RESPONSES OF COMMERCIAL BANKS IN KENYA TO THE CHALLENGE OF LOAN DEFAULTING

By

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A Management Research Project submitted in partial fulfillment of the requirements for the degree of Master of Business Administration (MBA), School of Business, University of Nairobi.

October, 2007

DECLARATION

This management research project is my original work and has not been presented for a degree in any other university.

Signed: ______________ Date: _______16th October 2007___________

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This management research project has been submitted for examination with my approval as the University Supervisor.

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DEDICATION

To my late Father and Mother

and

To my loving fiancée **"Hilda"** with whom we have faced the challenges of life together.

ACKNOWLEDGEMENTS

My heartfelt gratitude goes to my supervisor Dr. Ogutu whose guidance and direction the content of this research attest. To all the support I received from bankers who took the initiative of responding on short notice to my questionnaire.

This research would not have been possible without the support of my research team – Class of 2005 September to 2006. I owe you a lot and appreciate your advice. My family and future wife for their tolerance during the tight schedule this research took. It was trying time and I appreciate the fact that you stood by me.

Lastly, I appreciate the moderation I received from Prof. Kobonyo.

May God bless you all.

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DEFINITION OF TERMS

BBK - Barclays Bank of Kenya

CBA - Commercial Bank of Africa

CBK –Central Bank of Kenya

CO-Op - Co-Operative Bank of Kenya

CRBs– Credit reference Bureaus

KBS – Kenya Bankers Association

KCB - Kenya Commercial Bank

HFCK - Housing Finance Of Kenya

NBK - National Bank of Kenya

NIC - National Industrial

NPL- Non Performing Loans

ROI - Return on Investments

SCB - Standard Chartered Bank

S & L - Savings and Loans Ltd

ABSTRACT

Loan defaulting has been and continue to be a big threat to the banking industry both locally as well as globally. Many banks have sought to find ways of dealing with this threat but in vain. It is this threat that this research sought to unravel by studying the challenges that the banking industry face with regard to loan default. The research sought to further look at how the banking industry in Kenya respond to the challenge of loan defaulting. The two issues above set up the cornerstone of the research objectives for this study. The survey instruments targeted the entire banking fraternity with a random sample of 22 banks out of the 43 commercial banks currently in the republic. Data was collected through the use of questionnaires which had both Yes/No as well as multiple choices. A response rate of 82% was received from the number of questionnaires issued to respondents. Data analysis employed the use of percentages and tables for collation and summarization of data gathered.

This research found out that the main challenge that banks face in light with loan defaulting was loss of funds lent to the borrowers. Other challenges which were of notable mention were; accountability to stake holders of monies lent, liquidity problems among others. The data indicate that many banks do not face serious problems with Central bank of Kenya. The research further found out that banks employ many response mechanisms to curb loan defaulting. Of notable importance was use of credit reference bureau 82% of the respondents, use of stringent legal action, auction of security collateral, employment of technology when rating loans, offering of secured loans among other measures.

The study established that there is a significantly regulatory role which needs to be played by Central Bank of Kenya (CBK), Kenyan Parliament, and use of information technology. In addition, it was found that there is need to make public asset as well as liability declaration mandatory to all civil servants as well as cabinet ministers to curb political lending. The research further established that integrity is vital in the banking industry and that each bank offering loans should ensure it sets up a credible and well equipped loan processing department. The research takes cognizance to the fact that in order to arrest the menace of loan defaulting, there is need to have a concerted effort among all the stakeholders in the industry.

CHAPTER 1: INTRODUCTION

1.1 Background

The banking industry has been facing a myriad of challenges in the recent past, ranging from loss of cash on transit to money laundering, hyper competition, unstable interest rates and loan default among others. This paper looks at the challenges facing the banking industry and how the banking industry responds to these challenges. The aim of the research is to narrow down to loan defaulting and conduct an investigation into this problem of loan default.

Banks encounter numerous challenges in determination of appropriate provision for loan default. This difficulty arises because of paucity of skills required to determine the soundness of security valuation and the validity of legal charges associated with loan collateral (Mulei, 2003). The Banking industry has been, and continues to be, radically transformed by applications of new technology. Berger (1995) alleges that the evolution of the banking industry has presented both challenges and opportunities for commercial banking institutions. Over the last several years, financial modernization, deregulation, industry consolidation, the rise of new institutions, shifting trends in borrowing and lending, globalization and emerging technologies have influenced and affected how commercial banks operate.

