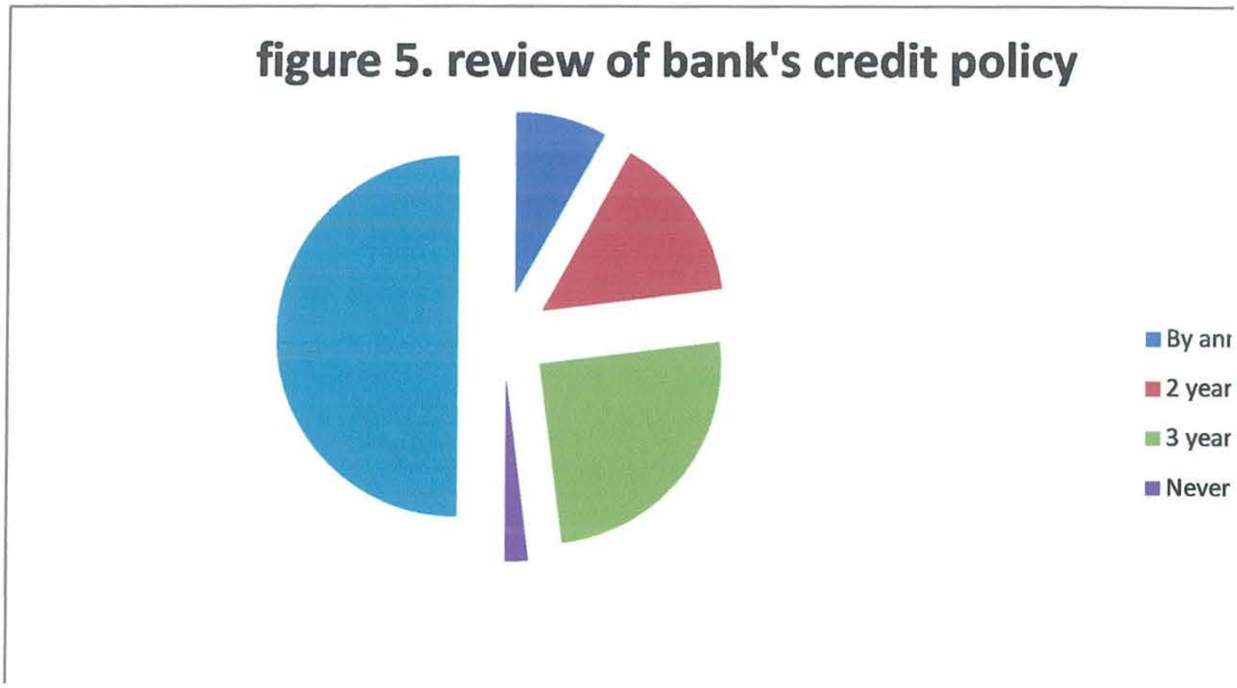
The researcher was interested to know when credit policies are reviewed

Table 5: management's review of the bank's credit policy

Review every:	Frequency	Percentage
By annually	8	16%
2 years	15	30%
3 years	25	50%
Never	2	4%
Total	50	100%

Source: **primary data**

Manager and head of departments review the bank's credit policies, procedures and directives periodically as shown above



Source: primary data

Most respondents said that the review is done at least within three years.

4.2.1 QUALIFICATIONS FOR A CLIENT TO ACCESS BANKS LOAN

Credit managers in KCB base their evaluations on the risk in extending credit on the assessments of the attributes of particular customers. These attributes are character; the customer should have a desire to pay off debts, the client should also have the capacity to pay debts as reflected in the cash flows of the individual or the firm. Credit managers also check on the conditions or the general economic circumstance of the firm's industry or the individual employment. Enough capital which depends primarily on the customer's net worth relatively to outstanding debt obligations. The client should also have enough collateral available to pledge against the debt.

4.2.2 EFFECTIVE CREDIT POLICY

The KCB bank management follows this process in the seeking of clients for credit purposes, granting credit to them as well as monitoring and diagnosing the dangerous signs for fortune to reduce the possibility of loss arising from the fact that interest or principle or both will not be paid as due. This agreed with (Smith 1991) that in order for commercial bank to gain public confidence; they should be backed by a stable credit management policy.

