CONTRIBUTION OF CREDIT RISK MANAGEMENT STRATEGIES ON FINANCIAL STABILITY: AN EVALUATION OF COMMERCIAL BANKS IN KILIFI COUNTY

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A project submitted in partial fulfillment of the requirements for the Degree of Master of Business Administration of Pwani University

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DECLARATION

This project is my original work and has not been presented or submitted for a degree in any other university:

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DEDICATION

I dedicate this work to my father, Mr. M’ithibutu, my mum, Madam Salome and my friend Senator Franklin Mithika Linturi for their unconditional support throughout.
ACKNOWLEDGEMENT

I would like to thank The Almighty God for giving me strength and courage to complete this project. I would like to thank my supervisors Dr. Fikirini Lugogo and Dr. Ronald Koech for their professional guidance, constructive criticism and encouragement throughout the study period. I am very grateful to my parents Mr. and Mrs. M’ithibutu, Senator Franklin Mithika Linturi and the entire family for granting me this opportunity and giving me financial support throughout the study. I am thankful to the Dean Prof. Samuel Mwakubo, staffs and my fellow students in the School of Business and Economics for their valuable input and moral support. I acknowledge the support and cooperation of the respondents and all Commercial Banks in Kilifi County. While I am not able to mention each person individually, I am sincerely grateful to each person who in one way or another contributed to the success of this project.
ABSTRACT

For a bank to sustain long-term profitability and a competitive advantage, the bank must respond strategically to challenges arising from credit risk. Over the years, there have been an increased number of significant bank problems in both matured and emerging economies. Credit problems, especially weakness in credit risk management, have been identified to be a part of the major reasons behind banking difficulties. The purpose of this study was to establish the contribution of credit risk management strategies to the financial stability of commercial banks in Kilifi County. This study borrowed from competitive advantage theory, resource based view theory and loan pricing theory to advance better credit risk management strategies to safeguard financial stability of the commercial banks. Descriptive research design was used and questionnaires were used to collect data. Analysis was done using descriptive statistics and content analysis as well as Mann Whitney and regression tests. Central Bank is the key player in prompting commercial banks to change their policies in regard to cushioning banks’ risks. Land is the most common and preferred assets to secure loan from commercial banks as a collateral as indicated by majority of the respondents. Many commercial banks prefer interest rates of between 16% and 19%. The study shows that commercial banks use numerous tools for controlling credit losses such as collaterals and credit protection. It also emerged that Majority of borrowers do not repay their debt in time as confirmed by more than three quarter of the respondents. Mann Whitney tests of medians were run to determine whether banks in Kilifi perceived credit control policies to be appropriate for a variety of credit scenarios among clients and whether some measures were considered superior to others. Collaterals and Credit protection were considered to be equally (W=1584 p=0.2902) robust tools to control credit losses but superior to agreements (W=1860.5 p=0.0001), credit rationing (W=1782 p=0.0352) and contract evaluation (W=1712.5 p=0.0368).
Credit protection as a strategy, to a great part contemplated as collateral by the bank, provided the most appropriate measure for handling multidimensional risks to credit for a diverse clientele operating in diverse client risk scenarios. The study recommends that Commercial Banks should develop risk management strategies that are consistent with their credit risk tolerance and their business goals. The management should periodically review the credit risk strategies and any changes and concerns should be effectively communicated to all relevant staffs. Shifts from the approved credit risk strategies should be subjected to appropriate review and endorsement.
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ABBREVIATIONS AND ACRONYMS

CBK  Central Bank of Kenya
CRM  Credit Risk Management
CRS  Credit Risk Strategies
CRB  Credit Reference Bureau
CHAPTER ONE

1.0. INTRODUCTION

1.1. Background to the Study

For a bank to sustain long-term profitability and a competitive advantage, the bank must respond strategically to challenges arising from credit risk. This will involve the formulation and implementation of strategies that will ensure full recovery of the principal and interests from the loan advanced to customers. A strategy is about the course in which an organization is trying to get in the long-term and how it intends to get there competitively putting into concern the values and prospects of its shareholders. Strategy is the course and scope of an organization over the long term, which attains advantage in a changing atmosphere through its configuration of resources and competences with the aim of fulfilling shareholder prospects (Johnson and Scholes 2008).

Credit risk management is consistent with the profit-maximizing objective of the bank and is evidenced by the focus of the commercial banks on providing home and personal loan packages to profitable low-risk customers (Saunders and Lange, 2004). In the case of commercial banks, the issue of credit risk is of more concern because of the higher levels of perceived risks resulting from some of the personalities of customers and business conditions that they find themselves in. Strategic management of credit risk in commercial banks starts with instituting well-organized strategies for managing the risk. Commercial banks face various risks that can be categorized into three groups: financial risk which is the likelihood that shareholders will lose money when they invest in a company that has debt, operational risk which is the prospect of loss resulting from failed procedures, systems or policies and strategic risk which is a risk that arises from making poor business decisions, from the substandard execution of decisions, from inadequate resource allocation, or from a failure to respond well to changes in the business environment.
(Cornett and Saunders, 2006). These risks have different impacts on the stability of commercial banks and are interrelated since they all result in financial instability of the commercial banks.

The magnitude and the level of loss caused by credit risk compared to others are severe and can easily cause bank failures (Richard et al, 2008). Over the years, there have been an increased number of significant bank problems in both matured and emerging economies. Credit problems, especially weakness in credit risk management, have been identified to be a part of the major reasons behind banking difficulties (Grasing, 2004). Financial institutions assume risks in their aim to create as well as maximize shareholder wealth. Risk is important for financial institutions as it affects the debt holders through capital adequacy and shareholders through return. Economic and financial crises have been linked to the lack of risk management and the willingness to adopt a more proactive risk based management styles (Bessis, 2010). Morgan (1997) pointed out that credit risk has become the key risk management challenge of today’s age.

Businesses are facing increased uncertainties as well as the commercial banks that provide the funds. Evaluating the investments of business loans has become an important issue in recent years due the large number of business failures and loan defaults among the borrowers and as a result, bank failures (Abid et al., 2016). Thus, the need for proper, proactive strategic risk management is essential for commercial banks survival in the current era of declining and uncertain market and volatile interest rate. Credit creation is the main income generating activity for the banks. But this activity involves huge risks to both the bank and the borrower.

The risk of a trading partner not fulfilling his or her obligation as per the contract can greatly jeopardize the smooth functioning of a bank’s business. On the other hand, a bank with high credit risk has high bankruptcy risk that puts the depositors in trouble. Lending
has been, and still is, the lifeblood of banking business, and this is more true to emerging economies (Richard et al., 2008; Chijoriga, 2011). The commercial banks in Kenya have witnessed substantial growth in customer lending. As a result, credit growth has brought conspicuous benefits to the economy, but the information irregularity that is prevailing in the lending environment present a real threat in the form of credit risk for the commercial banks in Kenya (Kithinji, 2010). There were 42 commercial Banks in Kenya as at April, 2016 (Maigua & Mouni 2016).

Financial stability is a crucial prerequisite not only for budgetary stability in commercial banks, but also for continued development of the economy. According to Alfi (2014) financial stability refers to a condition in which the financial system which includes commercial banks, financial markets and market structures is capable of enabling real economic activities efficiently and unraveling financial disparities arising from shocks. Vlahović (2014) contend that financial instability involves heavy costs for an economy since the instability of price variables in the financial markets upsurges economic risks and financial institutions or corporations may even go bankrupt.

These commercial banks offer both corporate and retail banking services. Licensing of financial institutions in Kenya is done by the Ministry of Finance through the Central Bank of Kenya. The Companies Act, the Banking Act and the Central Bank of Kenya, govern the banking industry. According to Central Bank of Kenya (2016), the banking sector demonstrated continued resilience both in its domestic and regional operations, with the industry’s total asset base growing by approximately 5.8 percent to KShs 3.7 trillion from KShs 3.5 trillion in 2015. The sector’s equity base also grew by 10.5 percent to KShs 598 billion in 2016 from KShs 541 billion in 2015. This performance was
registered against significant macro-economic challenges in the domestic and international environment, with Kenya’s GDP growing at 5.8 percent in 2016.

Banking sector in Kilifi County has experienced growth for the last six years after the establishment of Pwani University in Kilifi town and other business in the three major towns in Kilifi County that has brought visitors from within and outside Kenya (Fujo et al., 2016). There has been substantial expansion of the service sector as a result of this. Banking activity has been growing with about 12 banks (KCB, Barclays, Equity Bank, Cooperative Bank, Diamond Trust Bank, National Bank, Faulu, Standard Chartered, Eco Bank, Family Bank, Chase Bank and Habib Bank) as well as microfinance institutions. The study sought to establish the contribution of credit risk management strategies to the financial stability of commercial banks in Kilifi County.

1.2. Statement of the problem

Over the last five years the commercial banks in Kenya have faced problems as far as credit risk is concerned, this resulted in closure of several Banks including Imperial Bank, Dubai Bank and Chase Bank that was put under receivership. The Central Bank of Kenya pointed out that loan defaults and toxic lending practices led to the failure of the said banks. In order to survive in a dynamic environment, banks need strategies that focus on how to avoid credit risk and at a minimum cost. The strategies should adequately respond to challenges faced by the banks in trying to recover the loans advanced to customers as well as the interests. If superior and competitive strategies are effectively adopted, commercial banks can achieve long term and sustainable profitability and competitive advantage. Commercial banks have employed different strategies which have generated different performance results. With the different results, one would wonder just what the best strategy is or strategies for a bank to adopt in order to completely eliminate credit risk or loan defaults.
Credit risk management strategies is an issue of concern in commercial banks today and there is need to come up with improved strategies to deliver better results for future performance. Effective credit risk management strategies minimize the credit risk, therefore the level of loan losses. Financial stability is a priority for all managers in the banking sector. For commercial banks managers, strategic management of credit risk is equally very important. Managers need to reduce the risk of loan default because the banks financial stability is weakened by the loss of principal and interest; also banks run under objective of maximizing benefits to members which include the role of providing loans to help members improve their livelihoods. These roles may conflict with financial stability of commercial banks if managers become less strict in the lending strategies to evaluate and screen the credit risk of member borrowers.

This study seeks to evaluate the contribution of credit risk management strategies on the financial stability of commercial banks in Kilifi County.

1.3. Objective of the Study

To assess the contribution of credit risk management strategies on the financial stability of commercial banks in Kilifi County

1.3.1. Specific Objectives

1. To identify credit monitoring strategies and techniques used by commercial banks to safeguard financial stability.

2. To examine the credit terms used by commercial banks in Kilifi County to eliminate loan defaults.

3. To identify credit risk control measures used by commercial banks in Kilifi County to ensure financial stability.
4. To determine the credit recovery strategies used by commercial banks in Kilifi County to guarantee financial stability.

1.4. Research Question

1. What are the credit monitoring strategies and techniques used by commercial banks to safeguard financial stability?

2. What are the credit terms used by commercial banks to eliminate loan default?

3. What are the credit risk control measures used by commercial banks to ensure financial stability?

4. What are the recovery strategies used by commercial banks in Kilifi County to guarantee financial stability?

1.5. Significance of the Study

This study will help Commercial banks to obtain information about credit risk management strategies and its contribution on the financial stability and this information will mainly be significant and valuable to the senior management of commercial banks. This study also will help to ease exposure to the risk in all banking institutions. The government will get information on the significance of implementation of various legitimate structures in relation to credit risk management, policy making regarding credits and other regulatory requirements of commercial banks in Kilifi and in the country at large since this study will give insight of problems facing the lenders. The academicians will be equipped with information concerning strategic management of credit risk and its contribution to the financial stability of commercial banks. The study will contribute to the general knowledge and form a basis for further research.
1.6. Scope of the study

The study was carried out in Kilifi County covering three major towns in the County namely: Kilifi, Malindi and Mtwapa. The study focused on all commercial banks in Kilifi County, whose number stand at 12 currently. The respondents were (credit officer, recovery officer and branch risk head,) from each of the banks. Credit management department/division was the main focus.

1.7. Definition of terms

Credit Risk
Credit risk is defined as the probability that some of a bank’s assets, especially its loans, will decline in value and possibly become worthless (Nikolaidou & Vogiazas, 2014).

Evaluation
According to Reeve et al., (2007), evaluation is a systematic examination of values or features of a given venture, programme, activity or an object, taking into consideration the adopted criteria to enhance, improve or understand them better.

Financial stability
Financial stability is defined in terms of its ability to facilitate and enhance economic processes, manage risks, and absorb shocks (Smets and Villa 2016).

Commercial bank
The Banking Act, Cap 488 defines a bank as a company, which carries on, or purposes to carry on banking business. A bank is thus an institution that deals largely with money.