1.1.1 Organizational Responses to Environmental Challenges

Hill (2001) acknowledges that determining the need to respond is a complex process as managers' first need to recognize the factors necessitating the response. However, managers have difficulties determining that something is going wrong in their organization as problems may develop gradually and the organizational performance may slip for a number of years before it becomes obvious that there is need to respond. Response becomes eminent once strategic managers recognize that there is a gap between desired company performance and actual performance. This occurs when there are clear signs such as decline in; profitability, Return on Investments (ROI) falling, stock prices, loss of market share among other indicators of success. More importantly, response is necessary to correct the anomaly and bring back the organization to the intended track or to keep pace with competitors and to control market share among many other reasons. Response needs to be systematic as well as drastic. Most of the times, before response, the environmental opportunities need to be examined and threats that might explain the problem identified, route cause-analysis also needs to be done to establish the gravity of the situation at hand. Thus, the need to read competitor signal accurately to avoid being duped with bluffs to avoid responding to the wrong signals. It is vital to respond in the right way as this is the only way to steer the organization back on track.

1.1.2 Banking Industry in Kenya

According to Market Intelligence (2006) and Central Bank of Kenya - CBK (2006), the banking industry is broken down into, 43 commercial banks in Kenya, one non-bank financial institution (Prime Capital and Credit Ltd) and two mortgage finance companies (Housing Finance Of Kenya - HFCK and Savings and Loans Ltd – S & L). There are also 52 operational foreign exchange bureaus. Out of the 43 banks, major players include Barclays Bank of Kenya (BBK), Kenya Commercial Bank (KCB), Standard Chartered Bank (SCB), Citibank N.A, Co-Operative Bank of Kenya (Co-Op Bank), National Bank of Kenya (NBK), Commercial Bank of Africa (CBA) and National Industrial Credit (NIC). Competition is very stiff among the banking sector in Kenya; this competition has seen major players such as KCB, BBK and Co-op Bank open up many branches to cash in on the improving economy. Performance of many commercial banks also has improved tremendously as banks are beginning to return very good and encouraging figures in their annual income statements.

Of all the 43 Commercial Banks, 9 banks control 74% of the total assets in the sector. As a part of cost and business rationalization measures, a number of banks closed some branches resulting to the branch network of commercial banks declining to 488 by the end of June 2003 from 497 in June 2002. Assets of the banking sector were mainly made up of loans and advances (47%), investment in government securities (25%) and balances with Central bank (6%), foreign assets (6%) and cash and other assets (16%) (CBK, 2003).

The banking sector experienced high non-performing loans. The Bank reports that while the proportion of non-performing to total loans declined to 28.8% in June 2003 from 29.2% in June 2002, the absolute amounts of non-performing loans increased to KES 73.2 billion from KES 71.5 billion (CBK, 2003). The increasingly advanced levels of information technology embraced by banks have had a positive impact in the sector. The new and dynamic information systems adapted by most banks have enabled them to process data faster and efficiently. This has enabled them to downsize their branch operations, thereby cutting on cost and improving service delivery to their customers.

A study conducted by Centre for Governance Kenya (2004) found out that a number of mergers and acquisitions have taken place in the banking sector in Kenya. Some mergers were occasioned by the need to meet the increasing minimum core capital requirements and to enhance the institution's market share in the local banking environment. Between 1994 and 2001 there were 23 successful mergers. Acting as an overseer of other banks, CBK has the objectives of; formulating and implementing monetary policy directed to achieving and maintaining stability in the general level of prices; fostering the liquidity, solvency and proper functioning of a stable market based financial system; and licensing and supervising authorized dealers in the money market. The banking sector is generally divided into two clienteles; the retail banking and corporate banking. The retail banking deals with individual clients and is commonly referred to as the Personal banking sector. Most Kenyan banks are in the retail banking business (CBK, 2003).

A number of challenges confront the banking industry in Kenya today. Mulei (2003) acknowledges that a number of countries' financial systems have suffered acute crises involving the collapse of banks and other financial institutions. Such banking crises have been costly for the public who suffer loss of their deposits. The key cause of bank failures is usually mismanagement often linked with fraud and abuse by owners and managers. As with inflation, bank failures are regressive because those who have borrowed and failed to repay their loans are mostly from the richer strata of society while the depositors who lose their deposits are much poorer. Inappropriate systems predispose banks to risks such as hackers, internet fraud among others. We are in an era of global economic crimes from which Kenyan commercial banks are not immune, the Kenyan Banks are conscious of the nature and current trends of the menace-money laundering. At its most fundamental level, the fight against money laundering is based on the recognition of its serious adverse effects in the economy and society, if left unchecked money laundering can cripple the economy. Money laundering has a negative effect on the economy not only because it diverts resources to unproductive activities, but because it also facilitates corruption and crime.