4.2.3 RESPONSE ON THE IMPACT OF CREDIT POLICY ON THE PERFORMANCE OF KCB BANK

Credit policy helps in harmonizing the lending process of commercial banks. Credit earns the bank interest that contributes to its profitability and on the other hand, the borrowers' benefits by way of achieving a financial boost in business which depends on commercial banks innovativeness manifested on the credit policies as well as outreach by way of branch coverage. Credit policy also ensures operational consistency and adherence to uniform, sound practices. A sound policy contributes to a banks' success by supporting prompt credit decision.

4.2.4 HOW INTEREST RATE TO CHARGE A CLIENT IS DETERMINED BY THE KCB BANK

The interest rate defers with the length of time the client is borrowing. The longer the period, the bigger the interest rate. In the case of urgency, the client will be charged a bigger interest rate than the usual amount. The management also considers the use into which the money borrowed will be put. Some ventures are more risky than others. The more the venture is risky, the higher the interest rate charged. Mortgage loans are backed by the collateral of the property the loan was used to purchase. If someone does not pay his or her mortgage, the bank has the right to sell the property that was pledged as collateral and to collect the proceeds as payment for what it is owed. That means the bank's risks are lower, so interest rates on these loans are typically lower, too. The money that is loaned to people who do not pay off the balances on their credit cards every month represents a greater risk to banks, because no collateral is provided. Because the bank does not hold any title to the consumer's property for these loans, it charges a higher interest rate than it charges on mortgages. The higher rate allows the bank to collect enough money overall so that it can cover its losses when some of these riskier loans are not repaid.

The creditworthiness of the borrower is one reason why some kinds of loans have higher rates of interest than others do. Short-term loans made to people or businesses with a long history of stable income and employment, and who have assets that can be pledged as collateral that will become the bank's property if a loan is not repaid, will receive the lowest interest rates. For example, well-established firms such as Blue shield insurance company often pay what is called the bank's prime rate—the lowest available rate for business loans—when they borrow money. New, start-up companies pay higher rates because there is a greater risk they will default on the loan or even go out of business

4.2.5 THE REPAYMENT PERIOD FOR PARTICULAR LOANS

The researcher wanted to know the repayment period given to borrowers of the bank. She found out that KCB offers both short term and long term loans. Short term loans are loans that need to be repaid within a short time, say less than a year. This kind of loan is mostly characterized by a small amount of money. Long term loans take more than one year to be repaid. Its mostly characterized by a large sum of money. The period to pay back the loan depends on the contract between the bank and the client.

4.3 RESPONSE ON THE RELATIONSHIP BETWEEN CREDIT POLICY AND PERFORMANCE OF KCB BANK

The most important asset for every commercial bank is the debtors. Credit advanced to customers and bank investments are the most prominent sources of income to commercial banks. Due to stiff competition in the banking industry, the bank will lose its customers if it does not offer them credit. This calls for ethical credit policy if the bank is to sustain a sound financial performance.

4.4 RESPONSE ON CREDIT RECOVERY APPROACH.

Table 6: response on credit recovery approaches and their effectiveness

onse	HE		FE		NE		NR		Total
	F	%	F	%	F	%	F	%	
inuous supervision to ensure ›seful use of the loan.	15	30%	15	30%	20	40%	0	0%	**100%**
inuous customer sensitization : their financial obligation	25	50%	20	40%	4	8%	1	2%	**100%**
nder on phone, letters and cal customer contact.	35	70%	15	30%	0	0%	0	0%	**100%**
›f court bailiffs and mortgage of eral	30	60%	20	40%	0	0%	0	0%	**100%**
oning clients property	33	66%	16	32%	2	2%	0	0%	**100%**
ing to the customers	32	64%	18	36%	0	0%	0	0%	**100%**

Source: primary data

Key

High effective (**HE**), fairly effective (**FE**), Not effective (**NE**), Non response (**N**R)
Frequency (**F**)

In the evaluation on credit recovery approaches, the researcher wanted to find out their effectiveness. 30% of the respondents agreed that Continuous supervision to ensure purposeful use of the loan is highly effective in credit recovery approach however; it's a challenge for the bank to supervise what the clients do with their loans which they have been given by the bank.

50% of the respondents' agreed that Continuous customer sensitization about their financial obligation is highly effective in credit recovery approach while 40% of the respondents agreed that Continuous customer sensitization about their financial obligation is fairly effective.
The researcher also wanted to know whether reminder on phone, letters and physical customer contact is effective hence 70% of the respondents agreed it is highly effective since the bank has to remind its clients on their obligations.