Risk
This is the vulnerability that a certain unpredictable likelihood can occur, which causes randomness in cash flow (Witzany, 2017).
Strategy

Strategy is the course and scope of an organization over the long term, which attains advantage in a changing atmosphere through its configuration of resources and competences with the aim of fulfilling shareholder prospects (Johnson and Scholes 2008).
CHAPTER TWO

2.0. LITERATURE REVIEW

2.1. Introduction

This chapter reviews the literature that relate to the study. This chapter also reviews other studies related to the study in respect to the study objectives: These include credit risk management strategies, importance of strategic credit risk management, credit recovery and collection strategies, credit control measures, empirical literature conceptual framework, research gap and contributions and summary of literature review.

2.2. Theoretical Review

2.2.1 Analysis of the Theories Related to the Study

Theories which closely relate to this study are discussed, they include: the competitive strategy theory, the resource based view theory and modern portfolio theory. The researcher discussed the three theories and how they are directly linked to the study, giving the contribution of each theory.

2.2.1.1 The Competitive Strategy Theory

Porter (1980) generic competitive strategy theory contends that there are three generic strategies that a firm can embrace. The strategies include focus, cost and differentiation. In cost leadership the firm pursues to be the low-cost producer in its industry. In differentiation, the firm pursues to deliver products benefits that other firms do not provide. In focus, the firm aims a niche with either a cost or a benefit focus. Porter recommended that a firm’s strong point ultimately falls into one of these strategies and how it strategically positions itself with the competition.
Basing on the fact that strategic resources are heterogeneously spread across firms and that these differences are established overtime, Barney (1991) examines the connection between firm resources and continued competitive advantage. Four experimental indicators of the potential of firm resources to generate continued competitive advantage can be value, rareness, inimitability, and non-substitutability. According to Barney (1991), firm resources comprise assets, competences, organizational processes, firm attributes, information and knowledge controlled by a firm that enable the firm to conceive and implement strategies that improve its efficiency and effectiveness. A firm is said to have a competitive advantage when it is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors. Thus a bank must be unique and possess strategies that are not available to other banks in order to enjoy competitive and advantage and subsequently large profit base. Such strategies should include lower but reasonable interest rate (cost leadership), better and friendly credit terms (differentiation) as well as creating and targeting a particular market segment (focus) to ensure large customer base that will yield high profitability and ultimately leading to financial stability. This is the main theory that relate to this study as it explains how a bank can fix itself in the market in order to achieve the objective of maximizing the profit thus boosting its financial stability.

2.2.1.2 Resource Based View Theory

Resource based view theory by Wernerfelt (1984) introduced the importance of an organization exceptional resources to gain a maintainable competitive advantage. The theory recommends that strategy of a firm is a function of the resources that the firm owns. These resources govern how well that company performs its activities and betters its competitors. A company will be fruitful if it has the best and most exceptional resources
appropriate for its business and strategy. The resource-based theory stems from the principle that the source of firms competitive advantage lies in their internal resources, as opposed to their positioning in the external environment. That is rather than simply evaluating environmental opportunities and threats in conducting business, competitive advantage depends on the unique resources and strategies that a firm possesses (Barney, 2001). The resource-based view of the firm predicts that certain types of resources owned and controlled by firms have the potential and promise to generate competitive advantage and eventually superior firm performance (Ainuddin et al., 2007). Although tangible assets such as financial capital and loans are necessary for operations of the firm, intangible assets such as human capital knowledge, reputation and management skills are the real sources of competitive advantage. In order to shape and keep long-term competitive vigor in the commercial banks, there is need for banks to develop resource-based strategic focus as a basis of competitive strategy. These resources if well utilized and channeled in the right direction can help to create wealth and guarantee strong financial stability of the bank.

2.2.1.3 Loan Pricing Theory

Banks should consider the difficulties of hostile selection and moral danger since it is very difficult to forecast the borrower type at the start of the banking connection (Stiglitz and Weiss, 1981). If banks set interest rates too high, they may trigger harmful selection problems because high-risk borrowers are willing to accept these high rates.

Once these borrowers receive the loans, they may develop moral hazard behavior or so-called borrower moral hazard since they are likely to take on highly risky projects or investments (Chodechai, 2004). High interest rate is also likely to scare away potential
borrowers hence reducing the customer base and thus lowers profits for the bank. The ultimate result of low profit is unstable bank in terms of finances.

As greater banking competition decreases bank profit margins goes up, banks should take on riskier investments such as advancing loan to customers in order to boost their profits. However, greater bank concentration in the lending markets may increase instability through increased risks, since higher interest rates imposed on borrowers may make it harder for them to repay their loans, thus resulting to financial instability of the banks. It is therefore sound for the banks to put in place strategies on how to price their loans in order to enjoy the competitive advantage. This theory is related to this study because it explains why it is not wise for banks to set very high interest rates.

2.3. Review of Related Literature Guided by Specific Objectives

2.3.1 Competitive Credit Risk Management Strategies

Competitive strategy is about being unique from others. A strategy must be difficult to imitate. Porter suggested that competitive strategy comprises positioning the business to exploit the value of the competences that differentiate it from its competitors.

Strategic positioning involves a firm identifying a portion of its industry where the competitive forces are weaker; where it can avoid buyer and supplier power, threats to new entrants and substitutes and price-based rivalry (Maina, 2016). The firm then adapts its value chain to survive well with the forces in its industry. This is vital in formulation of long-term, maintainable and effective strategies. According to (Porter, 1985) for organizations to endure in the market, they should articulate strategies that sufficiently respond to the competition. Such strategies should fix them at a position of advantage in the market and give them a competitive advantage in the market. Porter (1979) introduced the five competitive forces framework. Porter contends that there are five forces that
influence industry structure and therefore an organization’s strategies. Industry structure strongly influences the competitive nature and range of strategies open to the organization. Pearce et al., (2010) specifies that designing viable strategies for an organization requires a systematic understanding of the organization’s industry and competition. Mintzberg et al., (2002) defined strategy as a plan, ploy, pattern, position and perspective.

Strategy as a plan specifies an intended course of action and is designed in advance of the actions it governs. Strategy as a ploy is specific maneuvers intended to outwit a competitor. Strategy as pattern is developed without pre-conception and patterns emerge from a set of actions. Strategy as a position is locating an organization in the environment in which it can develop as sustainable competitive advantage. Strategy as a perspective gives an organization an identity and reveals the way an organization perceives the external environment (Orsato, 2006).

Barney (2007) defines a competitive strategy as an organization’s theory of how to achieve high levels of performance in the markets and industries within which it is operating. Barney explains that there are two levels of strategic decisions; business level strategies and corporate level strategies. Business-level strategies are actions firms take to gain advantages in a single market or industry and these include cost leadership, product differentiation and flexibility. Corporate-level strategies are actions that organization takes to gain advantages by operating in multiple markets or industries and these include diversification strategies, merger and acquisitions and international strategies.

Whittington (2000) describes four different perspectives on strategy. These include the classical perspective, the evolutionary perspective, the procession perspective and the systemic perspective. The classical perspective assumes that the manager has near to complete control over how to allocate the internal and external resources of the firm, and
can thus manipulate the internal organization of the firm to better suit these objectives. In this view, strategic behavior is guided by rationality, opportunism and self-interest. The evolutionary perspective places emphasis on behavioral differences between firms and on the market selection mechanisms that allow some firms to grow and survive and others to fail. The procession perspective holds that economic outcomes emerge from the interactions between individuals and between individuals and their environment. The result of this interaction is unpredictable because actions are often unintended. The systemic perspective argues that each of the above approaches is characterized by a narrow view of the world and that the rationality of a particular strategy depends on its specific historical, social and cultural context.

Strategic credit risk management is an activity designed to develop risky bank lending policies, including the definition of the fundamental objectives and the means to achieve them (Pearce 1997). Strategic management can be seen as a continuous process of selecting and implementing the goals and strategies of the organization. The effectiveness of strategic management of credit risk depends on three main strategic goals of the bank: growth, protection and development (Montana 2012). The tools of strategic management of credit risk, in our view, include: the philosophy and mission of the bank, the overall credit risk strategy, credit policy in the realization of strategic goals and objectives of the bank in the management of credit risk. The most productive approach to strategic management of credit risk lies in the definition of basic credit risk policies and preferences of banking activities in accordance with the chosen direction of development.
2.3.2 Strategic Credit Risk Management and its Importance in Commercial Banks

Credit risk is defined as the probability that some of a bank's assets, especially its loans, will decline in value and possibly become worthless (Nikolaidou & Vogiazas 2014). Credit risk is the risk of a loss resulting from the debtor's failure to meet their obligations to the bank in full when due under the terms as agreed and stipulated in the agreement (Raghavan, 2003). The literature has revealed that the most common cause that leads the banks to bankruptcy is credit risk (Zribi and Boujelbène, 2011). Credit risk is among the oldest and most important financial risks (Altman and Karlin 2009).

The Basel Committee on Banking Supervision (2010) documents that for most banks, loans are the largest and most obvious source of credit risk; however, other sources of credit risk exist throughout the activities of a bank, including in the banking book and in the trading book, and both on and off the balance sheet. Indeed, credit risk can lead to financial crisis. Financial institutions are subject to a number of risks such as credit risk, operational risk, and liquidity risk (Foot, 2002). These risks are related to each other and it is rather difficulty to isolate one from others in practice. Although credit risk has always been of primary concern to these institutions, its importance became paramount during the recent financial crisis. The financial crisis exposed the shortcomings of existing credit risk management systems, and several firms saw significant losses resulting from failure of their counterparties to deliver on contracts (Acharya et al., 2009).

As Demirgüç-Kunt and Levine (2008) argued, fast financial liberalizing worsens the risk and fragility of the whole financial system. They believe that financial crisis will take place when serious credit risk occurs. Credit risk is the consequence of inappropriate connections between different parties. Research conducted by Stiglitz and Weiss (1981) illustrates that the borrower could easily obtain more information of the project they have
invested than the lenders do. This, therefore, raises negative selection and moral hazards in the credit market. Information asymmetry could lead to the credit risk. Competition in the market could also lead to commercial banks’ credit risk.

2.3.3 Credit Risk Management strategies and Techniques Used by Commercial Banks

The goal of managing credit risk is to maximize a bank's risk adjusted rate of return by maintaining credit risk exposure within acceptable parameters (Oldfield & Santomero, 2006). Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Banks should also consider the relationships between credit risk and other risks. Strategic management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization (Bessis, 2011). Credit risk management strategies should also be applied in conjunction with sound practices related to the assessment of asset quality, the adequacy of provisions and reserves, and the disclosure of credit risk, all of which have been addressed in other recent Basel Committee documents (Oldfield and Santomero, 2006).

Oldfield and Santomero (2006) investigated risk management in financial institutions. In their study, they suggested four steps for active risk management techniques: the establishment of standards and reports; the imposition of position limits and rules (i.e. contemporary exposures, credit limits and position concentration); the creation of self-investment guidelines and strategies; and the alignment of incentive contracts and compensation (performance-based compensation contracts). Profit efficiency is sensitive to credit risk and insolvency risk but not to liquidity risk or to the mix of loan products; risk management practices are a precondition for successful financial liberalization; commercial banks are mainly faced with credit risk; loans are the largest and most obvious
source of this type of risk; inspection by branch managers and financial statement analysis are the main methods used in risk identification; and the appropriate risk weight for an off-balance-sheet contract is likely to depend on the size of the bank (Hassan & Mohammed, 2007)

2.3.4 Credit Recovery and Collection Strategies

Credit recovery is the process of following loans which have not been paid in order to recover them by convincing the debtors to repay their outstanding loans. This role of recovering loans is not a stress-free task as debtors will go out of their way to prove unreachable to the lender. Commercial banks in most cases have a debt recovery entity which is in charge of following up loans before they become default. Use of reminders has proved to be a good measure to encourage debtors to pay up their debts. Some clients are not able to remember when their debts are due. In this case, reminders such as short text (SMS), email or a simple telephone call does the magic and enable the client remember their obligation to the bank thereby making them be in a position to repay their debts (Ogolla, 2012).

The advent of Credit Reference Bureau (CRB) has brought a lot of relief to commercial banks. Dodgers have been denied a chance to default across banks as banks now have a chance to report defaults and therefore lock out these defaulters from approaching other banks and taking loans from them therefore continuing with the loan default culture across banks. In Kenya, many banks in their credit policy now check with CRB before issuing loans to borrowers (Nyaoke, 2007). Banks have continued to employ products such as direct debits, mobile banking loan repayment platforms, Mpesa, Airtel money, Orange money and agent banking among other methods to add to the traditional loan repayment techniques such as direct deposits, standing orders, checking system as well as salary
check off system by employers. These channels have made it easy for borrowers to access the bank and make their payment in time without many problems.

2.3.5 Strategic Management of Credit Risk and Control Measures by Commercial Banks

Most commercial banks have credit risk management strategies in place to identify asses and respond to credit risk. Yet many are finding these strategies inadequate for today’s volatile and uncertain environment. One crucial gap is strategic management of credit risk, that is understanding of the critical credit risk affecting the bank’s ability to reach all its strategic aspirations; making deliberate choices as to which strategies and means to use and having explicit consideration of risk-return tradeoffs during major decisions as opposed to risk mitigation to manage surprises once decision are made and are being executed (Alshatti, 2015).

