EFFECTS OF CREDIT POLICY ON PERFORMANCE OF COMMERCIAL BANKS IN KENYA

BY

MW Aura Dorcas Wanja

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTERS IN BUSINESS ADMINISTRATION (FINANCE) SCHOOL OF BUSINESS, KENYATTA UNIVERSITY

FEBRUARY, 2012
DECLARATION

This research project is my original work and has not been presented for examination in
any other university for academic fulfillment.

Signed: ...........................................    Date: ...........................................

Dorcas Mwaura

D53/CE/10798/06

Approval by supervisors

This is to certify that this research project has been submitted for consideration with our
approval as the university supervisors.

1. Signed: ...........................................    Date: ...........................................

Dr. Jagongo A.O

2. Signed: ...........................................    Date: ...........................................

M/s. Abdul Farida

Lecturers, Department of Accounting and Finance

Approval by Chairman of Department

This is to certify that this project has been submitted for consideration with my approval
as the chairman of the department.

Signed: ...........................................    Date: ...........................................

Mr. F.W.S Ndede

The Chairman, Accounting and Finance Department
DEDICATION

This work is dedicated to my parents Mr. and Mrs. Charles Mwangi for instilling the value of education in my early life, my husband John Mbugua and, to my two daughters Maureen Nyokabi and Prudence Wanjiru for their love and encouragement. God bless them abundantly.

Abdul for their timeless guidance, constructive criticism, encouragement and support in this work since its inception. Above all thanks to God for giving me the strength to go uncomplimented. Their ability and competence in research work and work ethics is exemplary and we thank them for their support.

My special gratitude goes to my husband John Mbugua who instilled in me discipline and morality, my two daughters Maureen Nyokabi and Prudence Wanjiru who always supported me and never let me give up, but encouraged me to pursue to meet my goal of obtaining a degree. The love and support they have given me has been a blessing.

Finally to my parents Charles Mwangi and Helen Wanjiru who have always supported me in my education and their continuous prayers and moral support throughout my studies. May the living God bless them and prolong their days on earth to witness the fruit of their labour.

iii
ACKNOWLEDGEMENT

I wish to express my profound gratitude to God, the Almighty father, the source of all knowledge and wisdom. He has showed me with his blessings and the grace that has seen me through the successful completion of this project. His love endures forever.

I sincerely appreciate the effort of my supervisors Dr. Jagongo A. O and M/s. Farida Abdul for their tireless guidance, constructive criticisms, suggestions, advice and encouragement on this work since its inception. Above all their outstanding patience in going through my work and instilling hope when times seemed very difficult can never go uncommented. Their ability and competence in research work is undoubtful. I humbly thank them for their support.

My special gratitude goes to my husband John Mbugua who supported me financially and morally, my two daughters Maureen Nyokabi and Prudence Wanjiru who sacrificed and persevered to miss me the time they needed me most. May the Almighty God bless them to retain the love they have for me.

Finally to my parents Charles Mwangi and Hellen Wanjiru who laid the foundation of my education and their continuous prayers and moral support throughout my study period. May the living God bless them and prolong their days on earth to enjoy the fruits of their labour.
TABLE OF CONTENTS

Title.......................................................................................................................... ii
Declaration .............................................................................................................. ii
Dedication ................................................................................................................ iii
Acknowledgement .................................................................................................. iv
Table of Contents ................................................................................................... v
List of Tables .......................................................................................................... ix
List of Figures ......................................................................................................... x
Abbreviations and Acronyms ................................................................................ xi
Operational Definition of Terms ........................................................................... xii
Abstract .................................................................................................................... xiii

CHAPTER ONE: INTRODUCTION.............................................................................. 1
1.1 Background of the Study .................................................................................... 1
1.1.1 Commercial Banks in Kenya ....................................................................... 3
1.2 Statement of the Problem ................................................................................... 4
1.3 Objectives of the Study ...................................................................................... 5
1.3.1 General Objective ....................................................................................... 5
1.3.2 Specific objectives ...................................................................................... 5
1.4 Research Questions ........................................................................................... 6
1.5 Significance of the Study .................................................................................. 6
1.6 Scope of the Study ............................................................................................. 7
1.7 Limitations of the Study .................................................................................... 8

CHAPTER TWO: LITERATURE REVIEW.................................................................. 9
2.0 Introduction......................................................................................................... 9
2.1 The Legal Framework of Banking in Kenya ...................................................... 9
2.2 The Banking System in Kenya .......................................................................... 10
2.3 Bank Credit Policy ............................................................................................ 10
2.4 Theoretical Framework .................................................................................... 13
2.5 Empirical Review of Credit Policy ................................................................... 19
4.2.5 Percentage of the loan amount constituting loan transaction costs.................................................48
4.2.6 Handling of lending risks..................................................................................................................49
4.2.7 Influence of loan terms and conditions on loan volumes .................................................................49
4.2.8 Effect of loan terms and conditions on bank’s competitiveness.......................................................50
4.2.9 Effect of the adherence to loan terms and conditions on bank performance.................................51

4.3. Factors considered when developing credit policies ..............................................................................52
4.3.1 Number of processes for approving a loan ..........................................................................................52
4.3.2 Duration taken in processing loan application form ...........................................................................53
4.3.3 Duration taken in disbursing successful loan amounts ........................................................................54
4.3.4 Percentage of loan applications rejected for non compliance ............................................................55
4.3.5 Duration taken before loan repayment commences ...........................................................................56
4.3.6 Duration taken before computation of loan interest commence ..........................................................57
4.3.7 Effect of loan procedures adopted on the volume of loans .................................................................57

4.4 Effect of credit policies on performance of commercial banks ................................................................58
4.4.1 Success of loan applications ..............................................................................................................58
4.4.2 Reason for rejection of loan applications ..........................................................................................59
4.4.3 Level of satisfaction with loan amounts granted .................................................................................60
4.4.4 Appeals on failed loan applications ..................................................................................................61
4.4.5 Determination of loan tenures ...........................................................................................................61
4.4.6 Collateral requirements ......................................................................................................................62
4.4.7 Effect of loan requirements on loan volumes ......................................................................................63

4.5 Relationship between credit information and performance of commercial banks.................................64
4.5.1 Reliance on borrower’s credit history in approving loans .................................................................65
4.5.2 Reliance on account movement in approving loans .............................................................................65
4.5.3 Reliance on personal behaviour in approving loans ..........................................................................66

CHAPTER FIVE: SUMMARY, DISCUSSION, CONCLUSION AND RECOMMENDATIONS ..................................68
5.0 Introduction ..............................................................................................................................................68
5.1 Summary and Discussion ........................................................................................................................68
5.1.1 Relationship between loan terms and conditions on performance of commercial banks .................................................................68
5.1.2 Relationship between loan procedures and performance of commercial banks .................................................................71
5.1.4 Effect of credit policies on performance of commercial banks ......................................................................................73
5.1.5 Relationship between credit information and performance of commercial banks .............................................................75
5.2 Conclusion ...............................................................................................................................................................................76
5.3 Recommendations ............................................................................................................................................................78
5.4 Suggestions for further study ................................................................................................................................................80
References ..................................................................................................................................................................................81
Appendix I: List of Commercial Banks in Kenya ...........................................................................................................88
Appendix II: Transmittal Letter ................................................................................................................................................90
Appendix III: Questionnaire to the Credit Officer ..................................................................................................................91
LIST OF TABLES

Table 2.1: Mean values of selected loan aspects by formal and informal institutions .....22
Table 2.2: Results of t-test for the differences in means between the amounts applied for
and received in both formal and informal credit markets ..............................................25
Table 4.1 Setting of interest rates on loans ..............................................................47
Table 4.2 Setting of repayment schedules ...............................................................47
Table 4.3 Percentage of loan amount constituting transaction costs .......................48
Table 4.4 Number of processes for approving a loan .................................................52
Table 4.5 Reasons for rejection of loan applications .................................................59
Table 4.6 Determination of loan tenures .................................................................62
Table 4.7 Reliance on account movement in approving loans ....................................66

Figure 4.5 Percentage of loan applications rejected for non-completeness .................91
Figure 4.10 Duration taken for loan repayment to commence ....................................94
Figure 4.11 Duration taken before loan interest computation commences ..................95
Figure 4.12 Effect of loan procedures adopted on volume of loans ............................96
Figure 4.13 Success of loan applications .................................................................96
Figure 4.14 Level of satisfaction with loan amounts granted .....................................96
Figure 4.15 Appeals on failed loan applications .......................................................97
Figure 4.16 Collateral requirement on loan applications .............................................97
Figure 4.17 Effects of loan requirement on loan volumes ..........................................99
Figure 4.18 Reliance on borrower's credit history in approving loans .........................99
Figure 4.19 Reliance on borrower's personal behaviour in approving loans ..............99

ix
LIST OF FIGURES

Figure 2.1: Credit Policy model ................................................................. 18
Figure 2.2: Conceptual Framework ............................................................ 35
Figure 4.1 Presence of credit policy ......................................................... 45
Figure 4.2 Frequency of reviewing credit policy ....................................... 46
Figure 4.3 Handling of lending risks ......................................................... 49
Figure 4.4 Influence of loan terms and conditions on the volumes of loans ... 50
Figure 4.5 Effect of loan terms and conditions on bank's competitiveness ... 51
Figure 4.6 Effect of adherence to the loan terms and conditions on bank performance ... 52
Figure 4.7 Duration taken to process loan application form ....................... 53
Figure 4.8 Duration taken to disburse successful loan amounts ............... 54
Figure 4.9 Percentage of loan applications rejected for non compliance .... 55
Figure 4.10 Duration taken for loan repayment to commence .................. 56
Figure 4.11 Duration taken before loan interest computation commence ..... 57
Figure 4.12 Effect of loan procedures adopted on volume of loans .......... 58
Figure 4.13 Success of loan applications ................................................. 59
Figure 4.14 Level of satisfaction with loan amounts granted ................. 60
Figure 4.15 Appeals on failed loan applications ....................................... 61
Figure 4.16 Collateral requirements ....................................................... 63
Figure 4.17 Effects of loan requirements on loan volumes ...................... 64
Figure 4.18 Reliance on borrower's credit history in approving loans ....... 65
Figure 4.19 Reliance on borrower's personal behaviour in approving loans .... 67
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>C&amp;I</td>
<td>Commercial and Industrial.</td>
</tr>
<tr>
<td>5C</td>
<td>Character, capacity, capital, collateral and conditions.</td>
</tr>
<tr>
<td>SPSS</td>
<td>Statistical package for social science.</td>
</tr>
<tr>
<td>CBK</td>
<td>Central Bank of Kenya</td>
</tr>
<tr>
<td>FI</td>
<td>Financial instructions</td>
</tr>
<tr>
<td>LGS</td>
<td>Loan Guarantee scheme</td>
</tr>
<tr>
<td>NRB</td>
<td>Nairobi</td>
</tr>
<tr>
<td>G.O.K</td>
<td>Government of Kenya</td>
</tr>
<tr>
<td>KCB</td>
<td>Kenya Commercial Bank.</td>
</tr>
<tr>
<td>KPIs</td>
<td>Key Performance Indicators</td>
</tr>
<tr>
<td>KBA</td>
<td>Kenya Bankers Association</td>
</tr>
<tr>
<td>SACCO</td>
<td>Savings and Credit Co-operative</td>
</tr>
<tr>
<td>CR</td>
<td>Credit Risk</td>
</tr>
<tr>
<td>ICPAK</td>
<td>Institute of Certified Public Accountants.</td>
</tr>
<tr>
<td>IAS</td>
<td>International Accounting Standards.</td>
</tr>
<tr>
<td>CRM</td>
<td>Credit Risk Management.</td>
</tr>
</tbody>
</table>
OPERATIONAL DEFINITION OF TERMS

Policy: Refers to broad guidelines and pronouncement of development and related issues intended to deal with specific economic, political and social issues.

Credit policy: Credit policy is refers to statement of philosophy, standards and guidelines that bankers observe in granting or refusing a loan request. These polices determine which sector of the industry or business must be approved loans and which will be avoided and must be based on the country’s relevant laws and regulations.

Performance: Refers to changes in such indicators in a bank as loan portfolio, number of loans, loan products, number of customers, profit level, loan disbursement and loan delinquency rate.

Loan review: Refers to examination of outstanding loans to make sure that borrowers are adhering to their credit agreement and the financial institution is following its loan policies.

Open market operations: Buying and selling of government securities by Central Bank.