KCB bank also uses court bailiffs and mortgage of collateral as a way of credit approach recovery and this is represented by 60% of the respondents who agreed that it is highly effective while 40% of the respondents fairly agreed that court bailiffs and mortgage of collateral are effective.
66% of the respondents highly agreed that auctioning clients' property is effective approach of credit recovery since some clients' might not be able to pay their loans back yet the bank have their security thus the only option the bank have is to sell the security in order to get back their money. The respondents agreed that the bank has to warn the customer before auctioning their securities. 64% agreed that it is highly effective that the bank has to make the warning to the customers.

4.5 STRENGTH AND WEAKNESSES OF KCB'S CREDIT POLICIES.

The researcher found out that CP can overcome poor judgment of extending credit which insures the bank against possible losses. It maintains proper credit standard, avoids excessive risks and evaluates business opportunities properly.

However, excessive reliance on collateral has negatively affected the bank's profits since not all clients repay the loan. And though the bank can resell the clients collateral, sometimes it takes time before they get an interested buyer. Infrequent customer contact has caused the bank to lose track of the client till it's too late. The loan is not always supervised. There is also failure to improve collateral position as a credit deteriorates. Excessive overdraft lending to well establish firms sometimes reduces the money available for borrowing or repaying creditors of the bank. Sometimes the bank fails to control and audit the credit process effectively

The bank should rely more on monitoring the use put to the loan to ensure that its productive. It should offer continual supervision and advice on the client's project to ensure progress hence reduce the risk of default.

As credit deteriorates, it's a sign of regress hence a high chance of default. The bank should then improve collateral position.

The bank should also limit on the overdraft lending to its customers.

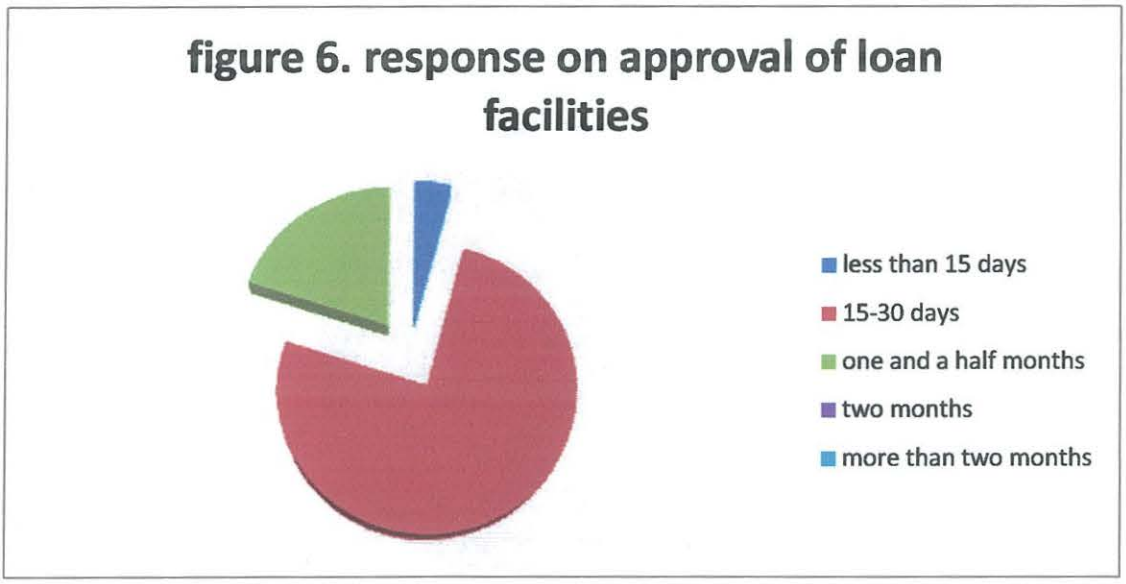
4.6 RESPONSE ON APPROVAL OF LOAN FACILITIES

Table 7. Response on Approval of loan facilities

Response	**Frequency**	**%- age**
Less that 15 days	2	4%
15- 30 days	38	76%
One and a half months	10	20%
Two months	0	0%
More than two months	0	0
Total	**50**	**100%**

Source: primary data

There are some clients who need less amount of loan from the bank and have all requirements that the bank need thus 4% of the respondents agreed that it takes less than 15 days for such clients to secure loans from the bank. While 20% of the respondents agreed that it takes one and a half months for a client to secure a loan from KCB bank.