Good management of credit risk strategically, requires a concerted effort by all top managers. As stewards of ensuring bank’s financial stability, they should ensure good strategies in managing credit risk. Thus, credit risk analysts should focus on issues that might emerge in future rather than focus on today’s issues; that is being strategically proactive as opposed to be reactive. Koch and Macdonald (2000) pointed out that the activities in the process of commercial banks loans follow eight steps: Application, credit analysis, decision, document preparation, closing, recording, servicing, administration and collection. The following tools: collateral, credit rationing, loan securitization and loan syndication have been used by commercial banks in controlling credit losses (Hugh, 2004). Marphatia and Tiwari (2004) argued that risk management is primarily about people – how they think and how they interact with one another.
Figure 1 gives a summary of the Credit Risk Management system as demonstrated by (Berger and Udell 2002). It is established in the financial economics literature that the Credit Risk Management system of commercial banks is made up of credit policy and strategies that offer general and thorough operative procedures. It also includes the facilitating features such as quality of workers and technology.

Figure 1: (Berger and Udell, 2002) Research model for Credit Risk Management by Banks

Source: (Berger and Udell, 2002)
2.3.6 Credit Risk Controlling Process and Risk Monitoring

According to (Basel, 2004), the management of Credit risk in banking industry follows the process of risk identification, measurement, assessment, monitoring and control. It involves identification of potential risk factors, estimate their consequences, monitor activities exposed to the identified risk factors and put in place control measures to prevent or reduce the undesirable effects. This process is applied within the strategic and operational framework of the bank. Proper risk assessment and monitoring helps bank management to discover mistakes at early stage (Al-Tamimi and Al-Mazrooei, 2007). Monitoring is the last step in the corporate risk management process and the shareholders of the institutions can use their rights to demand information in order to judge the efficiency of the risk management system (Parrenas 2005). The management report enables the shareholders to assess the status of the corporation knowledgeably and thoroughly. A key to successful strategic management of credit risk is to take a proactive action and properly monitoring and reporting the progress (Larman, 2004).

2.4. Empirical Literature

In terms of the empirical evidence, most researchers have focused on one or several countries and showed different results. In USA, Linbo (2004) evaluated efficiency versus risk and concluded that profit efficiency is sensitive to credit risk and insolvency. The study used a standard profit function and the stochastic frontier approach, and compares two standard functional forms to assess the tradeoff between precision and parsimony and found out that profit efficiency is sensitive to credit risk and insolvency risk but not to liquidity risk or to the mix of loan products. In Japan, Khambata and Bagdi (2003) evaluated the off-balance sheet credit risk across top 20 Japanese banks and found out that Loan commitments are largest source of credit. The study also indicated that financial
derivatives were heavily used by the top four banks and there is a wide difference across the banks in the use of derivative leverage.

Al-Tamimi (2002) investigated the degree to which the UAE commercial banks use risk management techniques in dealing with risks and the study found out that banks were facing credit risk and that inspection by branch managers and financial analysis were the main methods used in risk identification. The study used survey based methodology for data collection. The sample for the study comprised of six commercial banks from UAE with three non-Islamic and three Islamic banks and with 148 credit risk managers as respondents for the survey.

In Spain, Silas and Saurina (2002) evaluated credit risk in Spanish commercial banks and the findings of the study stressed on bank supervisory policy issues, the study used descriptive research design. Apparently, none of the above addresses the problems commercial banks in developing countries are facing. A study was conducted to examine the link between credit risk and bank performance by Felix and Claudine (2008) using return on asset and return on equity as measures of banks profitability and the ratio of non-performing loans to total loans as indicators of credit risk. It could be concluded from their findings that return on equity and return on assets both measuring profitability were inversely related to the ratio of non-performing loan to total loan of financial institutions thereby leading to a decline in profitability. Ahmad and Ariff (2007) carried out a study on the key determinants of banks performance and credit risk management, the outcome pointed out that credit risk of default in developing economies were higher than that of developed economies, indicating that guidelines and legal sensible requirement are important to the banking system that offers a wide range of services. Thus, judicious credit
risk management is vital in the case of loan dominated banks in emerging market and developing economies.

In Kenya, the following studies were carried: Wanjira (2010) carried out a study on the relationship between non-performing loans management practices and financial performance of commercial banks in Kenya. The study recommended adoption of non-performing loan management practices. Ochola (2009) conducted a study on the relationship between credit risk management and non-performing loans. The research found out that credit risk management coupled with close supervision by Central Bank, greatly reduces non-performing loans. Ngare (2008) conducted a survey of credit risk management practices by commercial banks in Kenya. Most commercial banks were found to use loan diversification, bank guarantees and bank covenants to mitigate against credit risk. Simiyu (2008) analyzed techniques of credit risk management and observed that many financial institutions use 6c’s techniques of credit risk management. The study also established that majority of the institutions used credit matrix to measure the credit trend and default rate.

2.5. Research Gaps and Critics

In as much as a lot of studies have been done on the impact of credit risk management and loan performance of the commercial banks, most of the local studies have put more weight on the various tools and practices of credit risk management used by commercial banks. Several studies have been carried out yet commercial banks continue to face problems that arise from credit risk caused by nonperforming loans causing financial instability and ultimately leading to bank failures as seen in the case of Dubai Bank, Imperial Bank and Chase Bank. Therefore, there existed a research gap and there was a need to conduct a research on it. For a theoretical contribution, the study fills the research
gap on the contribution of credit risk management strategies on the financial stability in commercial banks. Banks are using diversified derivatives to hedge counterparty default risks (Jones and Pérignon, 2013). The study provides more comprehensive knowledge to the readers. Also this study establishes the foundation for other researchers who wish to dig into further study of such area. The information provided in this study offers a guideline for bank managers, investors and bank supervisors. Banks thus can better arrange and allocate their resource regarding the position of credit risks.
2.6. Conceptual Framework

Indepedent Variables | Dependent Variable
--- | ---

**Monitoring strategies**
- Credit compliance
- Viability of the borrowers
- Projects approval
- Assessing results

**Credit terms**
- Time period
- Interest rates
- Market competition
- Collateral value

**Credit risk control**
- Evaluating contracts
- Credit protection
- Credit risk strategies
- Bank cash inflows

**Credit Recovery strategies**
- Time factor
- Resources
- Client compliance

Banks financial stability
2.6.1 Independent Variables

2.6.1.1 Monitoring Strategies

Monitoring Strategies play crucial role in achieving financial stability. The basic indicators in monitoring strategies can be as follows:

**Credit compliance** by the borrowers ensures that they follow the set rules and policies and in turn helps to safeguard the banks principal and interest earned. If credit compliance is observed, then the financial stability of the bank is guaranteed.

**Borrower’s viability:** this should be assessed to warrant complete repayment of loan advanced to the borrowers so as to avoid credit risk. When this element is not observed it may lead to higher credit risk consequently may result to financial instability and vice versa.

**Projects approval** is part of monitoring strategies to avert risks that arises from bad choice of ventures by the borrowers, thus projects approved should guarantee success to avoid loan default and financial instability. Assessing the results of the laid down strategies to check whether they are leading to financial stability or instability of the bank, is an integral part of good monitoring strategies aimed at profit maximization. It is through sound Projects approval that a bank realizes better financial position.

2.6.1.2 Credit Terms

Credit terms may include specific time period, rate of interest, market competition, collateral value and other conditions under which credit is advanced by financial institutions.

**Time period** given to customers to repay their loan either encourages or discourages potential borrowers this can either attract or shun away clients and it may lead to bank
financial stability similarly, holding some factors constant, the more the customer base the more the profit hence better financial position.

**Interest rates** are very sensitive parameters in any financial institutions. For instance high interest rates may warrant profitability on loans but at the same time tend to scare away potential borrowers. Therefore, when high interest rates are imposed in the short run can result to banks financial stability while in long term see can observe completely contrary effect that is high interest discourages potential borrowers and this may lead to financial instability.

**Market competition** is another important factor to be considered when spelling out credit terms; when the credit terms and conditionalities are simple and manageable compared to the competitors may attract as many potential borrowers eventually lead to banks financial stability and vice versa.

**Collateral value** of the borrower should equal or more than the principal plus the interest to guarantee full recovery of the loan and interest just in case the borrower fails to honor the contact. Good and well framed Collateral value will ensure banks recover their invested principal as well as the interests this ultimately improves the financial stability.

### 2.6.1.3 Credit Risk Control

Credit risk control ensures there are no loan failures thus making it possible for the bank to increase cash inflow and thus improving the financial stability of the bank.

**Evaluation of the contracts:** Through thorough checking of the level of compliance helps to avoid credit risk before it takes place, these safeguard the projected cash inflows and the desired financial base of the bank while poor contracts evaluation, banks experiences frequent credit risk and thus bank’s financial instability.

**Credit risk strategies:** this can be achieved through Credit protection which ensures banks biggest assets (loans) are protected and thus cash inflows is guaranteed in form of
interest earned from the loans. This helps to build a financially stable institution. Therefore Good credit risk strategies should be applied in order to protect the loan (credit) advanced to clients. This will ensure no loan default grieved by the banks and ultimately boosts the financial stability of the bank.

2.6.1.4 Credit Recovery Strategies

Developing a more focused loan recovery strategies can help commercial banks reduce the costs, save time and maximize the resources, this eventually leads to a more financially stable bank. There can be numerous ways and measures by which banks can set specific strategies for collecting and recovering money from borrowers though all these will depend on the following factors:

**Time factor:** it is healthy for the banks to recover the money in time so that it can be advanced to other customers. This helps to create more money for the bank hence leading to a more financially stable bank while if a lot time is wasted following up borrowers in order for them to pay back their loans, then the bank is moving towards instability financially.

**Resources:** banks should not use their resource to recover the loans advanced to customers, but in some cases banks are forced to use resource to recover loan including court battles. This does not only deplete the banks resources but also lead to financial instability.

**Clients’ compliance** is very important when it comes to repayment of loans advanced them. If all borrowers repay their loans in full and without much follow ups, then banks are able to realize their projected cash inflow thus leading financial stability of the bank. Banks instability arises when borrowers or customers are not honoring their contracts or are non-compliance.
2.6.2 Dependent Variable

2.6.2.1 Bank Financial Stability

The second box in the framework represents the outcome which is the **financial stability** of the commercial banks. Financial stability is defined in terms of its ability to facilitate and enhance economic processes, manage risks, and absorb shocks. This depends on how the credit risk is managed. A well-managed credit risk will have a positive and a more stable financial position, a poorly managed credit risk will have unstable or failed bank. The indicators of financial stability are: the ability of the bank to attract deposits, Capital cushion size to address expected or unexpected losses, banks readily available short term resources that can be used to meet short term obligation and the non-performing loans to total gross loans.

2.7. Summary of Literature Review

Studies have shown that even though banks are affected by many types of risk, the main type that has to be measured and monitored closely is the credit risk. Mismanagement of this type of risk has been found to bring about the occurrence of financial instability in commercial banks and ultimately the bankruptcy of commercial banks and other financial institutions causing major financial crises in various corners of the world affecting both developed and undeveloped economies. Various studies also show that credit risk is one threat that commercial banks live to fight. From the review of literature, study will focus on influence of Credit risk management strategies and its impacts on financial stability of commercial banks. This study aims at researching on contribution of credit risk management strategies on financial stability in commercial banks in Kilifi.
CHAPTER THREE

3.0. METHODOLOGY

3.1. Introduction

Research methodology is the systematic, theoretical analysis of the methods applied to a field of study, the procedures by which the researchers go about their work of describing, explaining and predicting phenomena (Rajasekar and Chinnathambi, 2006). This section discusses the study design, location of the study, target population, data collection methods and data analysis.

3.2. Study Design

According to Kothari (2004) research design is the plan and structure of investigation so conceived so as to obtain answers to research questions. The research design used in this study is descriptive research design. Descriptive research studies are made in such a way as to allow for the collection of pertinent and precise information with respect to the current status of phenomenon and whenever possible draw general conclusion from discovered facts (Lambert and Lambert, 2012). This type of research design is highly recommended especially where there are several respondents who should give answers to questions at one point in time. The design describes the state of affairs as it exists at present, it allows for collection of data using descriptive methods (Kothari, 2004). The design was adopted since the purpose of the study is to describe the relationship between credit risk management strategies and financial stability of commercial banks in Kilifi County.
3.3. Location of the Study and Target Population

The location of the study is Kilifi County, covering all the commercial banks. Kilifi County has three major towns: Mtwapa, Kilifi and Malindi. According to Mugenda (2004), target population is the entire set of units to which a researcher wants to generalize the results of the study. The target population for this study was all the commercial banks operating in Kilifi County of which the number stand at 12: Standard Chartered Bank, Eco bank, Chase bank, Family bank, Habib bank, Faulu bank, cooperative bank, equity bank, Barclays bank, KCB, Diamond Trust bank, and National bank.