1.2 Research Problem

The banking industry is the lifeline of development without which a country cannot operate. According to CBK (2003) the banking sector in Kenya is the fifth largest sector with a contribution to the GDP of about 10.6% and a total employment of 3.8%. The industry helps in the growth of the economy through generation of employment and creating opportunities for growth of incomes and more room for investments. Investment, whether foreign or local, thrives in an environment characterized by price and financial system stability. It is through the attainment of macroeconomic stability, which is reflected by stable exchange rates, low and stable rates of inflation and low and affordable lending rates, which can attract investors. Through banks, investors are able to acquire funds which when properly put into use can positively contribute to the improvement of the general lives of the people of Kenya. There has been a surge in non performing loans (NPLs). As of the end of May 2006, the NPLs were at 93.9 percent of gross loans (CBK, 2007). However, it is not easy to grasp the extent of the bad-loan problem in Kenyan commercial Banks. This is because of the complications involved in analyzing risks before issuing loans. There are people going around banks borrowing money and failing to repay. These "chronic" loan defaulters have perfected their act hence putting banks into serious financial crisis as banks have to provide for these bad loans hence denying the banks cash which would otherwise have been spent on important developments. Globally, loan default has been a thorn in the flesh of bankers who have been trying to find possible solutions. (Ping, 2003) The size of NPLs is generally considered the major threat for the banking system in China. Saunders and Cornett (2003) acknowledge that, debt repayment problems mirror the effect of negative externalities to global financial markets.

Recent studies of bank efficiencies have directly included measures of NPLs in cost or production relationships. The reasons provided for the adjustments are to control for the extra costs associated with NPLs and to control monitoring expenditures that influence loan quality. Berg and Jansen (1992) made far reaching observations and included NPLs in a non-parametric study of bank production. Virtually all research on the causes of bank and their failures find that failing institutions have large proportions of NPLs prior to failure and that asset quality is a statistically significant predictor of insolvency (Berger, 1997). Thus a part from having NPLs, banks approaching failure tend to be low on efficiency too Hughes (1993) acknowledges that banks with poor senior management may have problems in monitoring customer loans. African

Economic Outlook (2005) reaffirms the gravity of the loan default by stating that "In spite of the financial sector reforms pursued in the past, Kenya's financial system is still ailing. Its weaknesses include: High level of NPLs arising from political lending from public sector banks, insider or connected lending, and pervasive legal problems in enforcing creditor rights; under-capitalization, which leaves banks vulnerable to negative shocks; low or negative profitability and high costs, despite large intermediation margins, with spreads between lending and deposit rates of about 13% points; weak banking supervision; and a fragmented legal framework for insolvency and creditor rights, with outdated insolvency laws."

The figures of loan default across the banking fraternity are not encouraging going by the provisions for bad debts and the evidence in place on NPLs (CBK, 2006). Many banks continue to suffer silently as they lack the clear guideline to control the menace. A research to unravel this vice and provide strategies for combating it would be a blessing to the banking industry at large. It is therefore necessary for this research to be carried out to enable the banking industry to wake up from its slumber and assume a general strategy to confront loan default. This research therefore looked at various methods employed by banks to address the issues of loan default. Existing studies do not offer clear cut strategies that banks need to formulate and implement in the Kenyan context. Many studies in this area are foreign based hence the need to look at the study in the local context. Thus this paper attempts to come up with important policy, and research issues which aim at discovering the main causes of loan default and how banks respond to these causes, hence determining the most important focus which banks need to take to effectively respond to the problem in place. In a nut shell, the paper looked at what economists, bankers and financial risk analysts have done and look at strategies which commercial banks in Kenya use to tame the ghost of loan default in the banking industry in Kenya.

Research Question

The research addresses the question;

How are Kenyan commercial banks responding to loan defaulting?

1.3 Research Objectives

The study seeks to determine two major objectives;

i.) To determine the challenges of loan defaults to commercial banks in Kenya,

ii.) To establish how banks in Kenya are responding to loan defaults.

1.4 Importance of the Study

This research will assist banks deal with loan defaulters hence protect the shareholders interests by giving them better ROI. Stakeholders will be assured of the security of their deposits if the loan defaulting is reduced. The fear of losing funds due to bank closures emanating from loan default will be a thing of the past. Hence banks will gain from further deposits. Once deposit base increases, the economic power of the nation will sprout as borrowing will become cheaper. Borrowers are likely to enjoy reduction in interest rate. This is evident from the fact that currently banks inflate their interest rates to cushion the expected loss due to loans default. Generally the entire country's economic progress will be seen as borrowings from banks become cheap as soon as chronic loan defaulters are tamed. We shall hence have genuine borrowers only, which will put the country back to economic success.

CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

This chapter presents and discusses the literature relating to the strategy. The chapter begins by introducing the concept of strategy and environmental challenges. It then briefly explores how organizations respond to challenges and hence look at factors affecting effectiveness of organizational responses. It culminates by looking at challenges that organizations face when responding.

2.2 Concept of Strategy

Continuing scholarly interest in the process of strategy emanates from an ever abiding assumption that in some ways strategy is more efficacious than strategizing, and this leads to higher organization's performance in the long-run, better than chance alone would convey. Interest in and endorsements of the strategic process are abundant in the academic literature. As put forward by Pettigrew and Whipp (1991), and Schendel and Hofer (1979) who pioneered the definition of strategic management as a process in character required to emphasize the development and utilization of strategy. Porter (1996) expresses the obsession with the leadership and organizational challenges of managing the strategic process. And, Hamel (1988) expands the field to dedicate as much attention to strategy conduct to entail; strategy formulation, implementation and management. Senior managers and leaders are preoccupied with the question of how to make effective strategies as usually their number one priority of their agenda.