Source: primary data

4.7 RESPONSE ON THE EFFECTIVENESS OF THE POLICY

Table 8 response on the effectiveness of the policy

Response	Yes	%-age	No	%-age
Does Equity bank check and evaluate collateral before giving its clients loans?	50	100%	0	0%

Source: primary data

Results of the survey and interviews conducted indicated that 44% of the respondents agreed that the highest majority respondents took pride in the bank's credit policy considering the high repayment rates, due to strictness of the guideline in the policy and the clients also find the bank's credit policy bearable. 40% of the respondents revealed that the policy encourages the clients to borrow. This was due to the facts that loan processing takes less days, 16% of the respondents agreed that at times there are low repayment rate due to some weakness in the policy.

CHAPTER FIVE

DISCUSSION OF FINDINGS, RECOMMENDATION AND CONCLUSION

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 DISCUSSION OF FINDINGS.

Most of the participants were male, represented by 70% of the respondents. This showed that KCB bank employs more male and the number of people seeking for loan in the bank are male thus this has been indicated in the study. More male borrowers affect the bank's performance Negatively since most men are characterized by unproductive investments such as excessive alcohol intake. The fact that most of the participants have worked with the bank for more than two years indicates a high probability of more reliable answers.

5.1.1 CREDIT POLICY

These are used to guide the credit decision made and define the target markets of the bank, hence it was noted that credit policies are reviewed at least after every 2 years in the bank. 50% of the respondents agreed that the bank reviews their credit policies after every three years, while 15% agreed that credit policy is reviewed after two years. The performance of any commercial bank depends on its existing credit policy at any given time period. KCB bank has written credit policies, procedures and directives that are guided by the bank's mission and strategies.

KCB bank has also ensured effective credit policies process in the seeking of clients for credit purposes, granting credit to them as well as monitoring and diagnosing the dangerous signs for fortune to reduce the possibility of loss arising from the fact that interest or principle or both will not be paid as due.

The researcher agrees with ***Eugene F. Brigham and Joel F. Houston page 726- 28;*** who say that the term credit policy refer to the combination of the three decision variables namely credit standards, credit terms and collection efforts that influence the amount of credit extended by commercial banks. Credit period, which is the length the customers are given to pay their dues. Credit standards, 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.

5.1.2 CREDIT EVALUATION

Credit evaluation according to (Van Horne,1995) is the process of assessing the information about the applicant, his intentions, and base on the findings to approve or decline the loan proposal. For a firm to have an effective credit policy, it must have clear cut guidelines to reduce the possibility of default. According *to* ***Lawrence D. Schall and Charles W. Haley page 518***; Credit managers base their evaluations on the risk in extending credit on assessments of the attributes of particular customers. This can be seen in 5 C's' that is Character, capacity, collateral, capital and conditions.

Character: this is a customer own desire to pay off debts hence this is the most important attribute.

Capacity: this is the ability to pay debt as reflected in the cash flows of the individual of firm.

Conditions: these are general economic circumstances of the firm's industry or the individual employment.

Capital: this refers to financial strength of customer which depends primarily on the customer's net worth relatively to outstanding debt obligations.

Collateral: this is asset that the customer has available to pledge against the debt.

5.1.3 CREDIT RECOVERY APPROACH

This is the process through which KCB bank recovers the money it has lend its clients. According to the research, 70% of the respondents agreed that KCB bank use reminder on phone, letters and physical customer contact. 60% agreed that the bank use court bailiffs and mortgages as securities while giving loans, hence when clients fail to repay principal, 66% of the respondents agreed that KCB bank will auction the clients' property when they fail to pay their dues.

According to ***Ross Westerfield Jaff 1996,*** high percentage of nonperforming loans means that funds are not available to provide loan to new borrowers and if loans are not repaid, they eventually affect the profitability of the bank.

The lending bank cannot tell in advance which loans will turn bad or will cause trouble, but loans of different classes offer varying possibilities for risk. Credit policy helps to reduce this risk by reducing the rate of defaulters through monitoring loan given. And I do support the banks' idea of formulating recovery approaches.

According to ***Ross Westerfield Jaff 1996***, high percentage of nonperforming loans means that funds are not available to provide loan to new borrowers and if loans are not repaid, they eventually affect the profitability of the bank.