3.4. Census Sample

A census survey was conducted involving all the 12 operating Commercial banks in Kilifi County. The target respondents were: credit manager, credit officer and recovery officer (three respondents for each bank) in each Commercial Bank in Kilifi County.

3.5. Sampling Techniques

The study adopted the purposive sampling technique in deciding on the respondents. The choice of the purposive sampling technique is motivated by the fact that the information on credit risk management strategies is specific and therefore experts with the requisite experience were purposively selected in order to get the data that was reliable.

3.6. Data Collection Tools

Questionnaires were used to collect data. Self-administered Questionnaires were distributed to the respondents. The questionnaires were used because they could allow the respondents to give their responses in a free environment and save time and enabled collection of large volume of qualitative data. The questionnaires were divided into two sub sections; the first section pertaining to the area of the study and the second section pertaining to the profile of the respondent (See appendix 1).
3.7. Data Collection Procedures

The questionnaires were pilot tested on five randomly selected respondents before they were administered. The purpose of the pilot testing was to ensure that the questionnaires were understood. Few modifications were made after pilot testing; this helped the researcher to get the relevant responses from the respondents. The procedure that was used to collect data was through distribution of the questionnaires that is, dropping and picking questionnaires from respondents at their most convenient time agreeable to both parties. A letter of introduction, stating the purpose of the study was attached to each questionnaire (See Appendix 2). Once filled, the researcher personally collected the questionnaires. This gave the researcher the opportunity to clarify certain issues that emerged from the various responses.

3.8. Data Analysis and Processing

Data cleaning and coding from the 36 respondents (three in each bank) was performed using Microsoft Excel. The collected data from the questionnaire and other secondary sources were systematically organized in a manner that facilitated analysis. Data pertaining to the objectives of the study were analyzed by employing descriptive statistics, tables, graphs and charts for better understanding. The data pertaining to the profile of respondents were analyzed by employing content analysis which is a technique for systematically describing written, spoken or visual communication.
3.8. 1. Ordinal Logistic Regression Analysis

Quantitative values on credit control measures were derived from questionnaire ratings using a 5-tier Likert Scale ranging from 1 - for highly disagrees to 5 - for highly agree. Robustness of the factors and cause-effect relationships were analyzed using Mann Whitney and regression tests, respectively. Mann Whitney is a test used to compare the medians of two distributions that are not normal.

Normality of the data was tested using an Anderson-Darling probability test and indicated that all entries were not normal. The Anderson–Darling test is used to test the normality of a distribution while Ordinal logistic regression is used to test the influence of an independent variable on a dependent variable both of which are not normal as well as to test cause-effect relationship between variables that are not normal.

For this reason an Ordinal Logistic Regression analysis was preferred. Microsoft Excel and MINITAB soft wares were used as an aid in the analysis. The following general ordinal logistic regression model was adopted (Bender and Grouven, 1997).

\[ Y_i = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon_i \]

Where,

Y is the dependent variable

\( \alpha \) is the constant (Y intercepts)

\( \beta \) is the coefficient

X is the independent variable (predictor variable)

The assumptions of the model are:

1. The odds are proportional
2. There is no multicollinearity

3. There is one or more independent variables that is continuous, ordinal or categorical

4. Dependent variable should be measured at the ordinal level
CHAPTER FOUR

4.0 RESULTS AND DISCUSSIONS

4.1 Introduction

This chapter presents the findings of the study and discusses the results. The discussions are guided by the research objectives. This includes credit monitoring strategies, credit terms used by commercial banks to eliminate loan defaults, credit risk control measures and credit recovery strategies. The findings are presented in tables and figures that clearly show variations in responses to the study variables.

4.2 Background Information of the Bank

General information of the bank was sought and the results are summarized in Table 4.1.

Table 4.1: Number of years the bank has been operating in Kilifi

<table>
<thead>
<tr>
<th>Period of operation</th>
<th>Frequency (f)</th>
<th>Percent (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Above 10 years</td>
<td>5</td>
<td>14%</td>
</tr>
<tr>
<td>5 to 10 years</td>
<td>6</td>
<td>17%</td>
</tr>
<tr>
<td>1 to 5 years</td>
<td>25</td>
<td>69%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>36</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Source: Research Findings

The results in Table 4.1 show that majority of the banks (69%) have been in operation in Kilifi for a period of 1-5 years, 17% said they have been operating in Kilifi for above 5 years while 14% have been in Kilifi for above 10 years. The researcher asked the question to establish whether the banks have enough understanding of the area’s environment and economic status of the region. The assumption is the longer the bank operated in an area, the more understanding of the environment in which they operate. Majority indicated that the banks have been in operation for more than one year and thus they understand their clients, economic status of Kilifi and the environment in which they operate in regard to
credit risk management thus enabling them adopt credit risk strategies that suitable for that particular area. All the banks therefore have operated in the study area long enough and thus their responses are objective. In relation to the number of full time workers the researcher asked the respondents questions and the results are represented in the table 4.2.

Table 4.2: Number of full time workers in the bank (branch)

<table>
<thead>
<tr>
<th>No. of workers</th>
<th>Frequency (f)</th>
<th>Percent (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>21-40</td>
<td>9</td>
<td>25%</td>
</tr>
<tr>
<td>≤20</td>
<td>26</td>
<td>75%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>35</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Source: Research Findings

From the above table, many (75%) commercial banks had less than 20 full time workers in the bank’s branch while 25% had between 21 and 40 workers. The researcher sought to determine how stable and developed the banks were in regard to having enough staff members to carry the banks’ operations. Banks with many staff indicate growth in terms of finances, assets and operations. It is the number of employees in any organization that indicate how big or small they are (Edmiston, 2010).
In relation to the number of years the respondent worked in the bank, the researcher came up with the following results as shown in Table 4.3.

Table 4.3: Number of years the respondent worked in the bank

<table>
<thead>
<tr>
<th>Employees’ experience in years</th>
<th>Frequency (f)</th>
<th>Percent (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>less than 1 year</td>
<td>2</td>
<td>6%</td>
</tr>
<tr>
<td>between 1 and 5 years</td>
<td>21</td>
<td>58%</td>
</tr>
<tr>
<td>between 6 and 10 years</td>
<td>7</td>
<td>19%</td>
</tr>
<tr>
<td>10 years and above</td>
<td>6</td>
<td>17%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>36</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Source: Research Findings

From table 4.3 clearly shows that majority who constitute 58% had worked in their respective banks for a period between 1 and 5 years while 19% had worked in the bank for a period between 6 and 10 years, 17% had worked for 10 years and above moreover only 6% had an experience of less than a year. This is a confirmation that most of the respondents have been in the bank long enough thus they have more experience in credit risk management strategies and loan portfolio management of that particular bank.

On the question of number of branches each bank had in the country, the findings are represented in table 4.4

Table 4.4: Number of branches in Kenya

<table>
<thead>
<tr>
<th>No. of branches in Kenya</th>
<th>Frequency (f)</th>
<th>Percent (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Between 20 and 30</td>
<td>3</td>
<td>8%</td>
</tr>
<tr>
<td>More than 30</td>
<td>32</td>
<td>92%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>35</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Source: Research Findings

Table 4.4 shows that majority of the banks had more than 30 branches in Kenya and these constitute 92% of the banks while only a few had between 20 and 30 branches in Kenya
8%. The number of branches a bank has is an indicator of the size of the bank and area of coverage in the Kenya. The wider the branch network, the wider the area of coverage and the more established a bank is.

4.3 Credit Monitoring Strategies Used by Commercial Banks in Kilifi County

Under this objective the researcher sought to identify credit monitoring strategies used by commercial banks to safeguard financial stability. The respondents were asked whether their respective banks had credit manuals and also indicate factors that normally prompt the bank to change its policies to manage risk; whether their banks carry out project approval for borrowers to ensure that they invest the loans advanced to them in viable projects; the approaches employed by the banks to identify or prove viability of the borrowers. Finally the respondents were asked to identify the approaches that described the way risk management is reported within their banks.

4.3.1 Credit Manual as a Determinant of Credit Risk Management Strategies

The respondents were asked questions on whether they agree that their bank had credit manual which elaborates well the strategies for managing credit risk.

Figure 4.1 vividly illustrate the respondents’ perception on credit manual in managing credit risk in their respective banks.
Figure 4.1: Respondents’ perceptions on the credit manual in managing credit risk in their banks

From Figure 4.1, it is evident that most of the respondents constituting 64% strongly agreed that their banks had credit manuals for managing credit risk. The finding of the study also shows that 36% of the respondents agreed on the statement that their banks have credit manual for managing risks. This means that all the banks process credit manuals and as a result the banks can manage their credit risk since the workers operate under the same guidelines or policies developed by the bank. Commercial banks cannot survive without such policy documents because it helps the banks to deal with uncertainties that come with non-performing loans that brings about credit risk. Structures and processes of the banks are most effective when their design function match their environment and impact to bank’s strategies (Matej, 2008).
4.3.2 Examination of Factors that Prompt Bank to Change Policies to Manage Risk

The study sought to examine factors that normally prompt the bank to change its policies to manage risk.

These findings have been well illustrated in the figure 4.2 below.

![Figure 4.2: factors that prompt policy changes in regard to credit risk](image)

Figure 4.2: factors that prompt the bank to change its policies to manage risk

The findings in figure 4.2 indicate that Central Bank is the key player in determining policy changes. This is clear as 56% of the respondents agreed that Central Bank is the major factor that prompts the bank to change their policies in regard to credit risk management. From the figure also 28% said that prevailing competition make them change their policies, 11% indicated that environmental factors is a key factor in determining the way they frame their policies while 6% said that technology advancement prompt them to change their credit risk management policies. Central Bank carries out both on-site surveillance and off-site surveillance. On-site surveillance involves routine inspections conducted by Central Bank officers (inspectors) at the institution’s places of
business to examine business records to confirm the institution’s state of compliance with the legal and regulatory requirements. Off-site surveillance entails the review of the periodic returns submitted to the Central Bank by the commercial banks.

4.3.3 Project Approval for Borrowers by the Banks

To establish whether the banks carry out projects approval for borrowers, the respondents were asked whether their bank took responsibility of evaluating the projects undertaken by the clients and findings of the survey are presented in Table 4.5

Table 4.5: Awareness of the respondents on the project approval by the banks

<table>
<thead>
<tr>
<th>Project approval by banks</th>
<th>Frequency (f)</th>
<th>Percent (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>33</td>
<td>92%</td>
</tr>
<tr>
<td>No</td>
<td>3</td>
<td>8%</td>
</tr>
<tr>
<td>Total</td>
<td>36</td>
<td>100%</td>
</tr>
</tbody>
</table>

**Source: Research Findings**

Table 4.5 reveal that more than four fifth that is 92% of the respondents were aware of the project evaluation and approval by their banks for the borrowers. This confirms that banks in one way participate in ensuring that the loans they give to their customers are invested wisely and there is surety that borrowers will be able to repay their loan not only in time but also in full. 8% indicated that they were not aware of any activity involving projects approval by their banks; this poses a threat indirectly to the bank as borrowers could invest in unviable projects thus making them unable to repay their loan therefore loan default to the banks. The act of project approval aids in avoiding unnecessary losses to the borrowers and ultimately to the bank.
4.3.4 Credit Worthiness of the Borrowers

The respondents were asked on the approaches employed by their respective banks to identify or to prove the viability of the borrowers. The results are shown in Table 4.6

Table 4.6: Approaches employed by the bank to identify viability of the borrowers

<table>
<thead>
<tr>
<th>Approaches</th>
<th>Frequency (f)</th>
<th>Percent (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity based approach</td>
<td>7</td>
<td>19%</td>
</tr>
<tr>
<td>Sensitivity analysis</td>
<td>7</td>
<td>19%</td>
</tr>
<tr>
<td>Credit portfolio view</td>
<td>22</td>
<td>61%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>36</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

**Source: Research Findings**

Credit portfolio approach seems to be the most preferred by commercial banks in (61%) identifying viability of the borrowers, equity based and sensitivity analysis approaches are preferred by a few respectively (19%) as a way of determining the and proving the credit worthiness of the borrowers. It is important to understand the character of every borrower in regard to his or her ability to repay the loans given to them so as to only give or advance loans to those who have the highest chances of repaying the loan not only in full but in time. Equity based approach also known as asset-based lending is any kind of lending between the bank and the borrower that is secured by an asset (Shadab, 2013). This asset could be anything and is taken by the bank in case the borrower hasn’t re-paid the money back to the bank as agreed. Sensitivity analysis is an approach based on evaluating borrowers’ repayment capacity and general loan performance based on the level of risk exposure regarding the business they invest (Barnard and Yeager, 2013). Credit Portfolio View is an approach based upon the argument that loan default (non-performing loans) and migration probabilities are not independent of the business cycle but the prevailing economic status (Derbali, 2011). Credit portfolio view in risk includes
assessing the risk involved with each potential loan given to borrowers and analyzing the total amount of risk the portfolio incurs as a whole. The process is crucial to the banks who issue loans as a major part of doing business. Majority of the banks seems to prefer this because it helps to identify the viable borrowers and thus averting financial crisis that comes with loan default.