Liberalization: Banks are set free to manage and regulate themselves through their own by-laws in a free market without state protection.
ABSTRACT

The study intended to investigate the effects of credit policy used by commercial banks on their performance. Credit policy refers to statement of philosophy, standards and guidelines that bankers observe in granting or refusing a loan request while performance refers to change in number or value of loan granted and profit level. Commercial banks were used because of the role they play in the economy; they act as barometer to reflect important changes in the economy, they are governed by CBK which operates with favourable policies such as deregulation of interest rates, reduction of imposed regulations and restrictions of commercial banks. The study was guided by research objectives: to examine relationship between loan terms and conditions and performance, to examine the relationship between loan processing procedures and performance, to establish amount of loan disposable and their relationship with performance and to examine the relationship between credit information and length of credit relationship with the bank and performance. The problem of the study was that some commercial banks use stringent credit policy thus losing customers to other commercial banks with lenient credit policy, this has led to decline in performance of such banks. The study consisted of dependent variable which represent performance and independent variables which explain changes in commercial banks performance. The study was carried out using descriptive research design. The population for the study was all the forty three commercial banks headquarters thus a census was taken. To obtain information from respondents both open and closed ended questionnaires was used. In order to meet the study's objective both primary and secondary data was collected. The target population was forty three respondents consisting of credit officers of the banks. Pilot study was carried on four branches of commercial banks which were selected by simple random sampling method to test the validity of the instrument. Data collected was coded using statistical package for social science (SPSS). Descriptive statistics was used to analyze the data in terms of frequency tables, pie charts, graphs and percentages. The study found that the nature of loan terms and conditions have a large effect on the bank's competitiveness. Also it was found that the nature of the loan policies a bank adopts affect the volume of loan applications that a bank attracts. Further, it was found that most loan terms and conditions only affect the volumes of the loans procured at a bank to a small extent. Finally, the study found that most commercial banks rely to a large extent on the borrower's credit history in awarding loan amounts, that account movement is considered to be an important factor in considering and approving loans. And that majority of the commercial banks consider borrower's personal behaviour as an important factor in approving loans sought from the banks. Thus, the findings of the study indicated that the nature of the credit policies adopted by the banks influence the volumes of the loans procured by the banks and thus the competitiveness of the bank in lending and thus the performance in the industry.
CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

Credit making is considered by the banking industry as the most important function for the utilization of funds. Since banks earn their highest gross profits from loans, the administration of loan portfolio seriously affects the profitability of banks. Indeed, the large number of non-performing loans is the main cause of banks failure. Non-performing loans can be treated as undesirable outputs or cost to a lending bank which decreases a bank’s performance. For most banks, loan accounts for half or more of their total assets and about half to two thirds of their revenue. The quality of a bank’s loan portfolio and the soundness of its credit policy are the areas bank examiners look most closely. (Berlin & Loeys, 2008)

Credit services offered by commercial banks play an important role in the development of Kenya’s economy and general infrastructure. This development has been achieved through giving credit to prospective customers in private investment, as well as those in corporate sector. However funds acquired from customer’s deposits being the main source of credit funds have long since become a commodity bought and sold for the highest profits by commercial banks. Banks are learning to review their risk portfolio using the criteria laid down. Kantor & Maital (2009) have indicated that bank’s goal is to induce bankers to improve their risk management capability including how the institution’s price products, reserve for loss, and control their operations to reduce a
bank’s operational risk during the lending process through a better monitoring of employees in the credit department.

Credit policy is a statement of philosophy, standards and guidelines that bankers must observe in granting or refusing a loan requests www.marronfoods.com. These policies determine which sector of the industry or business will be approved loan and which will be avoided and must be based on the country’s relevant laws and regulations. Banks are the most important sources of external finance for firms and individuals. In inadequacies of banks appraisal processes in application under the Loan Guarantee Scheme were highlighted in the Robinson Rhodes Report (1984). Banks have instructions which regulate their credit creation. Although there is delegated decision making, bank managers make their lending decision against a background of rules and head office instructions. There are many variables which influence the rules and the work environment that affect the lending decision (for example, training, internal guidelines, upward referral system and discretionary limits, specific head directives). Therefore the credit decision is a process of interaction between the rules and managers experience.

To efficiently manage banks and financial institutions, identifying relevant metrics and performance indicators for the banking industry is very crucial. Banks exists to provide consumers and business financial services. They are financial institutions that receive, lend, safeguard and invest money on behalf of its customers or depositors. Services provided by banks are extremely important in the free market economies, like United States and Canada (Saunders et al 2006). Two of their primary functions are to supply
customers with mediums of exchange like checking accounts, credit cards, and cash and to accept money from depositors and lending to borrowers.

In the face of tight competition and changing customer’s loyalties, the use of key performance indicators KPIs and relevant metrics will help managers and executives make good corporate decisions that will help achieve their organizational performance. The metrics used as KPIs should yield information that will be useful for managers who are running banks. Key performance indicators may be financial and non-financial. Liquidity ratios are used and considered as crucial KPIs by many financial institutions. According to the uniform bank performance Report, there are twelve liquidity ratios that banks can use as KPIs (Deakens et al 2005). The amount of un-invested fund is another indicator that help bank managers to determine the amount or percentage of bank funds that are fully invested and income-generating. Another indicator is the amount of loan commitments the bank has from the beginning to the end of a certain period. Moreover, to obtain profitability information, it is a good idea to monitor outstanding loans, new loans, ending total loans and principal reduction.

1.1.1 Commercial Banks in Kenya

Kenya features a commercial banking system dominated by numerous commercial banks and a small number of non- bank financial institutions which concentrate mainly on mortgage finance, insurance and other related financial services. Over the years, the sector has grown into a complex scene of banking institutions of different types and ownership. The industry is dominated by a few large banks most of which are foreign-
owned, though some are partially owned locally (Central Bank of Kenya annual report 2010). The banks have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banks interest and addresses issues affecting member’s institutions. The commercial banking in Kenya has become visible and fiercely competitive. Each bank has a strategy unique to its corporate culture, but all of these banks have the same desire to be the customer’s number one choice for their banking products and services. The commercial banking industry in Kenya has been in a state of constant change ever since liberalization and this has seen new sources of risks emerge. More change always demands more leadership.

Due to economic liberalization, competition has become day to day phenomenal, forcing commercial banks to conform to the changing economic environment they find themselves operating in. To step up the competition, they face the challenge to restructure and redesign their credit policies and marketing strategies to become totally market oriented. For commercial banks to effectively survive the competition and retain their market niche, they have to be more innovative and their main drive should be customer’s competition and change (Ndungu, 2008). Currently they are 43 commercial banks in Kenya as at 31st December 2010 and 10 of them are foreign owned while the rest are locally owned. (http://www.centralbank.com)

1.2 Statement of the Problem

Various studies (Rouse 2003, Deakens and Philpott 2005, Bradford 2003) have shown that there is a relationship between credit policy and the performance of banks. Altman, 1971 argues that some element of qualitative, intuitive analysis is required in decision
making, general banks profits increase with change in credit decision. Change in credit policy affect bank performance and depends on the sensitivity of banks decision towards variations in open market policy, this implies that the credit policy is used as a planning and controlling tool of various banks and that there exists a relationship between credit policies and bank performance. Other studies in Kenya (Mwingi 2003, Kilonzo 2003, Kilongosi 2006, and Kimutai 2006) have dwelt more on the credit policies without specific references to the nature of relationship between credit policy and performance of commercial banks in Kenya. Furthermore, prior studies (Binks 2005 and Bachelor 2006) on credit policy were mainly confined to developed countries and very limited evidence is available on developing countries especially from the Africa region. This study therefore seeks to investigate the effects of credit policy on performance of commercial banks in Kenya.

1.3 Objectives of the Study

1.3.1 General Objective

The main objective of this study was to investigate the effect of credit policies and performance of commercial banks in Kenya.

1.3.2 Specific objectives

i. To establish the relationship between loan terms and conditions and performance of commercial banks in Kenya.

ii. To examine the relationship between loan procedures and performance of commercial banks in Kenya.

iii. To examine the relationship between amount of loan disposable and performance of commercial Banks in Kenya.
IV. To examine the relationship between credit information and performance of commercial banks.

1.4 Research Questions

i) What is the relationship between loan terms and conditions and performance of Commercial banks in Kenya?

ii) What is the relationship between loan procedures and performance of commercial banks in Kenya?

iii) What is the relationship between amount of loan disposable and performance of Commercial banks in Kenya?

iv) What is the relationship between credit information and performance of commercial banks in Kenya?

1.5 Significance of the Study

The findings will benefit a wide cross section of people and institutions. First by determining the influence of credit policy on bank profitability, banks will review their credit policies to suit client satisfaction. For instance, they may develop loans products with flexible requirements such as repayment periods, collateral requirements and loans tenure. Further from the recommendations of the study, banks may find it necessary to review transaction costs and length of loan procurement and disbursement procedures. The changes introduced will help the banks develop competitive credit policies and boost their revenue from lending.
The study findings will help the prospective loan seekers to make an optimal decision whereby they are able to choose a source of finance with minimum cost and more benefits both in the short run and long run. Thus their choice of commercial bank loan will be a knowledgeable decision unlike the current scenario whereby many people are ignorant about the cost element of loan capital.

By determining the influence of loan terms such as interest rates on procurement of credit, the government will gain insight into the need to regulate the highest interest rate that banks can charge. This will protect the consumers from exploitation as well as ensuring level play field for commercial banks. The government can use the findings of the study to form a basis of making policies in the banking sector.

Finally, knowledge and information realized through this research undertaking will benefit other researchers who wish to study the same subject as it will provide an insight of what has already been found. They will consequently save time, energy and effort to get areas from those identified for further research.

1.6 Scope of the Study

The study was concerned with the credit policies and their effects on commercial banks performance in Kenya. The study being a survey implies that data was collected from all the forty three Commercial Banks, credit officer was selected from the credit department of each commercial bank. Since most of the commercial banks have their headquarters in Nairobi, the survey was conducted within Nairobi areas.
1.7 Limitations of the Study

The researcher faced bottlenecks of the respondents not divulging all the required information which may have likely influenced achieving the desired results. This may have happened in cases whereby the respondents feared giving information due to lack of trust or giving important information to rival competitors or going against the organization rules and ethics.

The researcher assured the respondents that the information was to be treated with a lot of confidentiality it deserves and it was to be used strictly for research purposes only. The respondents were not willing to give out information pertaining to the subject since they feared that the information may not be confidentially handled which could lead to loss of their jobs. The only way this would happen was if the respondents were not made aware that the researcher was permitted by the management to carry out the investigation on the problem above. In this concern the researcher overcame this issue by giving the letter of research indicating that she was a researcher and that the information collected was for academic purposes. Also the researcher promised that if the information was not treated with a lot of confidentiality she would be held liable.
CHAPTER TWO
LITERATURE REVIEW

2.0 Introduction

This chapter gives the background information to aid the researcher have a wide understanding of the research area. The literature is reviewed to relate to past studies on bank credit policy and their effect on bank performance. Citation from various authors has extensively been involved to ensure a clear path to answering the research questions.

2.1 The Legal Framework of Banking in Kenya

The companies Act, the banking Act and the Central Bank Act and other prudential guidelines which are normally issued by the central banks, govern the banking industry in Kenya. The Central Bank is the main regulator of banks in Kenya. It is the regulating and supervising agency and the manager of monetary policy operations in Kenya. The Central Bank Act, Chapter 492 laws of Kenya empowers it to formulate and implement policy and foster the liquidity, solvency and proper funding of the financial system. One of the secondary objectives of the Central bank is to license and supervise authorized dealers in the money market. The bank also promotes a sound and stable banking system in Kenya by enforcing the requirement banking Act and prudential regulations, fostering liquidity and solvency of banking institutions, ensuring efficiency in banking operations and encouraging high standards of customer service. The bank also work closes with the institute of Certified Public Accounting to and of Kenya (ICPAK) to ensure that the banking sector leads the other sectors in the implementation of Internationals Accounting Standards (IAS).
2.2 The Banking System in Kenya

Kenya features a commercial banking system dominated by numerous commercial banks and a small number of non-bank financial institutions, which concentrate mainly on mortgage finance, insurances, lease hire and related financial services. Over the years, the sectors have grown into a more complex scene of banking institutions of different types and ownership. According to statistics by the Central Bank of Kenya, by the end of 2010, there are 43 Commercial Banks and the non-banking financial institutions offer corporate and retail banking services but a small number offer other services such as investment banking.

2.3 Bank Credit Policy

Bank credit policy is a statement of its philosophy, standards, and guidelines that its employees must observe in granting or refusing a loan request. These policies determine which sector of the industry or business will be approved for loans and which will be avoided and must be based on the country's relevant laws and regulations. Banks are the most important sources of external finance for firms and individuals (Kantor & Maital, 2009). Firms and individuals rely on short-term debt, in particular bank overdrafts from banks (Burns et al., 1992).