Whipp (1996) argues that "narrow conceptions of strategy have been allowed to dominate" the discourse for sometimes now. The distant history and origins of the concept of strategy can be found in the military, and the effect of this history is still evident in much of both the popular and academic discourse. Strategy is defined, for instance, as "something an organization needs or uses in order to win, or establish its legitimacy in a world of competitive rivalry. A strategy is what makes a firm unique, a winner, and a survivor." (Whipp, 1996). Strategy is clearly significant because it deals with the macro-dimensions of an organization, its overall identity, direction, its future trajectory, its evolution. A broader definition illustrates that strategy deals with the entrepreneurial work of the organization, with organizational renewal and growth, and more particularly, with developing and utilizing the strategy which is to guide the organization's operations (Schendel and Hofer, 1979). Gerry and Scholes (1999) consider strategy to be the direction and scope of an organization over the long-term, which aims to achieve advantage for the organization through its configuration of resources within a challenging environment, to meet the needs of markets and to fulfill stakeholder expectations.

Strategy is of particular importance for organizational development and change management precisely because it defines the overall direction of an organization. It is only fairly recently that the field of organizational theory has begun to address strategy itself (Porter, 1985) with enormous potential to open up the discourse from the limitations of what has largely been an economic, rationalist perspective. The primacy of the economic and of rational economic approaches in formulating the major goals, objectives, and parameters of an organization by definition turns all organizational change management efforts into secondary "implementation," working within constraints that have already been established by those in a position to define and direct the organization's overall strategy. Organizational development and change efforts may indeed have been very constrained and actually hindered by this predominant rational-economic mentality. Strategic Planning and its underlying assumptions have recently come under severe criticism from a number of sources.

Strategic planning found its most prominent and influential voices in the 60s in Chandler (1962) and Ansoff (1965). These authors focused on long term strategy, prediction and control. Rationalism and economic determinism were central, as was the notion of a knowable environment and a predictable future. Task was separated from performance, thinking from doing, and therefore formulation (thinking) from implementation (doing). An understanding of "the environment" was, and still is, an integral part of Strategic Planning. But what exactly constitutes that environment is not at all unproblematic.

Chandler (1962) considers strategy to be having a fundamental contribution to corporate success. He believes strategy determines the basic long term goals, the objectives of an enterprise, the adoption of courses of action and the allocation of resources necessary for carrying out these goals. Organizations may sometimes pursue strategies they never intended. Hence, they propose that the usual definition of strategy be called "intended strategy" and that strategy in general and "realized strategy" be defined as "a pattern in a stream of decisions (actions)." However, Porte (1980) considers strategy to be all about competition. Strategy may also mean a pattern of actions and resource allocations designed to achieve the goals of the organization.

Gerry, Scholes and Whittington (2005) consider strategy to fall in three different levels: corporate level strategy is concerned with the overall purpose and scope of an organization and how value will be added to the different parts of the organization. At strategic business level strategy concentrates on how to compete successfully in a particular market. At the operational level, strategy is concerned with how the component parts of an organization deliver effectively the corporate and business level strategies.

2.3 Environmental Challenges

Pearce and Robinson (1991) describe external environment as all conditions that affect a firm's strategic options but which are beyond the firm's control. Ansoff and McDonnel (1990) noted that changing environment brings about unpredictability. They referred to this as environmental turbulence. Aosa (1992) noted that this environmental turbulence brings about challenges to management. Chandler (1962) and Daft (1986) separately argued that organizations are environmentally dependant and changes in the external environment shapes the opportunities facing the organization. Thus understanding the environment helps a firm to objectively and rationally develop strategies that can cope with challenges affecting these organizations. According to Porter (1996), the environment is important in providing initial insight that underpins competitive advantage. The required inputs, accumulated knowledge and skills over time as are forces needed to keep progressing. The environment is changing rapidly and therefore it is imperative that organizations constantly adapt their activities to reflect the new requirements of the environment. Strategies therefore equip firms with the knowledge to counter the challenges of the environment (Bruce and Longdone, 2000). Strategy can be viewed as building defenses against competitive forces (Pearce and Robinson, 1991).

Gerry, Scholes and Whittington (2005) consider the environment to exist in the context of a complex political, economic, social, technological, environmental and legal world. This environment changes and is more complex for some organizations than others. There is need to understand environmental variables to be able to fully tame the environment. However, these variables are so varied that gaining a grip on the environment is always elusive. The environment of an organization in its most traditional sense is made up of competitors and technological innovations. In the more traditional economist approach of Ansoff, this means a known environment which is stable and predictable, with considerably less emphasis placed on innovation.