4.3.4 Reporting of Risk Management

The respondents were asked to identify the approach used by their banks to report on risk management. The findings are presented in Figure 4.3.

![Figure 4.3: Approaches of risk management](image)

In figure 4.3, the respondents were to shed some lights on the way risk management is reported in their respective banks. 61% of the respondents believed that there was continuous management reporting on credit risk while 39% of the respondent indicated that risk reporting took place on regular bases. It is clear from the figure that all the respondents agreed that risk reporting is a usual business in their banks. This helps the bank to make reactive measures in advance to avert impending credit risks.
4.4 Determination of Credit Terms used by the Commercial Banks to Eliminate Loan Defaults

This is where the researcher sought to determine credit terms used by commercial banks to eliminate loan defaults. The analysis focused on the frequency with which their bank check borrowers’ collateral value to ensure the loan is safeguarded and the common items used as collaterals, the most preferred period by borrowers to repay their loan and the interest rates that yield high profit for their banks. The objective also sought to determine the ease with which the customers accessed loans from the banks.

4.4.1 Borrowers’ Collateral Value Used to Secure Loan

The respondents were asked to indicate the frequency with which their bank checks borrowers’ collateral value to ensure the loan is safeguarded. The results are as shown in Figure 4.4.

Figure 4.4: Frequency for checking borrowers’ collateral value
From the figure 4.4 shows 47% indicated that their bank checked the borrowers’ collateral value often while 44% have also indicated that their banks check the borrowers’ collateral value very often and only 8% said that their banks rarely checked the borrowers’ collateral value. It is clear from the figure above that banks check the borrowers’ collateral value frequently. This is to ensure the value of the items used as collaterals does not depreciate below the value of the loan advanced to the borrowers. It also helps the bank to safeguard both the principle and the interest hence ensuring that the banks financial stability is guaranteed as far as income from loans is concerned.
4.4.2 Items Used as Collaterals by Borrowers to Secure Loans from the Banks

The respondents were queried further to identify the most common item used as collateral to secure loans. The findings are captured in Figure 4.5.

![Bar chart](image)

Figure 4.5: Items used as collaterals to secure loan in the bank.

From Figure 4.5, it emerges that land (title deeds) is the most preferred item used to secure loans in the bank as confirmed by 66%. Nevertheless, business units and car logbooks at 34% respectively serves as collaterals in some instances. With land the banks are assured of security for the loan advanced to the customers just in case the borrower is not able to repay the loan as agreed. This is informed by the fact that land value keeps on appreciating every year unlike other assets such as cars that depreciate with time.
4.4.3 Preferred Period by Borrowers to Repay their Loan

The respondents were asked to ascertain the most preferred period by borrowers to repay their loan. The results are as shown in Table 4.7

Table 4.7: Preferred period by borrowers to repay their loans

<table>
<thead>
<tr>
<th>Repayment Period in months</th>
<th>Frequency (f)</th>
<th>Percent (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>2</td>
<td>6%</td>
</tr>
<tr>
<td>12</td>
<td>5</td>
<td>14%</td>
</tr>
<tr>
<td>24</td>
<td>8</td>
<td>22%</td>
</tr>
<tr>
<td>36</td>
<td>15</td>
<td>42%</td>
</tr>
<tr>
<td>≥60</td>
<td>6</td>
<td>17%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>36</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Source: Research Findings

As per the responses, many borrowers prefer 36 months (42%) and above to repay their loans, however, 22% and 17% of the respondents have indicated that borrowers also prefer a period of 24 months and more than 60 months respectively as a repayment periods. Every borrower need enough time to prepare for loan repayment as many investments takes time to establish and able to generate enough profit to guarantee loan servicing without the business collapsing.
4.4.4 Interest Rates that Yield High Profit for their Banks

The respondents were asked to indicate the interest rates that yield high profit for their banks. The results are as in figure 4.6.

Figure 4.6: Preferred interest rates

From figure 4.6 above, respondents answered a question on the preferred interest rates that their respective banks use and that is able to yield profit for the banks. Majority (53%) said that interest rates of between 16 to 19 is good for the bank, 28% of the respondents indicated that interest rates of above 20% is preferred and yields high profit for their banks while 19% preferred interests rates. The banks choose interest rates that will give them high returns as well as attracts potential borrowers. This problem has been solved by the central bank regulations thus saving the borrowers the agony of dealing with high interest rates imposed to them by the commercial banks.
4.4.5 Accessibility of the Loans by Borrowers from the Banks

The respondents were asked the ease with which the customers can access loans in their bank. The results are presented in Figure 4.7.

![Figure 4.7: Accessibility of loans by customers](image)

Findings in Figure 4.7 show that 67% of the respondents have indicated that customers normally accessed loans from their banks (within the stipulated time and regulations by the bank). The remaining one third (33%) of the respondents acknowledge that the customers easily access the loans in their banks. Business growth is predicated upon many factors among these, is the ability of the business people to access credit facilities. Ninety percent of all small and micro enterprise collapse in their first year of startup, due to lack of financial resources (Kimuyu & Omiti, 2000). Therefore, demand for loanable funds arises and more new businesses are launched. In as much as commercial banks have the responsibility of giving their customers loans to help them advance economically, measures to ensure no losses for the banks should be in place.
4.5 Credit Risk Control Measures Used by Commercial Banks in Kilifi County

The third objective pursued to establish credit risk control measures used by commercial banks to eliminate credit risk and their contribution to averting financial instability in the bank. The study sought to ascertain whether banks used the tools that were listed to control credit losses and the degree to which banks carried out the activities that were given. The results were as follows.

4.5.1 Investigation of Tools Used to Control Credit Losses

The respondents were answering a question on the tool used in their respective banks to control credit losses. The tools were given in a table they were to choose the degree of use in the bank. The findings are as in the Table 4.8

Table 4.8: Tools used by commercial banks to control credit losses

<table>
<thead>
<tr>
<th>Variables</th>
<th>Very much</th>
<th>Much</th>
<th>Somehow</th>
<th>Neutral</th>
<th>Not at all</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agreements</td>
<td>33</td>
<td>36</td>
<td>17</td>
<td>8</td>
<td>6</td>
</tr>
<tr>
<td>Collaterals</td>
<td>67</td>
<td>31</td>
<td>3</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Credit rationing</td>
<td>50</td>
<td>28</td>
<td>6</td>
<td>17</td>
<td>0</td>
</tr>
<tr>
<td>Loan securitization</td>
<td>44</td>
<td>33</td>
<td>8</td>
<td>14</td>
<td>0</td>
</tr>
<tr>
<td>Evaluating contracts</td>
<td>50</td>
<td>33</td>
<td>8</td>
<td>6</td>
<td>3</td>
</tr>
<tr>
<td>Credit protection</td>
<td>64</td>
<td>33</td>
<td>0</td>
<td>3</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Research Findings

From Table 4.8, 69% of the respondents confirmed that they use agreement much and very much as a tool to control credit losses. Agreement helps both the bank and the borrowers because it sets out the terms and conditions under which it is prepared to make
a loan available to a borrower. It also helps the borrower understands his/her obligation in regards to repayment of the loan as well as making them aware of the consequences in case they fail to repay the loan as per the agreement.

The results from the table also indicate that more than two thirds agree that their banks use collaterals very much to control credit losses. These are the items against which the borrowers secure loan from the bank. In case the borrowers are not able to repay the loans the items are sold to help the bank recover their money hence avoiding the effects of credit losses and ultimately keeping them stable financially.

The findings also indicate that half of the respondents very much agree that their banks use credit rationing and evaluation of contracts to control credit losses. It is always healthy for the banks to evaluate contracts signed by the borrowers to ensure that the terms and conditions are being followed to avoid losses to the banks. Credit rationing helps the banks who are the lenders to safeguard their financial stability by limiting the supply of additional credit to borrowers who demand funds, even if they are willing to pay higher interest rates (Mishkin, 1997). This especially happens when the borrowers cannot provide sufficient collaterals to secure the loans; this is taken as a precautionary measure against credit losses.

The findings in the table show that over half of the respondents acknowledged that their banks use credit protection as way of controlling credit losses. Credit protection insures repayment of credit if the borrower dies, becomes ill or disabled, loses a job, or faces other circumstances that may prevent them from earning income to service the debt. This works to the advantage of the banks or lenders as some of the borrowers may suffer one of the misfortunes and hence cautioning against the losses that may arise.
4.5.2 Activities Carried Out by Commercial Banks as a Measure to Control Credit Losses

The study sought to determine the degree of use of the activities that were given in a table as a measure of credit loss control. The results are shown in the figure 4.8.

![Figure 4.8: Activities carried by the banks as a measure of credit loss control](image)

From Figure 4.8 the results indicate that 67% very much agree that their bank support borrowers in dealing with situations as they arise while 47% of the respondents very much agree that their banks create an atmosphere that encourages the borrowers’ problem solving in collaboration with the respective banks. On the other hand, 58% of the respondent also agreed very much that their respective banks monitor the borrowers’ business progress and also pay visit to the business sites. All these activities encourage
the borrowers to deal with the challenges as they arise as they are assured of the banks’ support.

**4.5.3 Quantitative Analysis on Credit Control Measures**

Quantitative values on credit control measures were derived from questionnaire ratings using a 5-tier Likert Scale ranging from 1 - for highly disagrees to 5 - for highly agree. Data cleaning and coding was performed using Microsoft Excel whereas robustness of the factors and cause-effect relationships were analyzed using Mann Whitney and regression tests, respectively on Minitab statistical package (ver 14). Normality of the data was tested using an Anderson-Darling probability test and indicated that all entries were not normal. For this reason an Ordinal Logistic Regression analysis was preferred. The results are presented and discussed below.

**4.5.3.1 Robustness of Credit Control Measures**

Mann Whitney tests of medians were run to determine whether banks in Kilifi perceived credit control policies to be appropriate for a variety of credit scenarios among clients and whether some measures were considered superior to others. The results are summarized in Table 1 below. Collaterals and Credit protection were considered to be equally robust tools to control credit losses but superior to agreements (W=1584 p=0.2902), credit rationing (W=1860.5 p=0.0001), credit rationing (W=1782 p=0.0352) and contract evaluation (W=1712.5 p=0.0368).
Table 4.9: Mann Whitney Test comparisons for various credit control measures (n=36)

<table>
<thead>
<tr>
<th>Comparisons</th>
<th>W</th>
<th>P</th>
</tr>
</thead>
<tbody>
<tr>
<td>Collaterals &gt; Agreements</td>
<td>1860.5</td>
<td>0.0001*</td>
</tr>
<tr>
<td>Collaterals &gt; Credit ration</td>
<td>1782.0</td>
<td>0.0352*</td>
</tr>
<tr>
<td>Collaterals &gt; Contract Evaluation</td>
<td>1712.5</td>
<td>0.0194*</td>
</tr>
<tr>
<td>Collaterals &gt; Credit protection</td>
<td>1584.0</td>
<td>0.2902</td>
</tr>
<tr>
<td>Regular contact &gt; Problem solving</td>
<td>1427.5</td>
<td>0.0751</td>
</tr>
<tr>
<td>Regular contact &gt; Supporting borrowers</td>
<td>1480.0</td>
<td>0.0194*</td>
</tr>
<tr>
<td>Regular contact &gt; Monitoring progress</td>
<td>1385.5</td>
<td>0.1738</td>
</tr>
<tr>
<td>Regular contact &gt; Regular review</td>
<td>1446.0</td>
<td>0.0482*</td>
</tr>
<tr>
<td>CRM &gt; Evaluation frequency</td>
<td>1459.5</td>
<td>0.0313*</td>
</tr>
<tr>
<td>CRM &gt; Repayment period</td>
<td>1717.5</td>
<td>0.0000*</td>
</tr>
<tr>
<td>CRM &gt; CRS</td>
<td>1399.0</td>
<td>0.1348</td>
</tr>
</tbody>
</table>

*indicates that results were significant at 95%

Key credit control services were also subjected to a similar test. The results indicated that Regular contact with borrowers, creating an atmosphere that encourages problem solving and monitoring progress of borrowers’ businesses through their bank accounts (W=1427.5 p=0.0751), (W=1386.5 p=0.1738), and (W=1446 p=0.0313) respectively, were all equally robust compared to supporting borrowers when in problems and dealing with situations as they arise (W=1480 p=0.0194).