Inadequacies of banks appraisal processes in applications under the loan guarantee scheme were highlighted in the Robson (Rhodes report, 2004). Loans that constitute a large proportion of the assets in most banks' portfolios are relatively illiquid (Besanko, Dranove and Stanley, 2006). The theory of asymmetric information argues that it may be
impossible to distinguish higher risk borrower from lower risk borrowers which may result in adverse selection and moral hazards. Adverse selection and moral hazards has led to substantial accumulation of non-performing accounts in banks (Altman, 2008). Adverse selection arises from information asymmetry in a credit market. It’s a problem a lender has in distinguishing between good risk and bad risk investment because the borrower has information that the lender does not (Stiglitz & Weiss, 1981). Financial institutions tend to lend to those borrowers who are highly risking while leaving out applicants who bear less risk. This occurs because high risk individual tend to have a high prosperity to borrower than low risk individuals. Moral hazard results from information asymmetry in that a party insulated from risk may behave differently from the way he would have if he was fully exposed to the risks. Moral hazard can occur with a borrower who may not act prudently in the view of the lender when he invest or spend borrowed funds recklessly.

Lending to high risk borrowers is termed as non-conforming lending which indicate that the loans do not meet traditional standards for mortgage insurance. Non-conforming lending includes giving credit to borrower with chequered credit history, unsubstantial incomes and unstable or no full time employment. Non-conforming credit market is only now gaining the attention of non-bank mortgage originators, which are interested in financing these loans by securitization. Banks continue to leave the non performing loan market to non-traditional provider such as finance companies, professional accountants, solicitors and builders which are able to charge high interest rates to compensate for substantial credit risk these borrowers represent.
Banks need to monitor carefully the risk return profile of their lending portfolio to meet capital adequacy guidelines and to ensure long term survival. The objective of the bank is to maximize profits thus maximize the shareholders wealth. If the primary objective of all bank lending is to make trouble free advances, the financial capacity and previous borrowing experience of a loan applicant and their determination to repay their debts is all important (Berlin & Loeys, 2008).

Research shows that low income earners have lower access to real estate and mortgages, but a higher priority for both, compared to high-income earners (Cheron et al 1999). At the same time, failure to accommodate credit risk increases the likelihood of loan default, which in the short term increase financial institution cost and in the long term is passed on to other borrowers in the form of more expensive and or less accessible retail credit (Luckett 2008). The consumer bankruptcy research emphasizes the need for managers to balance the accessible image and social responsibilities of banks with vigilant assessment and monitoring of the credit risk of individual borrowers.

The loan policy gives the management specific guidelines in making individual loan decision in shaping the institutions overall loan portfolio. This ensures that regulatory standards are met and promotes profitability in the organization. A written policy statement is beneficial as it communications to employees in the loan department which procedures they must follow and what are their responsibility. Therefore it helps the organization to move towards a loan portfolio, controlling its risk exposure and satisfying regulatory requirements. Any exceptions to the policy should be fully documented and
reasons for it listed. Loans department considers all such changes and periodically reviews all loans until they reach maturity. Loan review is crucial as it helps management to identify problematic loans more quickly and acts as a continuing check on whether loans policy is adhered to by loans officer (Rose 2002). Some commercial banks review loan more efficiency such that they are able to top up loan. Written policy guides the banks towards reducing their risks and thus maintaining their profitability thus high performance. It also guides the loan officer in evaluating the kind of client they give loan to. It also helps the bank in lending to those customers who are credit worth thus maintaining the bank performance high.

2.4 Theoretical Framework

Loans that constitute a large proportion of the assets in most banks’ portfolios are relatively illiquid and exhibit the highest Credit Risk (CR) (Koch and MacDonald, 2000). The theory of asymmetric information argues that it may be impossible to distinguish good borrowers from bad borrowers (Auronen, 2003), which may result in adverse selection and moral hazards problems. Adverse selection and moral hazards have led to substantial accumulation of non-performing accounts in banks (Bester, 1994; Bofondi and Gobbi, 2003). The very existence of banks is often interpreted in terms of its superior ability to overcome three basic problems of information asymmetry, namely ex ante, interim and ex post (Uyemura and Deventer, 1993).
The management of CR 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. Several risk-adjusted performance measures have been proposed (Heffernan, 1996; Kealhofer, 2003). The measures, however, focus on risk-return trade-off, i.e. measuring the risk inherent in each activity or product and charge it accordingly for the capital required to support it. This does not solve the issue of recovering loan amount. Effective system that ensures repayment of loans by borrowers is critical in dealing with asymmetric information problems and in reducing the level of loan losses, thus the long-term success of any banking organization (Basel, 1999; IAIS, 2003). Effective Credit Risk Management (CRM) involves establishing an appropriate CR environment; operating under a sound credit granting process; maintaining an appropriate credit administration that involves monitoring process as well as adequate controls over CR (Basel, 1999; Greuning and Bratanovic, 2003; IAIS, 2003). It requires top management to ensure that there are proper and clear guidelines in managing CR, i.e. all guidelines are properly communicated throughout the organization; and that everybody involved in CRM understand them.

Considerations that form the basis for sound CRM system include: policy and strategies (guidelines) that clearly outline the scope and allocation of a bank credit facilities and the manner in which a credit portfolio is managed, i.e. how loans are originated, appraised,
supervised and collected (Basel, 1999; Greuning and Bratanovic, 2003; Price Waterhouse, 1994). Screening borrowers is an activity that has widely been recommended by, among others, Derban et al. (2005). The recommendation has been widely put to use in the banking sector in the form of credit assessment. According to the asymmetric information theory, a collection of reliable information from prospective borrowers becomes critical in accomplishing effective screening.

The assessment of borrowers can be performed through the use of qualitative as well as quantitative techniques. One major challenge of using qualitative models is their subjective nature (Bryant, 1999; Chijoriga, 1997). However, borrowers attributes assessed through qualitative models can be assigned numbers with the sum of the values compared to a threshold. This technique is termed as “credit scoring” (Heffernan, 1996; Uyemura and Deventer, 1993). The technique cannot only minimize processing costs but also reduce subjective judgments and possible biases (Kraft, 2000; Bluhm et al., 2003; Derban et al., 2005). The rating systems if meaningful should signal changes in expected level of loan loss (Santomero, 1997). Chijoriga (1997) concluded that quantitative models make it possible to, among others, numerically establish which factors are important in explaining default risk, evaluate the relative degree of importance of the factors, improve the pricing of default risk, be more able to screen out bad loan applicants and be in a better position to calculate any reserve needed to meet expected future loan losses.
Clear established process for approving new credits and extending the existing credits has been observed to be very important while managing CR (Heffernan, 1996). Further, monitoring of borrowers is very important as current and potential exposures change with both the passage of time and the movements in the underlying variables (Donaldson, 1994; Mwisho, 2001), and also very important in dealing with moral hazard problem (Derban et al., 2005). Monitoring involves, among others, frequent contact with borrowers, creating an environment that the bank can be seen as a solver of problems and trusted adviser; develop the culture of being supportive to borrowers whenever they are recognized to be in difficulties and are striving to deal with the situation; monitoring the flow of borrower’s business through the bank’s account; regular review of the borrower’s reports as well as an on-site visit; updating borrowers credit files and periodically reviewing the borrowers rating assigned at the time the credit was granted (Donaldson, 1994; Treacy and Carey, 1998; Tummala and Burchett, 1999; Basel, 1999; Mwisho, 2001).

Tools like covenants, collateral, credit rationing, loan securitization and loan syndication have been used by banks in developing the world in controlling credit losses (Benveniste and Berger, 1987; Greenbaum and Thakor, 1987; Berger and Udell, 1992; Hugh, 2001). It has also been observed that high-quality CRM staffs are critical to ensure that the depth of knowledge and judgment needed is always available, thus successfully managing the CR in the CBs (Koford and Tschoegl, 1997; Wyman, 1999). Donaldson (1994) and Jeremy and Stein (1999) observed that computers are useful in credit analysis, monitoring and control, as they make it easy to keep track on trend of credits within the portfolio.
Marphata and Tiwari (2004) argued that risk management is primarily about people—how they think and how they interact with one another. Figure 1 represents a model that can be used to develop a prudent credit policy which would caution a bank from credit risks and stimulate borrowing and thus ensure optimum performance of a commercial bank through lending.
The current study will focus on the effect of credit policy adopted by a commercial bank on its performance. The scope of the study will cover the aspects stipulated by the credit policy in place that is; loan terms and conditions, loan procedure, amount of loan disposable and credit information and length of credit relationship. The study will
therefore review the effect of the factors on performance of a commercial bank through lending.

2.5 Empirical Review of Credit Policy

Many surveys on credit policies in Kenya have been mainly qualitative in nature (Raikes, 1989; Alila, 1991; Aleke Dondo, 1994; Daniels et al., 1995). Zeller (1993, 1994) used a univariate probit model to estimate the factors that determine an individual’s borrowing decisions, in terms of their participation in credit markets in Madagascar. The market segments were treated separately in order to identify similarities and differences between the sectors in credit applications and rationing. The results showed that among the informal lenders, age, schooling, wage income, sick days and household headship are significant determinants of applications for credit. On the other hand, gender and social events are not significant. Age, the years of schooling and the ratio of outstanding loans increase the probability of being supply constrained. Higher household wealth reduces the probability of being constrained. In the formal sector, being male significantly increases the probability of applying for a loan. Zeller divided the factors into individual characteristics, labour assets, household events that affect credit demand, and reasons for participation. This approach assumed that an individual’s decision is only affected by internal factors. However, external factors also play an important role in influencing participation in credit markets.
Another study, Nagarajan et al. (1995) identifies a number of conceptual models that can be used in estimating credit demand, especially in fragmented markets with imperfect information. In most models where there is the possibility of loan default due to imperfect contract enforcement, and an upward sloping supply curve, it is assumed that lenders offer borrowers a choice of points on the supply curve, to which they are restricted. It therefore becomes difficult to identify the loan demand schedule using information on observed loan amounts since this reflects only the existing supply. The credit demand function can only be identified from the borrower's participation decision; namely, the decision to borrow or not and from which sector to borrow.

Apart from the conceptual models used in identifying demand for credit, Nagarajan et al. (1995) noted that estimates of loan demand are often biased because they use models that do not adequately correct for selectivity bias or they use data that do not account for the existence of multiple loans. However, in a situation of supply constraints and multiple loans for individual households, it is important to develop a definition of loan demand and data so that all loans obtained from different sources can be measured. Moreover, Nagarajan et al. (1995) further argued that while loan demand is unobservable, it can be inferred under certain behavioural restrictions by aggregating individual loans received from various types of lenders. It therefore becomes important to gather such data that allow all loans from different lenders during a given period to be measured. The authors develop a theoretical and econometric framework to estimate credit demand from field data. This framework has been used by Elhiraika and Ahmed (1998) to estimate loan demand from field data from Sudan.
In another study on decisions adopted by banks in granting loans, Bigsten et al. (2000) estimated credit market participation and constraints faced by firms by modelling the explicit demand for funds by firms and assessing the decision rules used by financial institutions to grant loans. One of the recommendations of the study were that since applying for funds has transaction costs, firms can build internal funds from retained profits. It argued that controlling for risk attitudes, the factors that determine whether firms have a demand for credit are expected return on investment, the opportunity cost of using own funds and the cost of outside funds. Given credit market imperfections, firms may prefer external funds, but would not apply due to inability to meet collateral requirements, perceived low rate of application success, and high costs associated with loan application.

A number of factors explain why certain borrowers prefer to use only specific segments of the credit market. Factors related to the participation of entrepreneurs in credit markets were therefore investigated. Such factors can be divided into enterprise characteristics, and the loan terms and conditions imposed by lenders (Kashuliza and Kydd, 1996; Zeller, 1994).

The study further found out that lending terms and conditions affect the borrowers’ decision about which segment of the credit market to borrow from, and mainly determine the supply of credit. Table 2 presents the comparisons for the loan terms and conditions between the formal and informal sources.
Table 2.1: Mean values of selected loan aspects by formal and informal institutions

<table>
<thead>
<tr>
<th>Loan aspect</th>
<th>Formal</th>
<th>Informal</th>
<th>F-statistic</th>
<th>Level of significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Application fees</td>
<td>301</td>
<td>154</td>
<td>0.827</td>
<td>0.3644</td>
</tr>
<tr>
<td>Collateral value(Ksh)</td>
<td>12973</td>
<td>44</td>
<td>42.2051</td>
<td>0.0000</td>
</tr>
<tr>
<td>Application period(Months)</td>
<td>1.6</td>
<td>0.56</td>
<td>2.9099</td>
<td>0.916</td>
</tr>
<tr>
<td>Repayment period(months)</td>
<td>12</td>
<td>2</td>
<td>27.1857</td>
<td>0.0000</td>
</tr>
</tbody>
</table>

Source: Computed from survey data.