Lawrence and Lorsch (1967) emphasized the pace of market and technological innovation, and the concept of a rapidly changing environment, thus moving away from a static view of the environment. Hannan and Freeman (1977), representing the population ecology school, critique notions that managers and leaders formulate strategies for adapting to the environment. Their approach radically contrasted Ansoff's. They suggest that the logic of environmental selection is more appropriate given the structural inertia, lack of flexibility, constraints on information, and the constraints imposed by organizational history. The population ecology approach stresses the importance of environmental competition and resource scarcity. In this view, organizations survive or fail regardless of actions of leaders and strategists. The environment is not only not known, but put in their words simply "too powerful a force for organizational adaptation of any kind."

Porter's (1980) highly influential notion of "generic strategies" provides two ways of developing "competitive advantage" in a changing environment: either through value added to customers, who pay a premium to cover high costs, or cost based leadership, offering products and services at lowest cost. Strategy is defined by the way an organization's product is placed in the environment, which in turn is defined in economic terms as being confined to competition within the marketplace. Hence, the focus is on how to place an organization's product in the context of the existing environment. Porter has recently begun to argue for the importance of understanding organizational issues for strategy, calling this inclusion a significant extension toward operational improvement and positioning. One way these issues have been addressed is through the concept "fit" of organizational form and action to industry and market (Miles and Snow, 1984). The underlying assumption is still that an organization has to adapt its internal to external environment and external functions to an environment.

Dill (1958) not only stressed the importance the task environment, in the form of customers, competitors, shareholders, and government agencies, but also the contextual environment, in the form of social, cultural, and political factors. Emery and Trist (1965) focused on the turbulent nature of the environment, and stressed the concept of the context as a whole. They developed an important orientation to the future in which they argued that given a turbulent environment, and therefore not a known environment, what is required is not forecasting, but the development of collaborative action, value consensus, and shared norms and standards to provide basis for evolving patterns of relations. This leads to collective strategies involving networks of organizations linked by shared values and ideals emerge as the ideal means for coping with turbulent environments. Already there is a change in the understanding of the environment from stable to turbulent. This creates different prescriptions away from forecasting and plotting straight courses to a far more participative process which stresses internal factors such as values, consensus, and collaboration. Their work has hence produced the concept of self-managing organizations (Purser & Cabana, 1998). Weick (1987) addresses the importance of the internal environment with his focus on the symbolic and cultural dimension, of making meaning in strategy. He argues that through enactive view, there is an epistemological shift whereby the environment is not.

Smircich and Stubbart (1985) have focused the need to reflect on the way we think about and conceptualize the term environment altogether. They present three ways of thinking about the environment: First and foremost, the environment is looked at as an objective or unambiguous reality, a deterministic force, which is a fundamentally realist epistemology. Secondly, they look at the environment as an independent, real domain, but one that is perceived and therefore understood only partially. The stress is on the need to improve environmental understanding through extensive information gathering and environmental scanning. They argue that the environment is not known, in the traditional sense, but a good approximation can be achieved. Lastly, environment is enacted or socially constructed, a result of the language, ideas, and concepts of sense making. In this view, the separation of external and internal environment becomes far more problematic. Strategy becomes creative and flexible, with the view of discourses and understandings of the environment.

Today's environment of the firm is dynamic, due to the increasing rate of change and the drastic nature of these many changes. This environment compels organizations to strive for new management techniques of doing things. The environment is difficult to understand as it encapsulates many different influences, it is diverse and this diversity brings about its complexity. (Gerry, Scholes and Whittington, 2005). The environment is made up of interrelated parts, understanding these connections between the parts is of vital importance in building a strategic 'picture' of the organization. They emphasize that for a good strategy to be formulated; first and foremost, the environment must be understood since the environment influences the strategy of the firm. The understanding of the environment is key to strategy formulation as a web of relationships exist which influence the strategy to employ. The increased complexity and uncertainty of today's environment confronts managers with many challenges. Environmental characteristics and uncertainty have been important factors in explaining organizational structure, strategy, and performance.

Pettigrew and Whipp (1991) allege that the current state of growing economical, political and social changes, led to the need of reviewing organizational configurations in order to adapt them to the current turbulent and changing environment. It is necessary for a new organizational configuration to be planned gradually, considering that this new reality is just beginning. The need to introduce the notion of change and innovation in organizations cannot just be a passing fashion; it is a question of survival and the possibility of success. Organizations are a part of human life and they must allow critical, conscious and creative learning, using new change strategies with a new base of values. Thus, there seems to be a clear need to find ways to develop the learning capabilities of organizations through a process that includes critical thought and action. This will provide them with the conditions to respond quickly to the demands that are presented today, with the added advantage of being able to foresee possible alterations that may happen in the future.