4.5.3.2 Factors Affecting the Choice Credit Control Strategies

Ordinal logistic regression models were ran to determine factors that influenced banks in Kilifi to adopt a particular credit control strategy. Successful models were identified based on the significance of factors to the model (p-value), significance of the overall model (p-value), ability to fit the data (Pearson’s p-value) and predictive capability (Somers’ D). The following general ordinal logistic regression model was adopted (Bender and Grouven, 1997).
$Y_i = \alpha_0 + \beta_1 X_i + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4$

Where,

$Y$ is the dependent variable

$\alpha$ is the constant ($Y$ intercepts)

$\beta$ is the coefficient

$X$ is the independent variable (predictor variable)

The findings are explained for each strategy as follows:

4.5.3.3 Credit Protection

Although the relationship between factors analyzed was significant ($p=0.041$), relatively robust ($p=0.69$) and with a reasonable predictive capability (Somers’ $D=0.57$), none of the factors had a significant influence ($p>0.05$). The model gained significance ($p=0.015$) when it was regressed against Evaluation frequency ($p=0.022$) but with declines in robustness (Pearson $p=0.47$) and predictive capability (Somers’ $D=0.39$) see table 3. It follows, therefore, that the factor “Frequency of evaluating loan contracts” provided bank managers an opportunity to understand borrowers’ challenges and vice-versa and perhaps strengthened commitment from the two parties to identify and overcome credit repayment challenges. With a greater sample size was credit protection was expected to enhance the predictive capacity of the model. In the model the variable are as follows:

CreditProt = 10.977 ($\alpha_1$)+ 14.507 ($\alpha_2$) -1.59299 (CRM) – 1.15443 ($X_1$) -0.325 ($X_2$) – 0.38 ($X_3$)
Where,

Y is the credit protection, (Dependent variable)

$X_1$ is the frequency of evaluating collateral

$X_2$ is the repayment period

$X_3$ is the credit risk strategy

(Evaluating collateral, repayment period and credit risk strategy are independent variables)

Table 4.10: Table of regression analysis with CRM, Evaluation frequency, repayment period and CRS (n=36)

<table>
<thead>
<tr>
<th>Predictor</th>
<th>Coefficient</th>
<th>SE</th>
<th>Z</th>
<th>P</th>
<th>Odds Ratio</th>
<th>Lower</th>
<th>Upper</th>
</tr>
</thead>
<tbody>
<tr>
<td>Const (1)</td>
<td>10.98</td>
<td>6.50</td>
<td>1.69</td>
<td>0.091</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Const (2)</td>
<td>14.51</td>
<td>6.58</td>
<td>2.20</td>
<td>0.028</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CRM</td>
<td>-1.59</td>
<td>1.09</td>
<td>-1.46</td>
<td>0.144</td>
<td>0.20</td>
<td>0.02</td>
<td>1.72</td>
</tr>
<tr>
<td>Evaluation Freq</td>
<td>-1.15</td>
<td>0.71</td>
<td>-1.62</td>
<td>0.105</td>
<td>0.32</td>
<td>0.08</td>
<td>1.28</td>
</tr>
<tr>
<td>Repayment period</td>
<td>-0.33</td>
<td>0.50</td>
<td>-0.64</td>
<td>0.519</td>
<td>0.72</td>
<td>0.27</td>
<td>1.94</td>
</tr>
<tr>
<td>CRS</td>
<td>-0.38</td>
<td>0.60</td>
<td>-0.64</td>
<td>0.522</td>
<td>0.68</td>
<td>2.19</td>
<td>2.75</td>
</tr>
</tbody>
</table>
Table 4.11: Regressing the influence of evaluation frequency on a bank's choice of credit control measures (n=36)

<table>
<thead>
<tr>
<th>Predictor</th>
<th>Coefficient</th>
<th>SE Coef</th>
<th>Z</th>
<th>P</th>
<th>Odds Ratio</th>
<th>Lower</th>
<th>Upper</th>
</tr>
</thead>
<tbody>
<tr>
<td>Const (1)</td>
<td>2.39</td>
<td>2.64</td>
<td>0.90</td>
<td>0.367</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Const (2)</td>
<td>5.67</td>
<td>2.70</td>
<td>2.10</td>
<td>0.036</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Evaluation Freq</td>
<td>-1.44</td>
<td>0.63</td>
<td>-2.29</td>
<td>0.022</td>
<td>0.24</td>
<td>0.07</td>
<td>0.81</td>
</tr>
</tbody>
</table>

4.5.3.4 Regular Contacts with the Borrower

A model comprising all factors had a significant explanation of the choice of regular contacts (p=0.04) although more by chance than by the model factors (p>0.077). Other factors beyond those modeled were thought to have influenced this choice. The variables in the model are as follows:

Regular Cont’’ = 5.68 (α_1) + 7.62 (α_2) + 9.30 (α_3) - 0.12(CRM) - 1.25 (X_1) - 0.48 (X_2) - 0.56(X_3)

Where,

Y is the regular contact with borrowers, (Dependent variable)

X_1 is the frequency of evaluating collaterals,

X_2 is the repayment period

X_3 is the credit risk strategy
Table 4.12: Regressing the influence of CRM, evaluation frequency, repayment period and CRS on regular contacts with borrowers as a credit control measures (n=36)

<table>
<thead>
<tr>
<th>Predictor</th>
<th>Coefficient</th>
<th>SE Coef</th>
<th>Z</th>
<th>P</th>
<th>Odds Ratio</th>
<th>Lower</th>
<th>Upper</th>
</tr>
</thead>
<tbody>
<tr>
<td>Const (1)</td>
<td>5.68</td>
<td>6.20</td>
<td>0.92</td>
<td>0.359</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Const (2)</td>
<td>7.62</td>
<td>6.14</td>
<td>1.24</td>
<td>0.214</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Const (3)</td>
<td>9.30</td>
<td>6.19</td>
<td>1.50</td>
<td>0.133</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CRM</td>
<td>-0.12</td>
<td>1.06</td>
<td>-0.11</td>
<td>0.910</td>
<td>0.89</td>
<td>0.11</td>
<td>7.03</td>
</tr>
<tr>
<td>Evaluation Freq</td>
<td>-1.25</td>
<td>0.70</td>
<td>-1.77</td>
<td>0.077</td>
<td>0.29</td>
<td>0.07</td>
<td>1.14</td>
</tr>
<tr>
<td>Repayment period</td>
<td>-0.48</td>
<td>0.47</td>
<td>-1.02</td>
<td>0.306</td>
<td>0.62</td>
<td>0.24</td>
<td>1.55</td>
</tr>
<tr>
<td>CRS</td>
<td>-0.56</td>
<td>0.56</td>
<td>-1.00</td>
<td>0.315</td>
<td>0.57</td>
<td>0.19</td>
<td>1.71</td>
</tr>
</tbody>
</table>

4.5.3.5 Problem Solving

Besides evaluation frequency (p=0.001), the other model factors had a chance effect on the choice of problem solving (p>0.17) inasmuch as the model had a highly significant influence (p=0.001), relatively robust and with a high predictive capability (Somers’ D=0.64). On its own, evaluation frequency’s (p=0.000), enhanced the model’s significance (p=0.000), robustness (p=0.789) and reliability (Goodman-Kruskal Gamma=0.86). This implied that within a range of 3-32% (at 95% confidence interval), evaluation frequency could explain 78.9% of the variation in the decision to choose problem solving to manage credit risks 86% of the times. It is possible that during these sessions, the bank managers were able to understand financial challenges hindering the client from servicing the loan and were therefore better at customizing solutions that not only enhanced repayment but also communication and overall customer experience. The variables in the model are as follows:

Problemsolving=12.73(α1)+13.65(α2)+14.49(α3)+17.57(α4)-1.03(CRM)-2.39X₁-0.64X₂+0.00X₂
Where,

Y is problem solving, (Dependent variable)

X₁ is the frequency of evaluating collaterals,

X₂ is the repayment period

X₃ is the credit risk strategy

Table 4.13: Regressing the influence of CRM, evaluation frequency, repayment period and CRS on problem solving as a credit control measures (n=36)

<table>
<thead>
<tr>
<th>Predictor</th>
<th>Coefficient</th>
<th>SE Coef</th>
<th>Z</th>
<th>P</th>
<th>Odds Ratio</th>
<th>Lower</th>
<th>Upper</th>
</tr>
</thead>
<tbody>
<tr>
<td>Const (1)</td>
<td>12.73</td>
<td>6.28</td>
<td>2.03</td>
<td>0.043</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Const (2)</td>
<td>13.65</td>
<td>6.25</td>
<td>2.18</td>
<td>0.029</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Const (3)</td>
<td>14.49</td>
<td>6.25</td>
<td>2.32</td>
<td>0.020</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Const (4)</td>
<td>17.57</td>
<td>6.51</td>
<td>2.70</td>
<td>0.007</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CRM</td>
<td>-1.03</td>
<td>1.01</td>
<td>-1.01</td>
<td>0.311</td>
<td>0.36</td>
<td>0.05</td>
<td>2.61</td>
</tr>
<tr>
<td>Evaluation Freq</td>
<td>-2.39</td>
<td>0.74</td>
<td>-3.23</td>
<td>0.001</td>
<td>0.09</td>
<td>0.02</td>
<td>0.39</td>
</tr>
<tr>
<td>Repayment period</td>
<td>-0.64</td>
<td>0.47</td>
<td>-1.37</td>
<td>0.170</td>
<td>0.53</td>
<td>0.21</td>
<td>1.31</td>
</tr>
<tr>
<td>CRS</td>
<td>0.00</td>
<td>0.53</td>
<td>0.01</td>
<td>0.996</td>
<td>1.00</td>
<td>0.36</td>
<td>2.82</td>
</tr>
</tbody>
</table>

4.5.3.5 Supporting Borrowers

Frequency of evaluating collateral (p=0.007) among other factors under analysis had a highly significant impact on the choice to support borrowers (p=0.006) a moderately strong predictive capability but very weak goodness of fit (p=0.006). Co-linearity or external factors could have been responsible at influencing the choice of this strategy. The variables in the model are as follows:

Problemsolving=2.66(α₁)+4.79(α₂)-0.50(α₃)+1.38(CRM)-1.81X₁-0.43X₂-0.27X₃
Where,

Y is Problem solving, (Dependent variable)

$X_1$ is the frequency of evaluating collaterals,

$X_2$ is the repayment period

$X_3$ is the credit risk strategy

Table 4.14: Regressing the influence of CRM, evaluation frequency, repayment period and CRS on supporting borrowers as a credit control measures (n=36)

<table>
<thead>
<tr>
<th>Predictor</th>
<th>Coefficient</th>
<th>SE Coef</th>
<th>Z</th>
<th>P</th>
<th>Odds Ratio</th>
<th>95% Confidence Interval</th>
</tr>
</thead>
<tbody>
<tr>
<td>Const (1)</td>
<td>-0.50</td>
<td>4.69</td>
<td>-0.11</td>
<td>0.915</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Const (2)</td>
<td>2.66</td>
<td>4.62</td>
<td>0.58</td>
<td>0.57</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Const (3)</td>
<td>4.79</td>
<td>4.67</td>
<td>1.03</td>
<td>0.305</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CRM</td>
<td>1.38</td>
<td>0.92</td>
<td>1.51</td>
<td>0.132</td>
<td>3.98</td>
<td>0.66 - 24.00</td>
</tr>
<tr>
<td>Evaluation Freq</td>
<td>-1.81</td>
<td>0.67</td>
<td>-2.69</td>
<td>0.007</td>
<td>0.16</td>
<td>0.04 - 0.61</td>
</tr>
<tr>
<td>Repayment period</td>
<td>-0.43</td>
<td>0.38</td>
<td>-1.13</td>
<td>0.257</td>
<td>0.65</td>
<td>0.31 - 1.36</td>
</tr>
<tr>
<td>CRS</td>
<td>-0.27</td>
<td>0.54</td>
<td>-0.50</td>
<td>0.620</td>
<td>0.76</td>
<td>0.26 - 2.22</td>
</tr>
</tbody>
</table>

4.5.3.6 Monitoring Progress

There was no statistical explanation for choice of monitoring progress as a credit risk management strategy based on the analysed factors (p=0.376). Additionally, the model was very biased (Pearson’s p=0.002) and had a very low predictive ability (Somer’s D=0.26). The variables in the model are as follows:

Monitoring progress=$3.02(\alpha_1)+4.22(\alpha_2)+5.27(\alpha_3)-0.15(CRM)-0.95X_1-0.16X_2-0.07X_3$
Where,

Y is monitoring progress, (Dependent variable)

X₁ is the frequency of evaluating collaterals,

X₂ is the repayment period

X₃ is the credit risk strategy.