The results show that apart from application fees, all the other loan aspects are significantly different between formal and informal credit markets in this sample. In all cases, the values from formal sources are higher than those in the informal market. Loan terms and conditions therefore appear to be relevant in the choice of which credit market to use.

The lending terms and conditions imposed by formal lenders (emphasizing collateral security) ration a large number of borrowers out of the credit market, leaving only the few who can afford the required collateral. According to Stiglitz and Weiss (1981), lenders would like to identify borrowers most likely to repay their loans since the banks’ expected returns depend on the probability of repayment. In an attempt to identify borrowers with high probability of repayment, banks are likely to use the interest rates that an individual is willing to pay as a screening device. This is likely to be reflected in higher loan amounts applied for and disbursed by the formal sector lenders to the borrowers after rationing out those who do not qualify. The same argument can be extended to the different market segments of the informal sector. (Kraft, E. 2000)
The unique characteristics of credit services provided by the different segments of the informal market to a great extent explain the heterogeneity of the market. In addition, the existence of information asymmetries between borrowers and lenders limits the substitution of credit by switching between formal and informal sectors, thereby inhibiting competition and ensuring segmentation. (Stiglits J. & A. Wells, 1981). The credit market fragmentation also implies that there are few lending units that can satisfy the needs of borrowers interested in certain types of credit. This affects enterprises that want to expand. In this study, it was found that the average amount of credit from the informal market was significantly lower than that from the formal market segment. While credit from informal sources may serve the purpose of enabling small enterprises to start, it may not be adequate for those wanting to expand beyond a certain level of operation. Hence, whereas the informal market may be more accessible than the formal market, it does not satisfy the needs of a certain category of enterprises that are too big for it, but still do not meet the requirements of the formal market. This study therefore also reveals a credit gap in the rural credit markets, capturing those who cannot get credit from the formal market because of the lending terms and conditions, but who fail to get what they want from the informal lenders.(Chijoriga, M.M. 1997)

The availability of credit, or access to credit by borrowers, can be explained in terms of the credit rationing behaviour of lending institutions. According to a study by Zeller (1994), when borrowing credit is perceived as a decision making process, then it starts with the decision of the individual to apply for credit or not. This depends on whether the individual has a demand for credit. The study found out that 164 (49%) respondents who
had borrowed can classified as having had a demand for credit. However, among those who never used credit, there are those who did not apply because they did not need credit, and those who did not apply because they did not perceive any chance of getting credit. Those who did not apply because of lack of need for credit can be classified as not credit constrained, while those who did not apply because of other reasons are considered as credit constrained. In the study sample, 15% of the respondents did not apply because they had no need for credit and are therefore classified as not constrained. The remaining 36% were credit constrained.

Among the 49% who had used credit, there are also those whose loan applications were rationed and they did not get the total amount applied for. A comparison of means between the amount applied for and amount received showed that the amount applied for is significantly higher than the amount received from both formal and informal sources. This suggests the existence of loan quantity rationing in both the formal and informal segments of the credit market. The differences between the amount applied for and amount received in both markets was tested for statistical significance. The results are presented in Table 3. The extent of credit rationing in the three segments of the informal market was also tested.
Table 2.2: Results of t-test for the differences in means between the amounts applied for and received in both formal and informal credit markets

<table>
<thead>
<tr>
<th>Market type</th>
<th>Mean amount applied for (Ksh)</th>
<th>Mean amount received (Ksh)</th>
<th>t-value</th>
<th>Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal</td>
<td>51961</td>
<td>29018</td>
<td>2.77</td>
<td>0.008</td>
</tr>
<tr>
<td>Family and friends</td>
<td>10461</td>
<td>8870</td>
<td>1.53</td>
<td>0.140</td>
</tr>
<tr>
<td>Group based</td>
<td>2284</td>
<td>1703</td>
<td>1.85</td>
<td>0.072</td>
</tr>
<tr>
<td>Commercial renders</td>
<td>23012</td>
<td>11252</td>
<td>2.04</td>
<td>0.046</td>
</tr>
</tbody>
</table>

Source: Computed from research data.

The results show that the difference between the amount applied for and that received is statistically significant in both credit markets, suggesting the existence of credit rationing in both markets. However, in the informal market, the difference between amount applied for and amount received is only statistically significant among the group based lenders and the commercial lenders. Among family and friends, the differences are not statistically significant, suggesting less credit rationing in this market segment. The concern with loan repayment among the formal lenders is given more emphasis and determines the amount of credit actually disbursed to the borrower compared with the amount applied for. Among the informal lenders, the deviation between the amount applied for and that received is attributed to their limited resource base (Aryeeetey, 1996b). The result is a credit gap capturing those borrowers who cannot get the type of credit they need from informal sources, and yet do not qualify for credit from the formal sources due to their lending terms and conditions. Two types of credit rationing can
therefore be identified whereby those who are credit constrained are discouraged from seeking credit due to the lending terms and conditions, and loan quantity rationing whereby those who apply receive less than they applied for.

The small number of respondents who used credit is attributed to lack of information about credit and lack of security. As already seen only 15% of the sample was not credit constrained, although only 49% revealed their demand by applying for credit. For the remaining 36%, their perception about the credit market implies a lack of supply, which creates lack of demand, displayed in lack of revealed demand for credit through application. This also tends to support the argument that there are a number of obstacles preventing the transformation of potential demand into revealed demand in Africa (Aryeetey, 1996b). Although potential borrowers need credit, and may have the ability to repay the loans, the lending terms and conditions, especially by the formal institutions, prevent them from seeking credit. Due to lack of information about the borrowers, lenders are not able to extend loans to some of the applicants. On the other hand, borrowers’ ignorance about existing credit opportunities hinders them from seeking credit. Hence markets with information asymmetry and problems of contract enforcement result in loan rationing by the lenders and eventually the inability to satisfy the existing demand as implied by these results.

The studies reviewed in the ongoing discussion indicate that credit terms imposed by a bank or in any form of lending institution determine not only the demand for credit but also the category of the borrowers. Credit policy adopted by a bank therefore is critical in
determining the revenue that a lending institution can realize through lending. The current study will investigate the influence of credit policy adopted by a commercial bank on the performance of the bank.

2.6 Credit Analysis

According to Rose 2002 credit analysis refers to what makes a good loan. The credit department must ensure that the borrower is credit worthy. Borrower’s credit worthiness is the ability of a customer to pay out the credit when due with a comfortable margin of five aspect of loan application; character, capacity, cash/capital, collateral and conditions.

Character

Customer’s responsibility, truthfulness, serious purpose and intention to repay loan makes up character. If the customer is insincere in promising to use borrowed funds as planned and in repaying as agreed, the loan should not be made to avoid a credit problem. The loan officer must be convinced that a customer has a well defined purpose for requesting credit and a serious intention to repay.

Capacity

The capacity to borrow money refers to the authority to request a loan and the legal standing to sign a binding loan agreement by a customer. Thus a borrower must not be a minor and supportive documents must be provided for example pay slip of an employee. According to German and Forgue 1997 capacity refers to the income available to make
repayment. Having a substantial income, holding the same job for several years and
having few other debt payments suggest a strong financial capacity to repay.

**Cash/Capital**
This refers to borrower ability to generate enough cash, inform of cash flow, to repay the
loan. There are three sources used by a customer to repay a loan namely cash flows from
sale or income, sale or liquidation of assets or funds raised by issuing debt or equity
securities. There is strong preference for cash flows as the principal source of loan
repayment because assets sales can weaken a borrowing customer and make the creditor
position less secure.

**Collateral**
This refers to borrower’s possession of adequate quality assets to provide adequate
support for the loan. Its property offered and pledged to secure repayment of a loan and
subject to seizure should the borrower fail to repay as defined by (German and Forgue
1997).

**Conditions**
This refers to recent trends in the borrower’s line of work and how changing economic
conditions might affect the loan such as inflation, declining income or sales. For instance
when the government actions and market conditions result in a restriction in the supply of
money, less money is available for lending in such cases; many applicants who would
have been approved for credit under better condition will be rejected.
Borrowers credit worthiness is assessed after considering the ‘five C’s’ credit risk management should include strict delinquency monitoring, loan loss provision and collection procedures. Credit risk is measured most accurately when loans are approved and processed on the basis of ‘five C’s’ character, capacity or cash, capacity, collateral and conditions. Loans must be disbursed according to established credit polices and procedures (David & Murungi, 2004). Loan analysis should therefore be guided by policies; terms and conditions of lending requirements, loan acquisition procedures and amount of loan disposable.

2.6.1 Loan terms and conditions and their effects on performance

These are the basic requirements a member is required to meet to quality for a loan in the financial institution. The stricter the loan terms and conditions are, the less the members are willing to go for the service. Better terms will encourage borrowers to borrow for instance loan repayment period, which refers to the period a member is given to repay the amount of loan given, the longer the period the more attractive it is to members.

Other terms include interest rate of the loan which is based on the estimated risk of a particular borrower; the higher the interest rate the lesser the loan is attractive to members. To avoid the adverse selection problem i.e. the higher credit interest rate associated with higher loan risk, the internal performance measure tries to reduce the asymmetric information between the borrower and bank by monitoring the employees and accurately assess the borrower’s management capability and it strategic fit.
Small business operators and small business aspirants across the country have, for several years, been complaining about what many believe has been a generally negative posture on the part of local commercial banks towards lending for modest business venture. Their primary goal has to do with the banks’ lending conditions, which, the would-be borrowers contend, cannot, in many cases, be met by small struggling businesses. They point out too that since the vast majority of the local business sector comprises small businesses, it follows they contend, that commercial banks ought to assume more accommodating credit postures if they are really concerned about their role in helping the local economy to grow.

The banks, for their part, have been quick to point out that prudent management of risk lies at the very heart of their credit policies and that since, in many cases, the risks involved in lending for small business purposes are somewhat greater, that is all the more reason why their risk management systems must be both more efficient and more effective. In this case, commercial banks have terms and conditions with requirements which must be met when one wants a loan with them. Cheron, Boidin and Daghfous (2009) contend that many people or organizations find it hard to meet the necessary requirements in terms of interest rates, fees and repayment terms among others. This prevents them from accessing loans from commercial banks.

2.6.2 Amount of loan disposable and their effects on performance

This is the highest amount of loan a member can qualify for, based on his salary or lending requirements of commercial banks. The higher amount of loans given, the higher
it’s positively attracts its members. The bank will assess customer’s repayment capacity while deciding the loan eligibility. According to Hempel and Simonsen (2009), the amount of the loan depends on the tenure of the loan, collateral, borrower’s ability to repay and the rate of interest as these variables are related to the borrower’s monthly outflow which is turn depends on their disposable income. Banks generally fix an upper age limit for most loan applicants. This implies that people earning less and would like to get large loan amounts may not access them. The main concern of the bank is to make sure that the borrower comfortably repays the loan on time and ensures end use. The higher the monthly disposal income, the higher will be the amount a borrower will be eligible for loan. Typically a bank assumes that about 55 – 60% of a borrower’s monthly disposable income is available for repayment of loan.

2.6.3 Credit information and the length of credit relationship with the Bank and their effects on performance

This refers to information supplied by a credit agency of the economic circumstances of the borrower. The information helps lenders assess the risk of lending money to loan applicants. Many different scoring systems exist, but they all use the borrower’s credit history to predict the likelihood of repayment, based on the past behaviour of borrowers with similar profiles. Credit information and length of lending relationship with bank are among the most important factors when a lender makes a decision to reject or approve an applicant, and they also affect the rate and terms that lenders will offer (Deakins and Hussein, 2005). According to (Rajan (1992) and Peterseny Rasan (1994) among others, a long lending relationship reduces a severity of information asymmetries experienced by
the banks by providing it with information on the borrower’s credit history, and her account movements. The firm’s economic performance may convey valuable information to the banks, one it reveals the degree of competitiveness in the aggressive markets, two, it’s an indication of productive diversification against domestic shocks, thus the probability of default of such firms is lower (Atieno, 2004).

### 2.6.4 Loan procedures and their effects on performance

This is the process followed in obtaining a loan from a financial institution. The procedure of obtaining a loan from some commercial banks is lengthy in that, after submission of a loan application forms, there is loan verification by different department, documentation; before loan disbursement and finally cheques are dispatched. The bank with short loan application procedures attracts more customers. Saunders and Lange (2006) argue that there are many potential customers who stop the loan application halfway because of the frustrations they experience from banks. They opt for other financial sources which do not have complications as they call them. This gives the implication that the loan procedures used by commercial banks could either make or break a bank’s lending activity.