The elements of the general environment affect all organizations through factors that can be classified as technological, economical, political and social. In the analysis of the environment, however, there are attempts to distinguish the elements that are directly relevant to the organization from those that indirectly influence it. Hamel (2004) considers strategic innovation as the ability to reinvent the basis of competition within existing industries and to invent entirely new industries. He sees this as the next fundamental competitive advantage for companies around the world. Hamel points out that organizations that want to re-invent themselves and the rules of the game need diversity in opinions, impressions, experiences; they need conversations that cross the boundaries of function, technology, hierarchy, business, and geography; new perspectives and the commitment of all their people. Only a corporate culture with all these characteristics will release the necessary creativity to exploit unexpected opportunities and to react to changes flexibly. This approach implies that it is no longer the most important task to develop the perfect strategy. To develop a strategy that moves the company into the right direction, strategy needs to be adjusted and put in concrete terms by experimentation until the right strategy to the environmental challenge is attained. There are attempts to distinguish the elements that are directly relevant to the organization from those that indirectly influence it.

2.4 Organization Responses

This research looked at organizational responses in light of strategic response (corporate and business strategic response) and operational responses. Hill and Gareth (2001) acknowledges that response may come in many dimensions; Lowering cost through restructuring operations, downsizing, outsourcing, mergers, acquisition and divestment. Alternatively, the firm may respond by diversifying into new products by increasing product innovation. Other companies may strengthen their human resources by 'poaching' from competition. Response however, is a calculated guess and its correctness cannot be determined in advance.

Hauptman (1998) considers strategic response to refer to a decision that requires changing a major policy, program, or practice which involves some risk. Strategic response is engrossed with reassessing policies of an organization, cost cutting, re-engineering the organization by coming up with a structure which will deliver desired results, improving quality, and restructuring how the institution administers its programs and renders its services. It may include; introducing or expanding the use of technology to improve administrative functions, and increasing resource sharing by forming alliances and cooperating with other like minded institutions to gain competitive advantage.

Thiga (2002) found out that responses to environmental turbulence that characterized the aviation industry were diverse. The airlines surveyed had adapted strategies to enable them cope with changes in the environment. Majority of these airlines formed alliances and/or partnerships so as to quickly globalize their routes networks hence provide them with a competitive edge.

According to Scholes and Johnson (1999) Corporate Strategy is concerned with the overall purpose and scope of the business to meet stakeholder expectations. Corporate strategy is heavily influenced by investors in the business and acts to guide strategic decision-making throughout the business. It is responsible for developing the agency's accountability and improvement framework, in particular focusing on efficiency and effectiveness; corporate planning and ensuring performance against the organization's formal targets. Sloan (2007) considers Managers of today's organizations to face a baffling barrage of communication and information technologies that threaten the very core of their businesses. They also face brutal global competition. Hence, to stay out in front, they must take big risks and make big bets and manage all these strategically. Schendel (1999) states that the corporate strategy implementations of environmental regulations are important as various empirical studies suggest that most firms already spend between one and two percent of their revenues as a response to environmental concerns.

Corporate Strategy presents the latest methodologies for developing and implementing strategies that work since it explores the specific tasks and concepts key to ensuring the success of a corporate entity. It specifically concentrates on how competitive strategy for a global environment and world-class best practices for implementing strategic planning will be achieved. Corporate strategy seeks to identify the organizational culture and try to see how these cultures relate to strategy of the firm. It further explores the role of modern finance in strategic decision making, the international transferability of competitive advantages, hence recognizing technology as a major variable and considers relating organizational learning to competitive advantage so as to cope with the complexities, uncertainties, and changes that are reconfiguring the business world today. Corporate Strategy gives the organization the rare opportunity to share experiences with senior management from other departments thereby charting the way forward in an agreeable form (Sloan, 2007).

Every manager needs an effective, well planned business strategy to steer their organization as efficiently and successfully as possible. This success according to Scholes and Johnson (1999) can be achieved through Business Unit Strategy which is concerned with how a business competes successfully in a particular market. The main concerns of business strategic decisions is about choice of products, meeting needs of customers, gaining advantage over competitors, exploiting or creating new opportunities that would ensure the organization is ahead of competition.

Operational Strategy entails how each part of the business is organized to deliver the Corporate and Business Unit Level strategic direction. Operational strategy therefore focuses on issues of resources, processes, and people (Scholes and Johnson, 1999). Managers are always faced with the challenge of ensuring the survival as well as the success of their organizations. This success is only guaranteed if the firm adjusts to the environmental challenges (Ansoff, 1984). Delivery of success is therefore a strategy which has to be achieved through formulation of well conceived ideas as well as counter ideas to tame the otherwise irritant and ever changing environment. Strategic managers must determine desired future state of the company once problems are determined. It is from this point that the company responds to the problems taking into account that competitors' are likely to worsen the situation further through reactive strategies. Ansoff and Mc Donnel (1990) consider the bulk of managerial time to be devoted to trying to cope with uncertainties induced by the environment. They came up with three ways in which organizations respond (reactive, decisive and planned).