Table 4.15: Regressing the influence of CRM, evaluation frequency, repayment period and CRS on monitoring progress as a credit control measures (n=36)

<table>
<thead>
<tr>
<th>Predictor</th>
<th>Coefficient</th>
<th>SE Coef</th>
<th>Z</th>
<th>P</th>
<th>Odds Ratio</th>
<th>Lower</th>
<th>Upper</th>
</tr>
</thead>
<tbody>
<tr>
<td>Const (1)</td>
<td>3.02</td>
<td>4.09</td>
<td>0.62</td>
<td>0.538</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Const (2)</td>
<td>4.22</td>
<td>4.90</td>
<td>0.86</td>
<td>0.389</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Const (3)</td>
<td>5.27</td>
<td>4.92</td>
<td>1.07</td>
<td>0.284</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CRM</td>
<td>-0.15</td>
<td>0.88</td>
<td>-0.17</td>
<td>0.868</td>
<td>0.15</td>
<td>4.85</td>
<td></td>
</tr>
<tr>
<td>Evaluation Freq</td>
<td>-0.95</td>
<td>0.62</td>
<td>-1.54</td>
<td>0.124</td>
<td>0.39</td>
<td>0.11</td>
<td>1.30</td>
</tr>
<tr>
<td>Repayment period</td>
<td>-0.16</td>
<td>0.39</td>
<td>-0.40</td>
<td>0.687</td>
<td>0.39</td>
<td>0.39</td>
<td>1.85</td>
</tr>
<tr>
<td>CRS</td>
<td>-0.07</td>
<td>0.51</td>
<td>-0.14</td>
<td>0.886</td>
<td>0.34</td>
<td>2.51</td>
<td></td>
</tr>
</tbody>
</table>

4.5.3.7 Regular Review of Bank Account Reports

Frequency of evaluating collateral was the only significant factor (p=0.13) affecting the choice of regular reviews but the model relationship was significant (0.04) but not robust (p=0.008) or reliable enough (Somers’ D=0.43). The variables in the model are as follows:

Regular Review”=1.13(α₁)+2.85(α₂) +1.14(CRM)-1.64X₁-0.03X₂-0.165X₃

Where,

Y is the regular review of account reports, (Dependent variable)
$X_1$ is the frequency of evaluating collaterals,

$X_2$ is the repayment period

$X_3$ is the credit risk strategy

4.5.3.8 Summary of Findings

From the findings it could be plausibly concluded that credit protection as a strategy, to a great part contemplated as collateral by the bank, provided the most appropriate measure for handling multidimensional risks to credit for a diverse clientele operating in diverse client risk scenarios. Frequency of evaluating collateral, therefore, became a rational means for constantly assessing the credit risks and in the process provided a means for enhancing decision-making for the client either through provision of technical support or extension services to the investment projects. The resulting customer experience is thought to have strengthened loyalty and satisfaction to the bank. This study demonstrates that the motivation behind Banks in Kilifi choosing collateral as a credit risk management strategy derives from its robustness to fit diverse credit scenarios but importantly as a critical component for enhancing customer experience.

4.6 Credit Recovery Strategies Employed by Commercial Banks to Collect Debts

The fourth objective was designed to determine the credit recovery strategies by the commercial banks to ensure full repossession of the principal and the interests so as to ensure the banks are stable financially. The respondents were asked their level of agreement in regard to their respective banks having a well spelt out credit recovery strategies and if their banks used a lot of resources in recovering the loans advanced to their clients. Finally they were asked to confirm whether all the borrowers repay their loans in time.
4.6.1 Existence of Credit Recovery Strategies in the Commercial Banks

The respondents were asked their level of agreement in regard to their respective banks having a well spelt out credit recovery strategies. The results are presented in the Table 4.16.

Table 4.16: Credit recovery strategies used by commercial banks

<table>
<thead>
<tr>
<th>Level of agreement</th>
<th>Frequency (f)</th>
<th>Percent (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uncertain</td>
<td>1</td>
<td>3%</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>1</td>
<td>3%</td>
</tr>
<tr>
<td>Agree</td>
<td>15</td>
<td>42%</td>
</tr>
<tr>
<td>Strongly agree</td>
<td>19</td>
<td>53%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>36</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

From the findings in the table 4.16, most of the respondents agreed that their respective banks have a well spelt out recovery strategies. This is important for all banking institutions that give out loan to their customers because it helps them recover the loans with ease and at the same time avoid bad debts (non-performing loans).
In Figure 4.9 above, the results show that 53% of the respondents strongly agree that their banks had a well spelt out credit recovery strategies. 42% also agreed that their banks had a well spelt out credit recovery strategies. 3% indicated that they were uncertain and they strongly disagree that their banks had a well spelt out credit recovery strategies. Developing a more focused debt recovery strategy can help the bank reduce costs, save time and maximize your resources. This translate to more profit and investments by the bank as with good recovery strategies ensure full repayment of the principal and interests thus boosting financial stability of the bank.

4.6.2 Use of Resources in Recovering the Loans by Commercial Banks

The respondents were asked to indicate if their banks use resources in recovering the loans advanced to their clients. Below is Table 4.17 show the findings of the study.
Table 4.17: Use of resources by the bank in recovering loan

<table>
<thead>
<tr>
<th>Responses</th>
<th>Frequency (f)</th>
<th>Percent (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>12</td>
<td>33%</td>
</tr>
<tr>
<td>No</td>
<td>24</td>
<td>67%</td>
</tr>
<tr>
<td>Total</td>
<td>36</td>
<td>100%</td>
</tr>
</tbody>
</table>

The findings shows that majority of the banks do not use their resources to recover loan from their borrowers as indicated in the above table by two third of the respondents. Only one third of the respondents confirmed that their banks use resources in following up the loans advanced to their client. Use of resources in recovering the loans compromises the profit maximizing objective of commercial thus affecting the financial stability of the bank negatively.

Figure 4.10: Use of Resources in Recovering the Loans
From Figure 4.10 above, most of the respondents (67%) agreed said that their banks never use resources of any kind in recovering the loans from their clients. This is good for the banks as it is in line with profit maximizing objective of commercial banks. The recovery of loans by banks without spending resources means that the intended purpose of advancing loans to customers is achieved at minimal cost hence the financial stability of the bank is not affected.

4.6.3 Timely Repayment of Loans by Borrowers in the Commercial Banks

Respondents were given a chance to express their views on the trend and time taken by borrowers to repay their loans advanced to them by the banks. Table 4.18 below show the results of the study.

Table 4.18: Borrowers loan repayment

<table>
<thead>
<tr>
<th>Responses</th>
<th>Frequency (f)</th>
<th>Percent (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>4</td>
<td>11%</td>
</tr>
<tr>
<td>No</td>
<td>32</td>
<td>89%</td>
</tr>
<tr>
<td>Total</td>
<td>36</td>
<td>100%</td>
</tr>
</tbody>
</table>

The study established that majority of the borrowers do not pay their loans in time, this is represented in the table 4.18. This may explain the frequent financial crises experienced by commercial banks in the country.
Figure 4.11: borrowers’ loan repayment

The figure above shows that 89% of the respondents indicated that the borrowers do not repay their loans in time. This explains the reason behind bank failures in Kenya as observed recently. The sustainability of commercial banks depends largely on their ability to recover their loans as efficiently and effectively as possible. Many banks that have failed in Kenya recently are due to either delay or non-compliance by borrowers to repay their loan. This causes financial instability and ultimately bank failures.

4.7. Discussion

This section discusses the results of the study that are presented above. These discussions include credit monitoring strategies used by commercial banks in Kilifi, credit terms used by commercial banks in Kilifi, credit control measures used by banks in Kilifi and the
Credit recovery strategies used by commercial banks to guarantee financial stability in Kilifi County.

4.7.1 Credit Monitoring Strategies by Commercial Bank in Kilifi County

The study in its objective one sought to identify the credit monitoring strategies used by commercial banks to safeguard financial stability. The respondents were asked whether their respective banks had credit manuals and also indicate factors that normally prompt the bank to change its policies to manage risk; whether their banks carry out project approval for borrowers to ensure that they invest the loans advanced to them in viable projects; the approaches employed by the banks to identify or prove viability of the borrowers.

According to all the respondents, their banks have credit manual which clearly elaborate the strategies that are used to manage credit risk (figure 4.5). Commercial banks cannot survive without such policy documents because it helps the banks to deal with uncertainties that come with non-performing loans that brings about credit risk. The study is in agreement with Rahman (2011) who in his study argued that structures and processes of the banks are most effective when their design function and match their environment and have impact on the banks strategies. Also Chaplinska (2012) pointed out that lending institutions need to have a credit risk management policies in place and lack of it leads to bank failures as a result of non-performing loans.

More than half of the respondents indicated that central bank regulations are key to determining policy changes regarding management of risks (figure 4.6). Also the market competition from other lending institutions prompt banks to changes their policies as each want to cut a niche out of the market. The study is supported by Ongore et al, (2013) who said that Central Bank of Kenya has played a significant role in prevention of bank failures.
through its supervision and regulatory role and has protected many customers from the effects of bank failures due to toxic lending practices.

According to the respondents, credit portfolio approach is the most preferred way of identifying and determining the viability of the borrowers (figure 4.8). Credit Portfolio View is an approach based upon the argument that loan default (non-performing loans) and migration probabilities are not independent of the business cycle but the prevailing economic status (Derbali, 2011). Majority of the respondent also indicated that their respective bank carries out project approval for the borrowers in order to make sure that they invest the loans in viable projects that guarantee returns. The success of borrowers in their investments increases their ability to repay their loan together with the interest not only in time but also in full. Lending institutions must analyze the actions taken by borrowers towards investments so has to give clear directives where necessary to avoid any risk that may result from haste decisions made by borrowers (Generale and Gobbi, 2017).

Over three fifth of the respondents confirmed that there is continuous reporting of risk management as a key approach used by commercial banks to get information on risk management (figure 4.9). This approach helps the bank to identify non-performing loans and take appropriate action against the defaulters immediately. The findings of this study are in agreement with Lim et al., (2017) who suggested that the Risk Management Department and the Credit Risk Management Department of any financial institution should jointly monitor, analyze and submit suggestions on regular basis concerning credit risk and formulate and execute plans in connection with basic matters pertaining to credit risk management.
4.7.2 Determination of Credit Terms used by Commercial Banks to Eliminate Loan Default in Kilifi County

In objective two, the researcher sought to determine credit terms used by commercial banks to eliminate loan defaults. The respondents were asked to identify items preferred by the banks as collaterals to secure loans as well as the interest rate preferred by the banks for profit maximization.

The findings of the study confirmed that land is the most preferred as collateral to secure loans in Kilifi County compared to other assets such as business units and car logbooks (figure 4.11). This may be informed by the fact that majority of people in Kilifi are small scale farmers and do not have formal employment. The study by Charles et al., (2016) suggest that movable assets increase the likelihood that borrowers perceived to be less creditworthy will obtain loans from both informal and formal sources such as banks as opposed to immovable assets such as land.

More than half of the respondents indicated that the interest rates of 16-19% are preferred by their respective banks and they yield and help the banks in realizing their profit maximizing objective as well as attracting large customer base (figure 4.13). However (CBK, 2016) through their regulatory and supervision role in protecting the borrowers (citizens) caped the interest rates for all commercial banks to 14.5% that is 4.5% above the CBK lending rates. This capping was felt by both lending institutions and investors this was confirmed by study done by Mbuu (2017) who found out that the capping of interest rates made the bank shares less attractive as investors were worried about the reduced profitability from these institutions.
4.7.3 Credit Control Measures Used by Commercial by Commercial Banks in Kilifi County

The third objective sought to establish credit risk control measures used by commercial banks to ease credit risk in the banks. The respondents were asked to identify the tools used by their banks to control and ease credit risks.

The respondents confirmed that the following tools were used to control risk in their respective banks; agreements, collaterals, credit rationing, loan securitization, evaluation of contract regularly and credit protection. In addition the following activities were carried by the banks as a measures to control credit losses; supporting borrowers when in problem so as to deal with situations as they arise, creating an atmosphere that encourages problem solving between the lender and the borrower, monitoring the borrowers’ business progress through the activeness of their bank accounts so as to assess the ability to repay their loans, regular review of borrowers’ report as well as updating borrowers’ credit file regularly so as to ascertain their repayment capability. The findings of this study supported by Berger and Udell (2002) who pointed out that agreements, collaterals, credit protection, credit rationing and loan securitization have been used in developing countries in controlling credit losses.

Mann Whitney tests of medians were run to determine whether banks in Kilifi perceived credit control policies to be appropriate for a variety of credit scenarios among clients and whether some measures were considered superior to others. Collaterals and Credit protection were considered to be equally ($W=1584$ $p=0.2902$) robust tools to control credit losses but superior to agreements ($W=1860.5$ $p=0.0001$), credit rationing ($W=1782$ $p=0.0352$) and contract evaluation ($W=1712.5$ $p=0.0368$).
Key credit control services were also subjected to a similar test. The results indicated that regular contact with borrowers, creating an atmosphere that encourages problem solving and monitoring progress of borrowers’ businesses through their bank accounts (W=1427.5 p=0.0751), (W=1386.5 p=0.1738), and (W=1446 p=0.0313) respectively, were all equally robust compared to supporting borrowers when in problems and dealing with situations as they arise (W=1480 p=0.0194).

4.7.4 Credit Recovery Strategies Employed by Commercial Banks Collect Debts

The fourth objective was designed to determine the credit recovery strategies employed by commercial banks to ensure full recovery of principal and interest charged. The respondents were asked to confirm whether their respective banks had a well spelt out credit recovery strategies or policies, whether their banks used resources in terms of money as well as delegating the task of recovering loans to other companies and whether borrowers made commitment to repay their loan in time as agreed.