### 2.7 Commercial Banks Performance

Performance measurement by banks performance measurement is the process of identifying the strengths and weakness of a firm (Pandey, 2004). The management of an organization is interested in knowing the financial strength of the firm to make use of them. Similarly they are interested in establishing the financial weakness of the firm so
as to be able to take corrective actions (Coulthrust, 2001). Performance measures can be who as warning signs or indictors that corrective actions are needed to improve the firm’s financial position and profitability. The information provided from financial performance measures also allows managers to make strategic plans and track their progress relative to the firm’s goals.

Commercial banks performance which is in the deposits they determine the commercial banks competitiveness in the

Banks financial performance will be measured in terms of surplus generated. Other parameter to be used are; membership, total deposit, loan disbursement and loan delinquency rate. According to Jeremiah and Joseph (2007), capital accumulation depends on membership and deposit level which is used to generate profits. Therefore large membership and volumes of member deposit will lead to high capital formation as well as high profits for the banks as they will be able to meet high demand for loans. Kenya Commercial banks capital fund is massive and keeps them afloat in their financial business thus they are able to meet larger unsecured loans amounts by clients compared to SACCOS.
2.8 Conceptual Framework

There were four independent variables considered in the study namely; loan terms and conditions, loan procedures, amount of loan disposable and credit information and length of lending relationship. The research sought to establish the effects of these independent variables on commercial banks performance which is the dependent variable and how they determine the commercial banks competitiveness in the financial sector. The relationship between the independent and dependent variables can be conceptualized as below.

<table>
<thead>
<tr>
<th>Loan procedure</th>
<th>Ability to repay</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lengthy procedures.</td>
<td></td>
</tr>
<tr>
<td>Delay in loan processing and disbursement</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Amount of loan disposable</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan tenure</td>
<td></td>
</tr>
<tr>
<td>Collateral/ securities</td>
<td></td>
</tr>
<tr>
<td>Disposable income</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Credit information and length of credit relationship with bank</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrower's credit history</td>
<td></td>
</tr>
<tr>
<td>Account movement</td>
<td></td>
</tr>
<tr>
<td>Behavioural</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Researcher, 2011*
Figure 2.2: Conceptual Framework

Schematic diagram showing the relationship between independent variables and dependent variable.

**INDEPENDENT VARIABLES**

<table>
<thead>
<tr>
<th>Loan terms and conditions</th>
<th>INTERVENING VARIABLES</th>
<th>DEPENDENT VARIABLE</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Repayment period.</td>
<td>• Political factors</td>
<td>Commercial Banks</td>
</tr>
<tr>
<td>• Interest rates.</td>
<td>• Economics factors</td>
<td>Performance</td>
</tr>
<tr>
<td>• Credit transaction costs</td>
<td>• Regulatory framework</td>
<td>• Profitability</td>
</tr>
<tr>
<td>• Ability to repay</td>
<td></td>
<td>• Number of loans /value granted</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Loan procedure</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Lengthy procedures.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Delay in loan processing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>and disbursement</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Amount of loan disposable</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Loan tenure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Collateral / securities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Disposable income</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Credit information and length of credit relationship with bank</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Borrowers credit history</td>
<td></td>
</tr>
<tr>
<td>• Account movement</td>
<td></td>
</tr>
<tr>
<td>• Personal behaviour</td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Researcher, 2011
Loan terms and conditions

These are the basic requirements a member is required to meet to qualify for a loan in the financial institution.

Amount of loan disposable

This is the highest amount of loan a member can qualify for.

Loan procedure

This is the process followed in obtaining a loan from a financial institution.

Credit information and length of credit relationship with bank

This refers to information supplied by a credit agency of the economic circumstances of the borrower.

2.9 Summary of Literature and Research Gap

The literature review has addressed the effects of credit policy adopted by a bank. Credit policy has been defined as a statement of philosophy, standards and guidelines that bankers observe in granting or refusing a loan request while performance was taken to refer to change in number or value of loan granted and profit level. Commercial banks were used because of the role they play in the economy; they act as barometer to reflect important changes in the economy, they are governed by CBK which operates with favourable policies such as deregulation of interest rates, reduction of imposed regulations and restrictions of commercial banks. The literature reviewed has identified the aspects of credit policy that affect the performance of a bank as loan procedures, loan terms and conditions, amount of loan disposable as well as credit information gathered by the bank on the potential customer. The literature reviewed has however revealed that
the nature of the influence of the factors identified on the performance of a bank has not been extensively been addressed. The study will therefore seek to bridge the knowledge gap that exists on the impact of credit policy on the performance of the commercial banks.

3.1 Research Design

Research design refers to the way the study is designed, that is, how a research (Kothari, 2003). The study used descriptive research, an investigation in which data is collected and analyzed in order to describe phenomena in its current trends, current events and linkages between the current time (Kothari, 2004). Descriptive research design enables the researcher to generalize the findings to a larger population or therefore be able to generalize the findings to all commercial banks. This method was appropriate because it explores and describes the characteristics of variables in their natural setting without manipulating them. Survey information that can be analyzed, patterns extracted and constructs purpose of classification and provision on the basis of making decisions. Financial budget allocated and taking cognizance of the fact that contain many variables that cannot realistically be controlled, the most appropriate
CHAPTER THREE
RESEARCH METHODOLOGY

3.0 Introduction
This chapter focuses on the researcher’s scope of methodological procedures to be employed in the study. These include research design, target population, sampling design, data collection instrument, pilot study, data analysis techniques and validity and reliability of the instrument.

3.1 Research Design
Research design refers to the way the study is designed, that is, the method used to carry out a research (Kothari, 2004). The study used descriptive research which refers to the investigation in which data is collected and analyzed in order to describe the specific phenomena in its current trends, current events and linkages between different factors at the current time (Kothari, 2004). Descriptive research design was chosen because it enables the researcher to generalize the findings to a larger population. This study will therefore be able to generalize the findings to all commercial banks in Kenya. This method was appropriate because it explores and describes the relationships between variables in their natural setting without manipulating them. Surveys aim at obtaining information that can be analyzed, patterns extracted and comparison made for the purpose of classification and provision on the basis of making decisions. Given the time frame, budget allocated and taking cognizance of the fact that educational research contain many variables that cannot realistically be controlled, the descriptive design was the most appropriate.
3.2 Target Population

Population can be defined as a complete set of individuals, cases, objects with some common observable characteristics of a particular nature distinct from other population. Target population is defined as the population to which a researcher will generalize the results of a study. The population of the study constituted all the forty three commercial banks in Kenya as at 31st December 2010. (Central Bank of Kenya, 2010). The target population is forty three respondents. Credit officers from each commercial bank were required to fill the questionnaire.

3.3 Sampling Design

A census of these commercial banks was taken. The study being a survey implies that data was collected from the credit officers from all the forty three commercial banks. According to Mugenda & Mugenda (2003) subjects in the actual sample should not be used in the pilot study thus census was carried on headquarters of each commercial banks. Since most of Commercial banks have their headquarters in Nairobi the survey was conducted within Nairobi areas.

3.4 Pilot Study

Prior to the main research a pilot study was done to verify the instrument for data collections i.e. establish its validity and reliability of the instrument. According to Mugenda & Mugenda (2003), a pretest sample should be at least 10% of the population. Therefore four branches of commercial banks was selected using simple random sampling method. This method was used to ensure each and every element in the
population has an equal and independent chance of being included in the sample (Gall et al 1996) The importance of the pilot study was to find out if; the questionnaire covered all intended dimensions of the research, all questions are clear and unambiguous and the space provided for the answer was adequate. Any modification and adjustment to the questionnaire was made after the piloting, in preparation for the main research.

3.5 Data Collection Instrument

The researcher developed the instrument with which to collect the necessary information. Questionnaires are commonly used to obtain important information about the population (Orodho, 2004) especially when the respondents can be reached.

The questionnaire contained the questions which were structured of close-ended questions and also a few open –ended questions. Close-ended questions were accompanied by a list of possible alternatives from which respondents were required to select the answer that best describes their situations. The main advantage of closed ended questions is that they are easier to analyze since they are in an immediate usable form. They are also easy to administer because each item is followed by an alternative answer and is also economical to use in terms of time saving while open-ended questions will facilitate in-depth response and opinions beyond the researchers scope of under stability.

The questionnaire was divided into four sections which were filled by credit officers from each of the commercial banks.
3.5.1 Data Collection Procedures

An introduction letter from Kenyatta University was obtained to enable the researcher administer questionnaires. Two research assistants were engaged to minimize time spent on data collection. Respondents were assured of confidentiality in handling of responses. The questionnaires were delivered to credit officers at their respective banks.

Both primary and secondary data was used in this study. According to Ochola 2007 primary data is the one collected directly by the researcher for the purpose of his research while secondary data is information that has been collected by others for their specific use that a researcher intends to use. Secondary data was from available published financial statements of commercial banks in Kenya. Questionnaire was used to collect primary data and it was administered by “drop and pick” method to all respondents. This method was suitable as it avoids subjectivity due to absence of interviewer’s influence. Respondents were given sufficient time on items that require consultation before responding (Bless and Achola, 1987).

3.6 Data Analysis

To analyze is to search and identify meaningful patterns in data (Achola, 2007) points out that analysis means, categorizing, ordering, manipulating and summarizing of data to obtain answers to research questions. The data to be collected in the research was edited, coded, classified on the basis of similarity and then tabulated. Being a descriptive study, descriptive statistics such as percentages, frequencies tables, pie charts and graphs were used to summarize and relate variable which were obtained from the administered questionnaire.
To facilitate qualitative analysis, data was first organized into categories which were distinct from each other. Generating categories was done using codes and each code represented particular phenomena. The generation of categories and subsequent analysis has been made easier by the introduction of a qualitative data analysis computer programme which can locate and merge codes making it easier for the researcher to identify categories and specific patterns. Statistical Packages for Social Sciences (SPSS) was used to process data in order to determine the relationship between variables.

3.7 Validity and Reliability of the research instrument

3.7.1 Validation of research instrument

Validation is ensuring that a test measures what it is suppose to measure (Kombo & Trump, 2006). The content validity of the research instrument was ensured through expert judgment provided by the supervisors who examined the content of the instrument and indicated the degree to which the instrument could gather the intended information. Gall et al (1996) points out that content expert help to determine content validity by defining in precise terms the domain of the specific content that the test is assumed to represent and then determines how well that content universe is sampled by the test. Suggestions made by the supervisors were used to improve the instrument.

3.7.2 Reliability of research instrument

This is the degree to which a test consistency measures whatever it measures (Kombo & Trump). Reliability of the instrument was tested during piloting. The research instrument was piloted in four branches of commercial bank through credit officers. Wiersma (1985) observed that piloting is important as it, helps identify misunderstanding, ambiguities
4.0 Introduction.

This chapter presents the findings under the research questions that guided the study. The study is of descriptive nature and thus the data will be largely analyzed using percentages and presented using descriptive methods; that is, pie charts, bar graphs and tables.

i. What is the relationship between loan terms and conditions and performance of Commercial banks in Kenya?

ii. What is the relationship between loan procedures and performance of commercial banks in Kenya?

iii. What is the relationship between amount of loan disposable and performance of Commercial banks in Kenya?

iv. What is the relationship between credit information and performance of commercial banks in Kenya?

The purpose of the study was to determine the effect of credit policies and performance of commercial banks in Kenya and aimed at establishing the credit policies adopted by commercial banks, determining the factors considered when developing credit policies by commercial banks and determining the effect of credit policies on performance of commercial banks.
4.1 Response rate

The target population of the study was all the credit officers of commercial banks in Kenya located in Nairobi who numbered 43. Out of the 43 questionnaires that were administered 37 were received back accounting for 86.05% while 13.95% that is 7 questionnaires were not returned despite several reminder given to them to do so. This response rate was considered high enough to validate the findings of the study.

4.2 Credit policies adopted by commercial banks

Bank credit policy is a statement of its philosophy, standards, and guidelines that its employees must observe in granting or refusing a loan request. These policies determine which sector of the industry or business will be approved for loans and which will be avoided and must be based on the country’s relevant laws and regulations (Kantor & Maital, 2009).

4.2.1 Presence of a written credit policy

The researcher sought to find out whether banks have a written credit policy in force. The responses were as shown in figure 4.1.
The findings of the study revealed that majority of the banks (83.3%) have a written credit policy in force while a sizable proportion of the banks (16.2%) do not have one. Owing to the importance as underscored by (Kantor & Maital, 2009), the banks that operate without a written credit policy may lack a standard way of administering credit to their customers which may adversely affect their ability to compete with other players in the market.