Bett (1995) shows that economic reforms in the mid 1990s forced firms operating in Kenya to make certain adjustments in their marketing mix in order to adapt to changes in the environment in a bid to remain competitive in the liberalized Dairy industry. His contribution show that firms adopted market driven strategies so as to cope with competitive environment. The dairy firms also focused on their competitors with the aim of knowing the happenings within the wider market. This forced these firms to be flexible and adaptive to the environment. Kombo (1997) found out that motor vehicle firms adjusted their variables substantially to be able to remain competitive. Issues such as product development, differentiated products, segmentations and improved customer service, significant changes to the marketing mix variables of promotion, pricing changes was aimed at responding to competition and hence maintaining a competitive advantage.

Mugambi (2003) took a study on the strategic response of tourist hotels to the changes in the environment. He collected data using questionnaires from a census of about 21 hotels descriptive statistics was used to analyze data. The analysis revealed that several environmental factors have changed. It depicted firms struggling to respond to negative changes to ensure their own survival. Migunde (2003) studied strategic responses by Kenya Broadcasting Corporation (KBC) to increased competition. This study was based on the five forces by porter. Findings indicated that competition in the broadcasting media had intensifies over the years. The study also found out that KBC was not up to the challenge hence was struggling to survive yet its competitors were thriving in the business. Porter (1980) suggests that the central characteristic of competition is that firms are mutually dependent. They hence feel the effect of each others' move and are therefore prone to react (respond) to these moves. The outcome of competitive move by one firm depends at least to a greater extent to reactions by rivals. Firms will feel the impact of competitor's and are hence forced to react to competitor's initiatives. Even weaker competitors may pull a surprise by making reactive responses to curtail an otherwise good strategy. The outcome of a firm's competitive strategy is therefore a reflection of its rival's competitive moves. It is in this in mind that firms work smarter when devising strategies. They have to calculate the likely responses of competition before settling on their own. The dilemma with this arises when choosing responses that avoid the risk of 'warfare' and hence make the industry better off. Firms may choose to go for offensive or defensive responses. This however, depends on the degree of stability or instability in the industry. The structure of an industry also determines the kind of strategic response to be employed (Porter, 1980)

2.5 Factors Affecting the Effectiveness of Organization Responses

According to Porter (1980) Competitive rivalry comes into play as a major factor contributing to an organizational response. The greater the number of competitors, the more equal their relative power, their products are also highly standardized, their fixed costs are higher hence slower the growth of the industry. Responses in such a competitive industry is in the form of lowering prices, using cheaper raw materials, improving quality and employing mass production to gain economies of scale. Both offensive and defensive responses are very risky in a situation of intensive rivalry.

Ansoff and Mc Donnel (1990) concentrated on uncertainties as the major issue affecting the effectiveness response of organizations. They consider strategic response to involve changing the strategic behavior of a firm so as to guarantee success. Response is achieved through transforming the firm's environment which is always unpredictable to favor the organization. Strategic diagnosis identifies the need to make a change (Ansoff and Mc Donnel, 1990) if the diagnosis is wrong or misleading, then the action taken to correct the perceived problem may not be effective. Organizations survive to the extent that they are effective (Pfeffer and Salancik, 1978) they are only effective when the environmental information and resource dependencies are managed successfully. For an organization to operate effectively there has to be a generally accepted assumption which represent collective experience without which people who work together in an organization would have to re-invent their world for different circumstances they face. Culture of an organization may not permeate change hence any plan to respond through introduction of changes which may alter the status quo may be repulsed. In a nutshell, it is vital for organizations to heed to environmental variables to be able to succeed.

CHAPTER 3: METHODOLOGY

3.1 Introduction

This chapter sets out the research methodology to be used in this study. The chapter provides insight into the appropriate research design; it goes further looks at the population of interest before setting the sample design.

3.2 Research Design

This study used a sample survey design. The study sought to determine the responses of commercial banks to the challenge of loan defaulting and a survey was the most appropriate design. The choice of survey as a design was to provide an avenue of relating descriptions, explanations and predictions in a systematic manner. It is also the best design that defines the domain of generalizability (Frankfort and Nachmias, 1996). Similar studies have been carried out using this design and the results were satisfactory. Ndegwa (2003) and Odemo (2003).

3.3 Population of Interest

The population studied was all commercial banks in Kenya. This is because preliminary studies could not establish which banks had issues with loan default. As of May, 2007, there were 43 Commercial Banks in Kenya (CBK, 2007).