Most of the respondents agreed that their banks had laid down strategies for recovering loans from the borrowers (figure 4.17). Loan recovery strategies help to minimize losses that may arise as a result of borrowers not honoring the terms of the loans advanced to them thus loan recovery strategies are key to success of any lending institution. Loan recovery strategies contribute significantly in the decline of non-performing loans or loan defaults (Murthy et al., 2017).

The study also confirmed that not many banks use their resources to recover the advanced loans from the borrowers as this would compromise the profit maximizing objective of the bank (figure 4.18). Majority of borrowers do not repay their loans in time (figure 4.19) and this is the reason experienced instability in the banking sector in the year 2014 through
2015 and 2016. Delay in loan repayment is the main cause of bank failures both in developed and developing economies (Schiantarelli et al., 2016).
CHAPTER FIVE

5.0 SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter discusses the summary of the findings, conclusion and recommendations on the contribution of credit risk management strategies to the financial stability of commercial banks in Kilifi County.

5.2 Summary of the Major Findings

For a bank to sustain long-term profitability and a competitive advantage, the bank must respond strategically to challenges arising from credit risk. This will involve the formulation and implementation of strategies that will ensure fully recovery of the principal and interests from the loan advanced to customers.

5.2.1 Major Findings Related to Credit Monitoring Strategies Used by Commercial Banks in Kilifi

All commercial banks have credit manual documents which elaborate well the strategies for managing credit risk. This is indicated by respondents who agreed (100%) that their respective banks had the credit manual to manage credit risk. The study confirmed that there are several factors that prompt commercial banks to change their policies in managing risks these factors include Central bank, technology advancement, environmental change and prevailing competition in the market. Commercial banks do engage in approving borrowers intended investments in order to ensure the projects are viable and the chances of the customers are high (confirmed by majority of the respondents). The study also confirmed that almost all the commercial banks in Kilifi carry out project approval for the borrowers as an extension service to them to make sure
that their customers invest their loans wisely in viable investments that enables them to start repaying their loans in time. The study established that credit portfolio view approach is the most preferred way of identifying viability or credit worthiness and repayment capacity of borrowers. There is continuous reporting of risk management problems in majority of the banks as indicated by more than half of the respondents.

5.2.2 Major Findings Related Credit Terms used by the Commercial Banks to Eliminate Loan Defaults

Most of commercial banks regularly check the borrowers’ collateral value as pointed out by more than three quarter of the banks. Land is the most common and preferred assets to secure loan from commercial banks as collateral as indicated by majority of the respondents. From the study, it emerged that many of the borrowers prefer to start repaying their loans after a period of 36 months and above. Many commercial banks prefer interest rates of between 16% and 19%.

5.2.3 Major Findings Related to Credit Risk Control Measures Used by Commercial Banks in Kilifi

The study shows that commercial banks use numerous tools for controlling credit losses. The tools used are agreements, collaterals, credit rationing, loan securitization, evaluating contracts and credit protection. Collaterals, credit rationing and loan securitization have been used by banks in developing the world in controlling credit losses (Berger and Udell, 2002).

Commercial banks carry out various activities as a measure of credit loss control. These are: supporting borrowers when in problem dealing with situations as they arise, creating an atmosphere that encourages problem solving, monitoring the borrowers’ business progress, regular review of borrowers’ report and updating borrowers’ credit files
regularly at. From the findings it could be plausibly concluded that credit protection as a strategy, to a great part contemplated as collateral by the bank, provided the most appropriate measure for handling multidimensional risks to credit for a diverse clientele operating in diverse client risk scenarios. Frequency of evaluating collateral, therefore, is a rational means for constantly assessing the credit risks and in the process provided a means for enhancing decision-making for the client either through provision of technical support or extension services to the investment projects. The resulting customer experience strengthens loyalty and satisfaction to the bank. This study demonstrates that the motivation behind Banks in Kilifi choosing collateral as a credit risk management strategy derives from its robustness to fit diverse credit scenarios but importantly as a critical component for enhancing customer experience.

5.2.4 Major Findings Related to Credit Recovery Strategies Employed by Commercial Banks to Collect Debts

Commercial banks have a well spelt out credit recovery strategies that helps in recovering or collecting the debts from the customers as confirmed by the respondents involved in the study. Majority of borrowers do not repay their debt in time as confirmed by respondents.
5.3 Conclusions

From the study, majority of bank have credit manual which expound well the techniques for overseeing credit hazard. There are a few factors that incite business banks to change their arrangements in overseeing dangers these elements incorporate Central bank, technology advancement, environmental change and prevailing competition in the market. Persistent announcing of hazard administration issues in the commercial banks is extremely significant as it causes the bank to be proactive in taking care of advance default as they emerge.

Land is the most preferred item used as collateral to secure loans in Kilifi County. This could be attributed to the fact that because its value keeps appreciating as opposed to items such as motor vehicles whose value depreciates with time. Borrowers require enough time in order to prepare for loan repayment, this is because businesses take time to break even and be able to generate enough profit to enable the borrower repay his/her loan. From the discussions of the risks the researcher interacted with, they indicated that high interest rate increases the rate of loan default (non-performing loans) among the borrowers, with high interest rate; the bank will attract fewer customers and also make the existing borrowers unable to repay their loan. An increase in non-performing loans has a negative impact on banks profitability as they are required to set aside some cash covering the risk of default. The provisions are accounted for as operating expenses in banks’ books thereby eating into the profit and this may bring about financial instability.

It is paramount for all commercial banks to have comprehensive credit control measures in place; Effective credit control is a key to sustaining a fast-growth business especially in the lending institutions. Non-payment of loans can create major cash flow problems for commercial banks. As the banks increase their customer-base, managing credit inevitably
becomes more time-consuming and complex issue. Thus credit control measures such as use of agreements, collaterals; credit rationing, loan securitization; evaluating contracts and credit protection are used often as the main tools to control credit losses. Majority of commercial bank have a credit recovery strategy to help them reduce cost, save recovery time and maximize their profit making objective of the bank. This also helps in recovering the debts not only in time but also in time.

5.4 Recommendations

Commercial banks should develop risk management strategies that are consistent with their credit risk tolerance and their business goals. The management should periodically review the credit risk strategies and any changes and concerns should be effectively communicated to all relevant staffs. Shifts from the approved credit risk strategies should be subjected to appropriate review and endorsement.

Commercial banks should also accept other items such as stocks of the businesses as collaterals so as to open credit availability to those who do not own a piece of land or motor vehicles. This is because in the country we have large populations who have businesses and stocks and they should be able to access loan so as to help them grow their businesses.

Interest rate charged by the commercial banks should be reduced so as to benefits many citizens and make it easier for them to repay their loans.

The banks should have a clear and elaborate policy on how to give and recover loans from their clients. Finally all commercial banks should have a recovery strategy that will ensure all the borrowers repay their loan in time and in full (both principal and the interest charged) so as to safeguard their financial stability.
5.4.1 Recommendations for further studies

The study concentrated on responses from commercial banks, future studies should focus on the customers. This will give them an opportunity to express themselves on how credit risk management and policies should be in commercial banks.

Future researchers should carry out similar studies on other lending institutions such as microfinance to help shed some light on credit risk management to them.

It is also recommended that a study should be conducted to determine perception of the customers towards the lending institutions and the effect of the current interest rates capping on the banks profitability.
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APPENDICES

APPENDIX 1: QUESTIONNAIRE

Title of the Study: Contribution of credit risk management strategies on financial stability: An evaluation of commercial banks in Kilifi County

This study is being carried out by Mbiti Job M’ithibutu a postgraduate student in the Department of Business Management and Economics, Pwani University. This study would like to establish the contribution of credit risk management strategies on the financial stability of commercial banks in Kilifi County. This study will help Commercial banks to obtain information about credit risk management strategies and its contribution to the financial stability and this information will mainly be significant and valuable to the senior management. This study also will help to ease exposure to the credit risk. The government will get information on the significance of implementation of various legitimate structures in relation to credit risk management, policy making regarding credits and other regulatory requirements of commercial banks in Kilifi and in the country at large. Your responses will be used for academic purposes only and will be treated as confidential.

I the undersigned agree to participate in this study voluntarily, without coercion, undue influence or intimidation.

Sign ........................................ Date........................................

Introduction

Please provide your information on the space provided. Tick the box appropriately and give out explanations where necessary.
SECTION A: CREDIT RISK MONITORING STRATEGIES

1. Do you agree that your bank has credit manual which elaborates well the strategies for managing Credit risk? (Tick as appropriate)
   a) Strongly agree
   b) Agree
   c) Uncertain
   d) Disagree
   e) Strongly disagree

2. What normally prompt your bank to change its policies to manage risks?
   a) Environmental change
   b) Technological advancement
   c) Competition
   d) Central Bank regulations

3. Does your bank carry out project approval for borrowers to ensure that they invest the loans advanced to them in viable projects?
   Yes ☐                No ☐

4. Which of the below approaches are employed by your bank to identify or prove viability of the borrowers?
   a) Credit portfolio view
   b) Equity based approach
   c) Sensitivity analysis
   d) Others ..........................specify..........
5. Which of the below approaches describes the way risk management is reported within your bank in order to assess the results?

   a) Risk Reporting takes place on regular bases
   b) There is continuous management reporting on credit risk
   c) Credit risk issues are reported on an ad hoc basis
   d) Credit risk issues are not reported at all

SECTION B: QUESTIONS RELATED TO CREDIT TERMS

6. How often does your bank check for borrower’s collateral value to ensure the loan is safeguarded?

   a) Very often
   b) Often
   c) Rarely
   d) Never

7. Which are the most common items used as collaterals to secure loan in your bank?

   a) Land
   b) Houses
   c) Business units
   d) Others …………………………..specify

                    …………………………………………………
                    …………………………………………………
8. What is the most preferred period by borrowers to repay their loan?
   a) Six months
   b) Twelve months
   c) Twenty four months
   d) Thirty six months
   e) Sixty and above

9. Which of the bellow interest rates yields high profit in your bank?
   a) High interest rates (above 20%)
   b) Average interest rates (16-19%)
   c) Low interest rates (below 16%)

10. How can you describe the accessibility of loans by the customers compared to your competitors (other banks)?
    a) Easily accessed
    b) Normally accessed
    c) Difficult to access
    d) Difficult to tell
SECTION C: QUESTIONS RELATED TO CREDIT CONTROL MEASURES

11. Does your bank use the tool listed below to control credit losses? Please tick as appropriate

<table>
<thead>
<tr>
<th>Tool used to control credit losses</th>
<th>Not at all</th>
<th>neutral</th>
<th>somehow</th>
<th>much</th>
<th>Very much</th>
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</thead>
<tbody>
<tr>
<td>Agreements</td>
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<tr>
<td>Collaterals</td>
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<tr>
<td>Credit rationing</td>
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<td>Loan securitization</td>
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<td>Evaluating contracts</td>
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<tr>
<td>Credit protection</td>
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</tbody>
</table>
12. In regards to credit control measures, indicate the degree to which your bank carry out the activities listed below

<table>
<thead>
<tr>
<th>Activities</th>
<th>Not at all</th>
<th>Neutral</th>
<th>Somehow</th>
<th>Much</th>
<th>Very much</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular contact with borrowers</td>
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<td>Creating an atmosphere that encourages problem solving</td>
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<td>Supporting borrowers when in problem and dealing with situations as arise</td>
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<tr>
<td>Monitoring the borrowers business progress through the activeness of the bank account and visiting the business sites</td>
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<td>Regular review of borrowers report</td>
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<tr>
<td>Updating borrowers credit files regularly</td>
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</tbody>
</table>

**SECTION D: QUESTIONS RELATED TO RECOVERY STRATEGIES**

13. Do you agree that your bank has a well spelt out credit recovery strategies?

a) Strongly agree
   -

b) Agree
   -

c) Uncertain
   -

d) Disagree
   -

e) Strongly disagree
   -
14. Does your bank use a lot of resources in recovering the loan advanced to the customers, if yes how often does it happen?

Yes  ☐  No  ☐

15. Do all the borrowers repay their loans in time?

Yes  ☐  No  ☐

SECTION E: BACKGROUND INFORMATION OF THE BANK

16. Name of the bank ________________________________

17. How long has this bank been in operation in Kilifi? (Tick as appropriate)

(a). Less than 1 year  ☐
(b). 1 to 5 years  ☐
(c).10 years and above  ☐

18. How many full time workers does your bank have (Pleas tick as appropriate)?

(a). Less than 20  ☐
(b). 21 to 40  ☐
(c). 41 to 75  ☐
(d). 76 to 100  ☐
(e). 101 workers and above  ☐

19. How long have you worked in the bank? (Tick as appropriate)

(a). Less than 1 year  ☐
(b). between 1 and 5 years  ☐
(c). between 6 and 10 years  ☐
(d). 10 years and above  ☐

20. Please indicate the number of branches you have in Kenya

(a). Less than 10  ☐
(b). Between 10-20

(c). Between 20-30

(d). More than 30