4.2.2 Frequency of reviewing credit policy

When asked how often the banks review their credit policies. The findings were as displayed in figure 4.2.
Majority (49%) of the respondents said that their banks review their credit policies very often, 27% of the respondents said their banks review the credit policies often, 14% said the banks do not review their credit policies often while only a small proportion of the respondents said that the banks never review their credit policies. The findings of the study therefore report that in the banks where the credit policies are in force, the policies are reviewed regularly.

### 4.2.3 Setting interest rates charged on loans

The researcher further sought to find out how the banks set the interest rates on the loans they process. The findings of the study were as summarized in table 4.1.
Table 4.1 Setting of interest rates on loans

<table>
<thead>
<tr>
<th>Setting of Interest Rates</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subsidized</td>
<td>10</td>
<td>27.0</td>
</tr>
<tr>
<td>Prevailing market rate</td>
<td>20</td>
<td>54.1</td>
</tr>
<tr>
<td>At a premium rate</td>
<td>7</td>
<td>18.9</td>
</tr>
<tr>
<td>Total</td>
<td>37</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Majority of the respondents (54.1%) reported that their banks set the interest rates for the loans procured from the banks at the prevailing market rates. 27% of the respondents said that their banks set the interest rates below the prevailing market rates at a subsidized rates while only a small proportion of the respondents (18.9%) reported that their banks set the interest rates at a premium rate; that is; above the prevailing market rates. The findings therefore imply that most banks offer loans at the market rate or at a premium rate.

4.2.4 Setting repayment schedules

The researcher sought to find out how the banks set the repayment schedules. The findings were as displayed in table 4.2

Table 4.2 Setting of repayment schedules

<table>
<thead>
<tr>
<th>Setting of Repayment Schedules</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negotiated with client</td>
<td>13</td>
<td>35.1</td>
</tr>
<tr>
<td>Pegged to type of loan</td>
<td>11</td>
<td>29.7</td>
</tr>
<tr>
<td>Depend on principal amount</td>
<td>7</td>
<td>18.9</td>
</tr>
<tr>
<td>Fixed by bank</td>
<td>6</td>
<td>16.2</td>
</tr>
<tr>
<td>Total</td>
<td>37</td>
<td>100.0</td>
</tr>
</tbody>
</table>

47
Majority of the respondents 35.1% said that their banks negotiate with their clients in order to come up with the repayment schedules, 29.7% of the respondents reported that their banks peg the repayment schedules to the type of the loan, 18.9% of the respondents said that the repayment schedules are determined by the principal amount of the loans granted while 16.2% said that the interest rates are fixed by the banks. The findings therefore indicate that majority of the banks are responsive to their clients as far as the fixing of repayment schedules are concerned. This is likely to boost the competitiveness of the banks that negotiate with their clients in fixing the repayment schedules for the loans.

4.2.5 Percentage of the loan amount constituting loan transaction costs

The researcher further sought to establish the portion of the loan granted by the banks that go to financing of the loan transactions and which have to be offset upfront from the loan amount granted. The findings were as tabulated in table 4.3.

<table>
<thead>
<tr>
<th>Table 4.3 Percentage of loan amount constituting transaction costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
</tr>
<tr>
<td>---</td>
</tr>
<tr>
<td>Percentage of loan taken by transaction costs 37</td>
</tr>
</tbody>
</table>

The findings of the study show that the transaction costs charged by the banks range from 2.5% to 5.5% of the loan amount granted. The average transaction cost charged by the banks is 3.7838% and the standard deviation of 0.84344. The findings therefore imply that the deviation between the transaction costs charged by the banks is low and thus the banks charge almost equal transaction costs on the loans.
### 4.2.6 Handling of lending risks

On the lending risks and the way the banks manage them, the study sought to determine how the banks manage the lending risks. The responses were as displayed in figure 4.3.

**Figure 4.3 Handling of lending risks**

- Charged on the client: 40.5%
- Absorbed by the bank: 37.8%
- Insured: 21.6%

Majority of the respondents (40.5%) said that their banks have an insurance policy against the lending risks. 37.8% of the banks charge the lending risks on their customers while only 21.6% of the banks absorb the lending risks.

### 4.2.7 Influence of loan terms and conditions on loan volumes

The study sought to establish the influence of loan terms and conditions on the loan volumes sought from a bank. The findings were as summarised in figure 4.4.
Majority of the respondents (91.9%) said that loan terms and conditions influence the volumes of loans sought from a bank. Only a small proportion (8.1%) of the respondents said that loan terms and conditions have no influence on the volume of loans sought from a bank.

4.2.8 Effect of loan terms and conditions on bank’s competitiveness

The study further sought to determine the effect of loan terms and conditions on the competitiveness of a bank. The findings of the study were as summarised in figure 4.5.
Majority of the respondents (37.8%) said that loan terms and conditions affect a bank’s competitiveness to a large extent, 21.6% responded; to a small extent, 18.9% responded; to a very small extent, 13.5% said to a very large extent while only 8.1% said that loan terms and conditions have no effect on the bank’s competitiveness. The findings therefore imply that the nature of loan terms and conditions have a large effect on the bank’s competitiveness.

4.2.9 Effect of the adherence to loan terms and conditions on bank performance.

When asked whether the number of and adherence to the loan terms and conditions have any effect on the performance of a bank, the findings were as summarised in figure 4.6.
Figure 4.6 Effect of adherence to the loan terms and conditions on bank performance

Most respondents (73%) said they do affect while a few (27%) said they do not. The findings therefore imply that the number of the loan terms and conditions and the strictness of a bank in adhering to them have an effect of the performance of a bank.

4.3. Factors considered when developing credit policies

Having established the nature of the influence of credit policy on the performance of a bank, the study sought to determine the factors considered when developing the credit policy for a bank.

4.3.1 Number of processes for approving a loan

Table 4.4 Number of processes for approving a loan

<table>
<thead>
<tr>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of processes of approving a loan</td>
<td>37</td>
<td>2.00 5.00</td>
</tr>
</tbody>
</table>

52
The findings of the study shown in table 4.5 indicate that the number of processes of approving the loan application forms range from 2 to 5 among the banks with a mean of 3.27 and standard deviation of 0.99. This implies that the number of processes of approving a loan application is fairly uniform across the banks. This further implies that the number of processes involved in the approval of loans is a factor considered to be instrumental to the revenue generation through lending by most of the banks.

4.3.2 Duration taken in process loan application form

When asked how long their banks take to process loan application forms, the responses were as shown in figure 4.7

Figure 4.7 Duration taken to process loan application form

Majority of the banks (37.8%) take 1-3 days, 24.3% take less than a day and 21.6% take 4-5 days while only 16.2% of the respondents take more than five days. The findings indicate that majority of the banks take less than 3 days to process application forms. This
indicates that the length of time taken in processing of loan is considered by most of the banks as one of the important factors in drafting a credit policy.

4.3.3 Duration taken in disbursing successful loan amounts

The study sought to establish the amount of time the banks take to disburse successful loan amounts. Figure 4.8 shows the responses obtained.

![Figure 4.8 Duration taken to disburse successful loan amounts](image)

Majority of the banks (49%) take 1-3 days to disburse loan amounts, 24% take less than a day and 19% take 4-5 days while 8% of the banks take more than five days. The findings indicate that majority of the banks take up to 3 days to disburse loan amounts to the successful applicants. The number of the banks taking more than three days is very small which means that time taken before disbursing the loan amounts is important to most banks in drafting the credit policy.
4.3.4 Percentage of loan applications rejected for non compliance

On the adverse effects of the conditions imposed by the credit policies on the loan applications, the study sought to determine the percentage of loan applications that are rejected for not complying with the loan terms and conditions. Figure 4.9 shows the responses obtained.

Figure 4.9 Percentage of loan applications rejected for non compliance

Most respondents (41%) said that 1.1%-3% of the loan applications are rejected, 35% of the respondents said that 3.1%-5% of the applications are rejected, 16% said that below 1% of the applications are rejected and only 8% of the respondents said that above 5% of the loan applications are rejected for non compliance. The findings show that very small number of loan applications is rejected for not complying with the terms and conditions spelt out in the credit policies.
4.3.5 Duration taken before loan repayment commences

The study also sought to examine the duration of time taken before loan repayment is commenced. The findings of the study were as displayed on figure 4.10.

**Figure 4.10 Duration taken for loan repayment to commence**

![Bar chart showing duration taken for loan repayment to commence](image)

Majority of the respondents (38%) said that repayment begins between 1-2 months after completing the loan contract, 35% said that the loan repayment begins more than two months after completing the loan contract forms while 27% of the respondents said that loan repayment begins less than one month after signing the loan contract. The findings indicate that most banks start recovering the loans more than one month after the loan contract is signed and thus the customers are allowed time to re adjust to the new financial arrangements.
4.3.6 Duration taken before computation of loan interest commence

Further, the study sought to establish the duration taken before computation of loan interest commences.

Figure 4.11 Duration taken before loan interest computation commence

![Bar chart showing the percentage of respondents indicating the period before commencement of interest computation.](chart)

Majority of the respondents (43%) said that the commutation of the loan interest begins after the first installment is due, 32%, that it begins after disbursement of the loan amount while 24% of the after signing the loan contract. The findings indicate that most banks do not compute the loan interest until the loan amount is disbursed to the customer.

4.3.7 Effect of loan procedures adopted on the volume of loans

The study sought to determine the effect of loan application procedures applied by the banks on the volume of loans sought from the banks. Figure 4.12
Majority of the respondents (86.5%) said that loan procedures adopted by the banks affect the loan volumes and only 13.5% of the respondents said that loan conditions do not affect loan volumes procured at the banks. This implies that in most cases the nature of the loan policies a bank adopts affect the volume of loan applications that a bank attracts.

4.4 Effect of credit policies on performance of commercial banks

The study further aimed at quantifying the effect of credit policies on the performance of commercial banks. This was carried out by surveying the success rates of the loan applications.

4.4.1 Success of loan applications

On the rate of success of loan application forms, the responses elicited were as displayed in figure 4.13.

58
The findings show that majority of the respondents (62.2%) said that all the loan applications received succeed while 37.8% of the respondents said that not all the loan applications succeed. The findings imply that most of the loan applications received by the banks are approved.

4.4.2 Reason for rejection of loan applications

Further, the study sought to establish the reasons given for rejection of the loan applications. Table 4.5 summarizes the responses obtained.

Table 4.5 Reasons for rejection of loan applications

<table>
<thead>
<tr>
<th>Reason</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non compliance with conditions</td>
<td>21</td>
<td>91.3</td>
</tr>
<tr>
<td>Lack of sufficient liquidity</td>
<td>2</td>
<td>8.7</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100.0</td>
</tr>
</tbody>
</table>
A large majority (91.3%) cite non compliance with the conditions in force as the major reason for rejection of loan applications while only 8.7% of the respondents give lack of sufficient liquidity in the bank as the reason behind rejection of loan applications. The findings therefore conclude that most of the loans are rejected due to their inability to meet the loan terms and conditions as spelt out in the credit policies. This further implies that credit policies are very vital in deciding which loans are rejected or accepted.

4.4.3 Level of satisfaction with loan amounts granted

The study sought to determine the levels of satisfaction of loan applicants with the amounts of the loans granted after being completed. Figure 4.14 summarize the findings obtained.

Figure 4.14 Level of satisfaction with loan amounts granted

Majority of the respondents (78.4%) said that the customers are satisfied with the loan amounts granted while only 21.6% were of the opinion that the customers are not satisfied with the loan amounts granted.
4.4.4 Appeals on failed loan applications

When asked whether the customers whose loan applications do not succeed appeal for more allocations. The responses obtained were as shown in figure 4.15.

Figure 4.15 Appeals on failed loan applications

 Majority of the respondents (86%) said that the customers whose applications fail do not appeal for more allocations while only 14% of the respondents said that the customers appeal for more allocations. This implies that most of the customers are satisfied with the verdict given according to the credit policy.

4.4.5 Determination of loan tenures

Further, the study sought to determine how the loan repayment schedules are fixed. The responses were as summarized in table 4.6.
Table 4.6 Determination of loan tenures

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discussed with client</td>
<td>13</td>
<td>35.1</td>
</tr>
<tr>
<td>Determined by loan amount</td>
<td>19</td>
<td>51.4</td>
</tr>
<tr>
<td>Determined by loan type</td>
<td>5</td>
<td>13.5</td>
</tr>
<tr>
<td>Total</td>
<td>37</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Majority of the respondents (51.4%) said that the loan repayment schedules are determined by the loan amounts, 35.1% of the respondents said that the loan repayment schedules are determined with discussion with the client while 13.5% of the respondents said that the repayment schedules are determined by the loan type. This implies that in most banks, the credit policy dictates the loan repayment schedules and that the schedules are not flexible.