5.1.4 DETERMINANTS ON INTEREST RATE TO CHARGE A CLIENT

The longer the repayment period, the bigger the interest rate. In the case of urgency, the client will be charged a bigger interest rate than the usual amount. The management also considers the use into which the money borrowed will be put. Some ventures are more risky than others. The more the venture is risky, the higher the interest rate charged. Mortgage loans are backed by the collateral of the property the loan was used to purchase. If someone does not pay his or her mortgage, the bank has the right to sell the property that was pledged as collateral and to collect the proceeds as payment for what it is owed. That means the bank's risks are lower, so interest rates on these loans are typically lower, too. The money that is loaned to people who do not pay off the balances on their credit cards every month represents a greater risk to banks, because no collateral is provided. Because the bank does not hold any title to the consumer's property for these loans, it charges a higher interest rate than it charges on mortgages. The higher rate allows the bank to collect enough money overall so that it can cover its losses when some of these riskier loans are not repaid.

The creditworthiness of the borrower is one reason why some kinds of loans have higher rates of interest than others do. Short-term loans made to people or businesses with a long history of stable income and employment, and who have assets that can be pledged as collateral that will become the bank's property if a loan is not repaid, will receive the lowest interest rates.

5.1.5 DURATION GIVEN TO BORROWERS.

KCB bank treats its customers equally whether he is the first borrower or second borrower or third so long as he meets the requirements of the bank, but the only difference depends on the amount of loan one takes from the bank; those who take large amount of loan, their interest rates and time paying back their principal and interest are different from those who take small amount of loan.

Frederics Mishkin 1992 defines credit management as the activity of: Deciding whether a firm should grant credit to a customer and how much credit (that is, for what amount of money and the length of time) should be granted thus this ensures that customers who have been granted credit are paying on time. It is therefore very prudent that the banks treat their customers equally with no discrimination.

5.1.6 STRENGTH AND WEAKNESSES OF KCB'S CREDIT POLICIES AND POSSIBLE SOLUTIONS

CP can overcome poor judgment of extending credit which insures the bank against possible losses. It maintains proper credit standard, avoids excessive risks and evaluates business opportunities properly.

However, excessive reliance on collateral has negatively affected the bank's profits since not all clients repay the loan. Infrequent customer contact has caused the bank to lose track of the client till it's too late. The loan is not always supervised. There is also failure to improve collateral position as a credit deteriorates. Excessive overdraft lending to well establish firms sometimes reduces the money available for borrowing or repaying creditors of the bank. Sometimes the bank fails to control and audit the credit process effectively

The bank should rely more on monitoring the use put to the loan to ensure that its productive. It should offer continual supervision and advice on the client's project to ensure progress hence reduce the risk of default.

As credit deteriorates, it's a sign of regress hence a high chance of default. The bank should then improve collateral position.
The bank should also limit on the overdraft lending to its customers.

5.2 RECOMMENDATION

Commercial banks must operate within a well defined credit granting criteria. These criteria should also include a clear indication of banks customers a thorough understanding of borrower and purpose of credit and its source of payment.

Banks should put into place effective credit analysis methods as to maintain pertaining loan portfolio

Put into place, stringent CP well written down as to provide standards upon which credit personnel should operate

It should be the responsibility of a bank credit officer to ensure that the policies are well implemented otherwise lending problems, proper documentation and implementation of these policies increase their effectiveness and therefore an increase in performance of credits in commercial banks

Credit policies should also be reviewed often and made clear to all the persons working under credit department and even other departments so that KCB bank customers should be well informed on the bank's policies.

Commercial banks in Kenya should realize the importance of credit policies

5.3 AREA OF FURTHER STUDY

Factors that contribute to the successful implementation of an effective credit management policy in commercial banks

5.4 CONCLUSION

From the above findings, the following have been analyzed to show extend to which credit policy affect performance of commercial banks. Managing Credit policy is essential and a critical element in maintaining the soundness and safety of commercial banks. Credit policy must be part of the commercial banks at all times and should be stringent enough.

5.5 LIMITATIONS OF THE STUDY

The researcher found the following limitations in the process of this research:

- Accessing information was a challenge to the researcher, KCB bank management invoke confidentiality and internal use only clauses and regulations thus this also led to delay in data collection.

- Respondents' could not act in time due to unfavorable timing, especially during times when they were busy with the office work thus this led to delay of data collection and analysis.