4.4.6 Collateral requirements

On the collateral requirements demanded by the banks, the study sought to determine how relaxed they are. The responses obtained were as displayed in figure 4.16.
Majority of the respondents (59%) rated the collateral requirements of their banks as relaxed, 24% as very relaxed, 11% as stringent and 5% as very stringent. The findings indicate that in most banks, the collateral requirements are not fixed but can be varied as need arises. This is likely to increase the volume of loans procured since an appreciable number of customers who seek lending lack collateral.

4.4.7 Effect of loan requirements on loan volumes

The study sought to determine the effect of loan requirements on loans volumes. The findings of the study are as summarized in figure 4.17.
Majority of the respondents (64.9%) said that loan terms and conditions affect loan volumes to a small extent, 18.9% said that loan terms and conditions affect the loan volumes to a very small extent, 10.8% said that the loan terms and conditions affect the loan volumes to large extent while 5.4% of the respondents were of the opinion that loan terms and conditions affect the volume of loans sought from the bank by a very large extent. The findings of the study therefore imply that most loan terms and conditions only affect the volumes of the loans procured at a bank to a small extent.

4.5 Relationship between credit information and performance of commercial banks

The study also sought to establish the relationship between credit information and the performance of commercial banks. Credit information was operationalized by reliance of the credit information, account movement and personal behaviour of the customers.
4.5.1 Reliance on borrower’s credit history in approving loans

On the reliance on the borrower’s history, the responses are as summarised in figure 4.18.

Figure 4.18 Reliance on borrower’s credit history in approving loans

![Bar chart showing the extent of reliance on borrower's credit history in approving loans.]

The findings indicated that most banks (54%) rely on the borrower’s credit history to a small extent, 32% to a large extent, 8% to a very large extent and 5% to a very small extent. This indicates that most commercial banks rely to a large extent on the borrower’s credit history in awarding loan amounts.

4.5.2 Reliance on account movement in approving loans

On the reliance on account movement in approving loans, the responses were as summarized in table 4.7.
Table 4.7 Reliance on account movement in approving loans

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very large extent</td>
<td>24</td>
<td>64.9</td>
</tr>
<tr>
<td>Large extent</td>
<td>5</td>
<td>13.5</td>
</tr>
<tr>
<td>Small extent</td>
<td>5</td>
<td>13.5</td>
</tr>
<tr>
<td>Very small extent</td>
<td>3</td>
<td>8.1</td>
</tr>
<tr>
<td>Total</td>
<td>37</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Majority of the respondents (64.9%) of the respondents were of the opinion that their banks rely on the account movement to a large extent, 13.5% that their banks rely on the account movement to a large extent, 13.5% that their banks rely on the account movement to a small extent and only 8.1% of the respondents were of the opinion that their banks rely on the account movement to a very small extent. The findings indicate that account movement is considered to be an important factor in considering and approving loans.

4.5.3 Reliance on personal behaviour in approving loans

On the reliance on the borrower’s personal behaviour in approving loans, the responses were as summarized in figure 4.19.
Majority of the respondents (54%) were of the opinion that their banks rely on the borrower's personal behaviour to a large extent, 24% to a small extent, 11% to a very large extent and 11% to a very small extent. The findings therefore indicate that majority of the commercial banks consider borrower's personal behaviour as an important factor in approving loans sought from the banks.
5.0 Introduction

This chapter addresses the summary of the findings of the study in relation to the objectives outlined in chapter one. It also presents the conclusion of the study together with the recommendations of the researcher based on the findings. Suggestions for further research are also given.

5.1 Summary and Discussion

The study aimed at the following objectives four objectives which aimed at determining the effect of credit policies on the performance of commercial banks in Kenya. The findings of the study were as summarized in the ongoing sections.

5.1.1 Relationship between loan terms and conditions on performance of commercial banks

The findings of the study revealed that majority of the banks (83.3%) have a written credit policy in force while a sizable proportion of the banks (16.2%) do not have one. Majority (49%) of the respondents said that their banks review their credit policies very often, 27% of the respondents said their banks review the credit policies often, 14% said the banks do not review their credit policies often while only a small proportion of the respondents said that the banks never review their credit policies. The findings of the
study therefore report that in the banks where the credit policies are in force, they are reviewed regularly.

On the setting of the interest rates, majority of the respondents (54.1%) reported that their banks set the interest rates for the loans procured from the banks at the prevailing market rates, 27% of the respondents said that their banks set the interest rates below the prevailing market rates at a subsidized rates while only a small proportion of the respondents (18.9%) reported that their banks set the interest rates at a premium rate; that is; above the prevailing market rates. The findings therefore imply that most banks offer loans at the market rate or at a premium rate.

Majority of the respondents 35.1% said that their banks negotiate with their clients in order to come up with the repayment schedules, 29.7% of the respondents reported that their banks peg the repayment schedules to the type of the loan, 18.9% said that their repayment schedules depend on the principal amount of the loans granted while 16.2% said that the interest rates are fixed by the banks. The findings therefore indicate that majority of the banks are responsive to their clients as far as the fixing of repayment schedules are concerned. This is likely to boost the competitiveness of the banks that negotiate with their clients in fixing the repayment schedules for the loans.

On the transaction costs, the findings of the study show that the transaction costs charged by the banks range from 2.5% to 5.5% of the loan amount granted. The average transaction cost charged by the banks is 3.7838% and the standard deviation of 0.84344.
The findings therefore imply that the deviation between the transaction costs charged by the banks is low and thus the banks charge almost equal transaction costs on the loans.

On the management of the lending risks, majority of the respondents (40.5%) said that their banks have an insurance policy against the lending risks. 37.8% of the banks charge the lending risks on their customers while only 21.6% of the banks absorb the lending risks. Majority of the respondents (91.9%) said that loan terms and conditions influence the volumes of loans sought from a bank. Only a small proportion (8.1%) of the respondents said that loan terms and conditions have no influence on the volume of loans sought from a bank.

On the effect of loan terms and conditions on the bank’s competitiveness, majority of the respondents (37.8%) said that loan terms and conditions affect a bank’s competitiveness to a large extent, 21.6% responded; to a small extent, 18.9% responded; to a very small extent, 13.5% said to a very large extent while only 8.1% said that loan terms and conditions have no effect on the bank’s competitiveness. The findings therefore imply that the nature of loan terms and conditions have a large effect on the bank’s competitiveness.

Asked whether in their opinion the number and the strictness of a bank in adhering to the loan terms and conditions affect the performance of the commercial banks, most respondents (73%) said they do affect while a few (27%) said they do not. The findings
therefore imply that the number of the loan terms and conditions and the strictness of a bank in adhering to them have an effect of the performance of a bank.

5.1.2 Relationship between loan procedures and performance of commercial banks

When asked to state the number of processes involved in approving a loan application forms range from 2 to 5 among the banks with a mean of 3.27 and standard deviation of 0.99. This implies that the number of processes of approving a loan application is fairly uniform across the banks. This further implies that the number of processes involved in the approval of loans is a factor considered to be instrumental to the revenue generation through lending by most of the banks.

On the length of time taken to process a loan application form, majority of the banks (37.8%) take 1-3 days, 24.3% take less than a day, 21.6% take 4-5 days while only 16.2% of the respondents take more than five days. The findings indicate that majority of the banks take less than 3 days to process application forms. This indicates that the length of time taken in processing of loan is considered by most of the banks as one of the important factors in drafting a credit policy.

When asked to state how long it takes to disburse loan amounts once granted, majority of the banks (49%) take 1-3 days to disburse loan amounts, 24% take less than a day, 19% take 4-5 days while 8% of the banks take more than five days. The findings indicate that majority of the banks take up to 3 days to disburse loan amounts to the successful applicants. The number of the banks taking more than three days is very small which
means that time taken before disbursing the loan amounts is important to most banks in drafting the credit policy.

On the rate of rejection of loan applications, most respondents (41%) said that 1.1%-3% of the loan applications are rejected, 35% of the respondents said that 3.1% - 5% of the applications are rejected, 16% said that below 1% of the applications are rejected and only 8% of the respondents said that above 5% of the loan applications are rejected for non compliance. The findings show that very small number of loan applications is rejected for not complying with the terms and conditions spelt out in the credit policies.

When asked to state the duration that lapses between approval of a loan and the commencement of the repayment, majority of the respondents (38%) said that repayment begins between 1-2 months after completing the loan contract, 35% said that the loan repayment begins more than two months after completing the loan contract forms while 27% of the respondents said that loan repayment begins less than one month after signing the loan contract. The findings indicate that most banks start recovering the loans more than one month after the loan contract is signed and thus the customers are allowed time to re adjust to the new financial arrangements.

On the duration taken to start computing the interest on the loan, majority of the respondents (43%) said that the computation of the loan interest begins after the first installment is due, 32% said that it begins after disbursement of the loan amount while 24% of the respondents said after signing the loan contract. The findings indicate that
most banks do not compute the loan interest until the loan amount is disbursed to the customer.

On the effect of loan procedures adopted by banks on the volumes of loans procured at the banks, majority of the respondents (86.5%) said that loan procedures adopted by the banks affect the loan volumes and only 13.5% of the respondents said that loan procedures do not affect loan volumes procured at the banks. This implies that in most cases the nature of the loan policies a bank adopts affect the volume of loan applications that a bank attracts.

5.1.4 Effect of credit policies on performance of commercial banks

The study further aimed at quantifying the effect of credit policies on the performance of commercial banks. This was carried out by surveying the success rates of the loan applications. The findings show that majority of the respondents (62.2%) said that all the loan applications received succeed while 37.8% of the respondents said that not all the loan applications succeed. The findings imply that most of the loan applications received by the banks are approved.

When asked to state why loan applications fail, a large majority (91.3%) cite non compliance with the conditions in force as the major reason for rejection of loan applications while only 8.7% of the respondents give lack of sufficient liquidity in the bank as the reason behind rejection of loan applications. The findings therefore concluded that most of the loans are rejected due to their inability to meet the loan terms
and conditions as spelt out in the credit policies. This further implies that credit policies are very vital in deciding which loans are rejected or accepted. On the extent of the satisfaction of the customers with the loan amounts approved, majority of the respondents (78.4%) said that the customers are satisfied with the loan amounts granted while only 21.6% were of the opinion that the customers are not satisfied with the loan amounts granted.

When asked whether the customers whose loan applications do not succeed appeal for more allocations, majority of the respondents (86%) said that the customers whose applications fail do not appeal for more allocations while only 14% of the respondents said that the customers appeal for more allocations. This implies that most of the customers are satisfied with the verdict given according to the credit policy. On the setting of the repayment schedules, majority of the respondents (51.4%) said that the loan repayment schedules are determined by the loan amounts, 35.1% of the respondents said that the loan repayment schedules are determined with discussion with the client while 13.5% of the respondents said that the repayment schedules are determined by the loan type. This implies that in most banks, the credit policy dictates the loan repayment schedules and that the schedules are not flexible.

On the collateral requirements demanded by the banks, the study sought to determine how relaxed they are. Majority of the respondents (59%) rated the collateral requirements of their banks as relaxed, 24% as very relaxed, 11% as stringent and 5% as very stringent. The findings indicate that in most banks, the collateral requirements are not fixed but can
be varied as need arises. This is likely to increase the volume of loans procured since an appreciable number of customers who seek lending lack collateral. The study further sought to determine the effect of loan requirements on loans volumes. Majority of the respondents (64.9%) said that loan terms and conditions affect loan volumes to a small extent, 18.9% said that loan terms and conditions affect the loan volumes to a very small extent, 10.8% said that the loan terms and conditions affect the loan volumes to a large extent while 5.4% of the respondents were of the opinion that loan terms and conditions affect the volume of loans sought from the bank by a very large extent. The findings of the study therefore imply that most loan terms and conditions only affect the volumes of the loans procured at a bank to a small extent.

5.1.5 Relationship between credit information and performance of commercial banks.

The study also sought to establish the relationship between credit information and the performance of commercial banks. Credit information was operationalized by reliance of the borrower’s credit history, account movement and personal behaviour of the customers. On the reliance on the borrower’s history, the findings indicated that most banks (54%) rely on the borrower’s credit history to a small extent, 32% to a large extent, 8% to a very large extent and 5% to a very small extent. This indicates that most commercial banks rely to a large extent on the borrower’s credit history in awarding loan amounts.
On the reliance on account movement in approving loans, Majority of the respondents (64.9%) of the respondents were of the opinion that their banks rely on the account movement to a very large extent, 13.5% that their banks rely on the account movement to a large extent, 13.5% that their banks rely on the account movement to a small extent and only 8.1% of the respondents were of the opinion that their banks rely on the account movement to a very small extent. The findings indicate that account movement is considered to be an important factor in considering and approving loans. On the reliance on the borrower’s personal behaviour in approving loans, majority of the respondents (54%) were of the opinion that their banks rely on the borrower’s personal behaviour to a large extent, 24% to a small extent, 11% to a very large extent and 11% to a very small extent. The findings therefore indicate that majority of the commercial banks consider borrower’s personal behaviour as an important factor in approving loans sought from the banks.