- Some of the respondents were hesitant to answer the questionnaires thus leading to the delay in data collection since banker's information and business finance sources are a very sensitive issue in most organizations

APPENDIX 1

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http://www.kcbbank.com

APPENDIX 2

PROPOSED BUDGET

ITEM	TOTAL COST (Ush.)
Stationeries including internet usage	70,000
Books photocopies Printing and binding	120,000
Data collection instruments and transport	100,000
Compilation and analysis of data expenses	50,000
TOTAL	**340,000**

APPENDIX 3
WORK PLAN

ACTIVITY	TIME PERIOD IN WEEKS
Choosing research topic	1
Problem definition /back ground information	1
Literature review	7
Methodologies	1
Writing first proposal	5
Revision and correction	1
Typing and presentation	1
Collecting data	5
TOTAL WEEKS	**22**

APPENDIX 5

RESPONDENTS QUESTIONNAIRE

Questions to the employees of KCB bank

DEAR SIR/MADAM,

I kindly request for an access to data collection concerning the impacts credit policy on the performance of your organization. I am a 3rd year student in Kampala International University pursuing degree in Business Administration. The data given will be for academic use only, where it will be treated with due confidentiality. Please tick the correct answers or simply comment on the given space. Thanks

Yours faithfully

Joyce Wanjiru Maina

PART ONE

1. Gender

   (a) Male [ ] (b) female [ ]

2. What is your area of specialization in the organization?

   (a) Loan Officer [ ] (b) Credit Officer [ ] (c) Credit Rating Officer [ ]
   (d) Manager (e) Client [ ] (f) Others [ ]

3. How long have you served the organization?

   (a) Less than two years [ ] (b) 2-5 years [ ] (c) 5-8 years [ ] (d) More than 8 year [ ]

PART TWO

4. How often is credit policies reviewed?

(a) Monthly [ ] (b) Annually [ ] (c) After 2 years [ ] (d) After 3 years [ ] (e) Never [ ]

5 What are the qualifications for a client to access your bank's loan who doesn't? qualify?

....

....

6. How do you determine the interest rate to charge on client borrowing loan?

....

....

7. what is the repayment period for particular loans?

....

....

8. How do you ensure an effective credit policy in your bank?

....

....

9. What are the effects of credit policy on performance of your bank?

....

....

10. What is the relationship between credit policy and financial performance of your Bank?

....

....

11. What credit recovery approaches does your bank use, and how effective are those approaches

(a)Highly effective [ ] (b) Fairly effective [ ] (c) Not effective[ ]

12. What are the strength and weaknesses of KCB?

....

....

QUESTIONNAIRES TO THE CLIENTS.

DEAR SIR/MADAM,

I kindly request for an access to data collection concerning the impacts credit management policy on the performance of your organization. I am a 3rd year student in Kampala International University pursuing degree in Business Administration. The data given will be for academic use only, where it will be treated with due confidentiality. Please tick the correct answers or simply comment on the given space. Thanks

Yours faithfully

Joyce Wanjiru Maina

PART ONE

1. Gender

   (a) Male [ ] (b) female [ ]

2. Occupation

   Casual worker [ ] Civil servant [ ] Businessman [ ]
   Farmer [ ] others (specify) [ ]

PART TWO

3. On average, how long does it take from one lender in application for credit facility and when the client has access to the funds?

   a) Less than 15 days [ ] (b) 15-30 days [ ] (c) One month and a half month [ ] (d) Two months [ ] (e) More than two months [ ]

4. Does KCB bank check and evaluate collateral before giving its clients loans?

   (a) Yes [ ] (b) No [ ]

6. What is the effect of credit policy on the performance of your bank?

   ....

   ....

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OFFICE OF THE DEAN

SCHOOL OF BUSINESS AND MANAGEMENT

Date: 7th April, 2008

THE HUMAN RESOURCES MANAGER
KCB-MOI AVENUE BRANCH - KENYA

Dear Sir/Madam

RE: MAINA JOYCE WANJIRU REG. NO. BBA/7216 /52DF

The above mentioned is a bonafide student of Kampala International University pursuing a Bachelor of Business Administration programme in the School of Business and Management of the University.

She is currently conducting field research and the title of the Research project is "THE IMPACT OF CREDIT POLICY ON PERFORMANCE OF FINANCIAL INSTITUTIONS" A CASE STUDY OF KCB MOI AVENUE BRANCH. As part of her studies (research work) she has to collect relevant information through questionnaires, interviews and other relevant reading materials.

Your institution has been identified as a valuable source of information pertaining to her research project. The purpose of this letter is to request you to avail her with the pertinent information she may need.

All and any information shared with her will be used for academic purpose only and we promise to share our findings with your institution.

Any assistance rendered to her in this regard will be highly appreciated.

Yours Sincerely,

DR. SENOGA EDWARD
ASSOCIATE - DEAN SCHOOL OF BUSINESS