5.2 Conclusion

The study aimed at determining the effect of credit policies adopted by banks on their performance. It was guided by four objectives which were, to determine the relationship between loan terms and conditions and performance of Commercial banks, to establish the relationship between loan procedures and performance of commercial banks, to determine the relationship between amount of loan disposable and performance of commercial banks and to establish the relationship between credit information and performance of commercial banks in Kenya. The findings of the study are summarized in the following paragraphs.
On the relationship between loan terms and conditions and performance of commercial banks, the study found that, majority of the respondents (91.9%) were of the opinion that loan terms and conditions influence the volumes of loans sought from a bank and only a small proportion (8.1%) of the respondents said that loan terms and conditions have no influence on the volume of loans sought from a bank. Further, on the effect of loan terms and conditions on the bank’s competitiveness, majority of the respondents (37.8%) said that loan terms and conditions affect a bank’s competitiveness to a large extent while only 8.1% said that loan terms and conditions have no effect on the bank’s competitiveness. The findings therefore imply that the nature of loan terms and conditions have a large effect on the bank’s competitiveness.

On the effect of loan procedures adopted by banks on the volumes of loans procured at the banks, majority of the respondents (86.5%) felt that loan procedures adopted by the banks affect the loan volumes and only 13.5% of the respondents said that loan conditions do not affect loan volumes procured at the banks. This implies that in most cases the nature of the loan policies a bank adopts affect the volume of loan applications that a bank attracts. On the effect of credit policies on performance of commercial banks, the study found that majority of the respondents (64.9%) said that loan terms and conditions affect loan volumes to a small extent while 5.4% of the respondents were of the opinion that loan terms and conditions affect the volume of loans sought from the bank by a very large extent. The findings of the study therefore imply that most loan terms and conditions only affect the volumes of the loans procured at a bank to a small extent.
Finally, on the relationship between credit information and performance of commercial banks, the findings indicated that most banks (54%) rely on the borrower’s credit history to a small extent, and only 5% were to the opinion that banks rely on the borrower’s credit policy to a very small extent. This indicates that most commercial banks rely to a large extent on the borrower’s credit history in awarding loan amounts. On the reliance on account movement in approving loans, majority of the respondents (64.9%) of the respondents were of the opinion that their banks rely on the account movement to a large extent and only 8.1% of the respondents were of the opinion that their banks rely on the account movement to a very small extent. The findings indicate that account movement is considered to be an important factor in considering and approving loans. Further, on the reliance on the borrower’s personal behaviour in approving loans, majority of the respondents (54%) were of the opinion that their banks rely on the borrower’s personal behaviour to a large extent and only 11% felt that banks rely on borrower’s personal behaviour to a very small extent. The findings therefore indicate that majority of the commercial banks consider borrower’s personal behaviour as an important factor in approving loans sought from the banks.

5.3 Recommendations

Based on the findings of the study, various recommendations can be made:

Firstly, since the study found that the nature of loan terms and conditions has a large effect on the bank’s competitiveness and the volume of loans sought from the bank, banks need to develop well structured schedules of terms and conditions that will be
instrumental to attracting more loan seekers. The terms and conditions should be competitive enough in order to attract the attention of potential borrowers.

Secondly, the study found out that most commercial banks rely to a large extent on the borrower’s credit history in awarding loan amounts. This is meant to reduce the lending risks occasioned by cases of default in repayment. The nature of the borrowers history relied on must therefore be accurate and updated. It is however evident that the detailed information on the borrower’s credit history especially on first time borrowers from the bank may not be accessible. As such, there is need to develop ways and means of availing the information on credit history of the potential borrowers for effective and efficient access. This could be achieved through the use of database for each potential borrower which all the financial institutions update regularly the credit details of their clients. The banks seeking information on the potential borrower could make use of the information by accessing the database.

Thirdly, the findings indicate that account movement is considered to be an important factor in considering and approving loans. This is meant to ensure that the borrower’s bank account has sufficient liquidity to serve the loan. The information accessible to the bank may sometimes be inadequate or insufficient to enable bank to make quality decisions in approving loans. This information could however be availed through centralized system accessible to all the banks and financial institutions.

Fourthly, the banks should consider amendment of some by-laws to relax some lending conditions and terms as well as reduce bureaucracy of loan granting process in order for them to remain competitive against the changing lending environments. Again loan terms
and conditions should be flexible in order to suit various categories of customers. This will boost the volumes of loans procured from the banks.

Finally, on credit policies, due to its importance as found out by the current study in boosting the competitiveness in lending, the study recommends that the banks come up with well structured credit policies that will give them a competitive advantage over the players in the market.

5.4 Suggestions for further study

This study was limited only to investigation on effect of credit policies on performance of commercial banks in Kenya. Further research should be conducted in the following areas:

i. Aspects of a credit policy on the profitability of banks in lending.

ii. Effects of various aspects of credit policy in influencing the borrower’s decisions

iii. A study can be taken to establish how commercial banks are able to cope with competition despite so many key players.
REFERENCES


Atieno, R. (2004). *Institutional credit lending policies and the efficient of resources use among small scale farmers in Kenya*.


Coulthrust, N. (2001). *Article on performance measurement*:


APPENDIX I

LIST OF COMMERCIAL BANKS IN KENYA

1. Kenya Commercial Bank
2. Stanbic Bank
3. Victorial Commercial Bank Ltd.
4. Bank of Baroda
5. Bank of India
6. Fidelity Commercial Bank
8. CFC Bank
9. Akiba Bank
12. Consolidated bank.
13. Credit Bank.
14. Investment and mortgages Bank
15. Middle East Bank of Kenya.
30. Southern Credit Banking Corporation.
31. Commercial Bank of Africa
32. City Finance Bank.
35. Habib Bank A.G Zurich.
36. Citi Bank N.A. Kenya
37. Habib Bank Ltd.
38. Bank of Africa.
40. Daima Bank.
41. Imperial Bank.
42. Development of Bank of Kenya.
43. Equity Bank.

Source: Central Bank of Kenya. (31st December 2010)
Dear Sir/Madam,

RE: PERMISSION TO CONDUCT RESEARCH

I am a MBA student at Kenyatta University undertaking a research project as a partial fulfilment of the Masters of Business Administration degree course. I am researching on “Effect of credit policy on performance of commercial banks in Kenya”. I am therefore seeking your assistance in providing the necessary information in the above areas. Your participation will assist me in completing my studies. Any information collected will be treated strictly confidential and used solely for academic purposes. Any report from the study will only show statistical summarizes and not individual responses.

Your assistance and cooperation will be highly appreciation.

Yours faithfully,

MWAURA DORCAS
APPENDIX III

QUESTIONNAIRE TO THE CREDIT OFFICER

This questionnaire is aimed at collecting data about effect of credit policy on performance of commercial banks in Kenya. It’s hoped that the results of this study can be used by financial institutions to attain a competitive edge towards the competitors by structuring effective credit policies. Please respond to the questions as accurately, completely and as honest as possible and tick (✓) one response as appropriate or filling the space provided.

SECTION A: LOAN TERMS AND CONDITIONS

1. Does your bank have any written credit policy?
   (a) Yes ( )
   (b) No ( )
   (c) Not sure ( )

2. If your answer for question 1 above is YES, how frequently does your bank review its credit policy?
   (a) Very often ( )
   (b) Often ( )
   (c) Not often ( )
   (d) Never ( )

3. How does your bank set interest rates charged on loans?
   a) At a subsidized rates ( )
   b) At the prevailing market rate ( )
   c) At a premium rate ( )
4. How are the repayment schedules set for each loan procured at the bank?
   a) Negotiated with the client
   b) Pegged to the type of the loan
   c) Dependent on the principal amount of the loan
   d) Fixed by the bank

5. What percentage of the loan amount does the loan transaction costs constitute? %

6. How does the bank cater for the lending risks?
   a) Loan insurance schemes
   b) Charged on the client
   c) Absorbed by the bank
   d) Others (specify)

7. In your opinion, does the loan terms and conditions practiced by your bank influence the volume of loans procured from your bank?
   a) Yes
   b) No

8. If your answer for question 7 is yes, what is the nature of the influence of the loan terms and conditions on the volume of loans disbursed by your bank?
   a) Positive
   b) Negative

9. In your own opinion, to what extent does the nature of loan terms and conditions put in place by a bank affect its ability to attract credit seekers?
   a) To a very large extent
   b) To a large extent
   c) To a small extent
d) To a very small extent  

e) No effect

10. Terms and conditions of obtaining credit from commercial Banks are many and followed strictly thus affecting its performance in the financial sector. Do you agree with this statement?

Yes ( )  No ( )

(b) If Yes what is your bank doing to this situation?

SECTION B: LOAN PROCEDURES

11. How many processes does approving of a loan by your bank take? _______

12. State precisely how long your bank takes to complete the following processes:

i. Process loan application form

   a) Less than a day ( )

   b) 1-3 days ( )

   c) 4-5 days ( )

   d) More than 5 days ( )

ii. Disburse successful loan amounts to the customer accounts.

   a) Less than a day ( )

   b) 1-3 days ( )

   c) 4-5 days ( )

   d) More than 5 days ( )

13. How many normal loan applications are received monthly?

   (a) Below 30,000 ( )

   (b) 30,001-50,000 ( )
14. What percentage is rejected due to not meeting certain conditions of credit policy?
   (a) Below 1%  
   (b) 1.1 -3%  
   (c) 3.1 -5%  
   (d) Above 5%  

15. How many departments are involved in approving a loan in your bank?  

16. Under ordinary circumstances, when is loan repayment for loans scheduled to begin?
   a) More than 2 months after disbursement  
   b) 1-2 months after disbursement  
   c) Less than one month after disbursement  
   Any other (specify)  

17. How soon does the computation of interest due on a loan begin?
   a) After the first loan repayment instalment  
   b) Immediately after disbursement  
   c) After signing the loan contract  
   Any other (specify)  

18. In your opinion does nature of the loan procedures adopted affect the volume of loans sought from the bank?
   a) Yes  
   b) No  

94
19. Advanced information technology is readily adopted by commercial banks, such that loan processing has been made easier and faster. How has your bank embraced it in provision of its loan services?

(a) Hardly adopted
(b) Not adopted
(c) Moderately adopted
(d) Highly adopted

SECTION C: LOAN DISPOSABLE

20. Do all members who apply for the loan get?

(a) Yes
(b) No

21. If NO, to the above question what could be the reason? Tick all applicable

(a) Most of them don’t qualify
(b) The bank does not have sufficient funds to meet all of them
(c) Any other reason(s) specify ____________________________

22. Are your members satisfied with the amount of loan granted to them

(a) Yes
(b) No

23. Do some members appeal against the amount granted?

(a) Yes
(b) No

24. If Yes, to the above question, how has your bank reacted to the appeals?

25. What is the single highest amount of loan have your bank processed for a member

(a) 1,000,000 -5,000,000

95
26. Which of the following best describes how your bank determines the loan tenures for different loans products?
   a) Discussed with client
   b) Determined by the loan amount involved
   c) Determined by the type of the loan
   d) Depends on the characteristics of the client

   Others (specify) ______________________________________

27. How would you rate the collateral requirements for loans procured from your bank?
   a) Very stringent
   b) Stringent
   c) Relaxed
   d) Very relaxed

28. In your own opinion, to what extent does loan requirements imposed by banks affect the volume of loans approved?
   a) To a very large extent
   b) To a large extent
   c) To a small extent
   d) To a very small extent
   e) No effect

SECTION D: CREDIT INFORMATION AND CREDIT RELATIONSHIP

29. To what extent does your bank rely on the following in approving or disapproving a loan?
   (i) Borrower’s history
a) To a very large extent ( )  
b) To a large extent ( )  
c) To a small extent ( )  
d) To a very small extent ( )  

(ii) Account movement  

a) To a very large extent ( )  
b) To a large extent ( )  
c) To a small extent ( )  
d) To a very small extent ( )  

(iii) Personal behaviour  

a) To a very large extent ( )  
b) To a large extent ( )  
c) To a small extent ( )  
d) To a very small extent ( )  

30. In your own opinion, does relying on the borrower’s credit history in approving or disapproving loans affect a bank’s revenues from lending?  

a) Yes ( )  
b) No ( )  

31. If your answer in the above question is yes, what nature of influence does relying on borrower’s credit history in approving or disapproving loans have on bank’s profitability from lending?  

a) Positive ( )  
b) Negative ( )  

THANK YOU FOR COOPERATION IN COMPLETING THIS QUESTIONNAIRE