3.4 Sampling Design

This study focused on Commercial Banks in Kenya. A random sample of 22 Commercial Banks was selected out of the existing 43 commercial banks (See Appendix I). A random numbers table was used to arrive at the indicated number of banks after which each bank was given a number unique to itself. The procedure applied was considered effective as each bank had a non zero chance of being included in the study. This was a representative sample which was able to provide appropriate data for the research. This sampling frame was generated from a simple random sample (see Appendix II). Although a census would have been done, it may not be possible due to the timeframe available for this study. Deming (1990) supports usage of sample by purporting that the quality of a sample study is often better with sampling than with a census since samples are more accurate and manageable. Previous studies have been done using samples

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3.5 Data Collection

The study relied on primary data, which was collected using a semi structured questionnaire (Appendix IV). The questionnaire was divided into two sections: Section A addressed the challenges of loan defaults to commercial banks in Kenya while Section B addressed how Commercial Banks in Kenya are responding to these challenges. The questionnaires was administered through three means; email attachments for the officers whose email addresses were available, drop and pick method as well as posting through the Kenya Post Office for those contacts whose email address were not available. The questionnaires targeted respondents dealing with loan issuance as well as recovery. This research targeted Credit controllers or their equivalence in the banks in situation where the credit controller title is not in use.

3.6 Data Analysis

This research used descriptive statistics to analyze data. First level data quality checks was done at the data collection level while secondary level quality checks was done at the data entry level. The development of ranges, skip and fill rules accompanied by validation checks with all possible means of data cleaning was used to meet the assumptions of the analytical techniques employed. The use of frequencies and percentages came in handy. Analysis of these facts were presented in tabular manner on tables.

CHAPTER 4: DATA ANALYSIS AND INTERPRETAION

4.1 Demographic Profiles

There are only 43 banks in Kenya today. Out of these 43 banks 22 banks (51.2%) were sampled for the survey. These banks have been in existence for a period ranging from 1 to over 100 years (KCB, 2007). Data was collected mainly from staff, who take part in the daily administration of loans. These included credit officers and controllers, loans officers, loans managers and credit administrators.

4.2 Challenges of Loan Default

This study sought to determine the challenges of loan defaults to commercial banks in Kenya. Data was collected by multiple choices and Yes/No questions. A response rate of 82% was achieved. Data analysis was done using percentages. The higher the percentage in the questions on the questionnaires was taken to be the greater the challenge and vice versa. Results are shown in tables 1.

Table 1: Challenges of Loan Defaulting

	Challenge	Frequency	Percentage
1.	Accountability to Shareholders	14	64%
2.	Loss of Funds	16	73%
3.	Liquidity Problems	12	55%
4.	Problems with Central Bank of Kenya	9	41%

n=22

As table 1 above shows, a larger percentage of banks lose funds as a result of lending. This makes fear of loss of funds the main challenge followed by shareholders accountability by directors of these banks. Liquidity problem is also of necessity as a challenge. However CBK problems rank least among the challenges this research generated. Among the challenges brought about by majority of the respondents was Competition. Out of the 22 questionnaires posted, 59% of the respondents felt that competition is a new challenge promoting loan default. This they argued was due to the hopping of borrowers from one bank to the other as a result of strictness in other financial institutions to their customers hence evasion of due diligence.

4.3 Responses of Banks to the challenges of loan default

The study also sought to establish how banks in Kenya are responding to loan defaults. Questions were asked with regard to how banks respond to loan defaulters. From a response rate of 82% of data collected, these responses were collate in tables 2. The higher the percentage in the responses provides was considered to be the best response. Analysis was done using percentages.

Table 2: Responses of Banks to the challenges of loan default

	Responses to defaulters	Frequency	Percentage
1.	Credit Reference Bureau	18	82%
2.	Take Defaulters to Court	16	73%
3.	Auction their Security	16	73%
4.	Write off their Loans	6	27%
5.	Setting up Loans Department	14	64%
6.	Usage of Bank Policies	8	37%
7.	Use of technology for loan assessment	10	45%
8.	Outsource Loan Recovery	15	68%
9.	Offering only secured Loans	16	73%
10.	Stringent Legal Measures on Defaulters	12	55%
11.	Training Loans Officers/Staff	14	64%

n=22

Table 2 displays the responses that banks employ to tame loan defaulting. An overriding number makes use of CRBs 82%, 73% take loonies to court, auction their security and choose to offer only secured loans in situations where they are not willing to risk default. 68% outsource loan recovery to outside parties at a fee. 64 % of respondents said they set up competent loan processing departments and also conduct a thorough training on loan processing staff. 55 % advocate for stringent legal measures to tame defaulting. Use of technology as well as bank policies ranked lowers at 45% and 37 %. Lastly 27% of respondents write off their long term defaults.

CHAPTER 5: SUMMARY, DISCUSSIONS AND CONCLUSIONS

5.1 Summary, Discussions and Conclusions

This study was set up to determine the challenges of loan defaults to commercial banks in Kenya, and secondly to establish how banks in Kenya are responding to loan defaults. The results show that 82 % of banks use CRBs to check the ever growing loan default. The following are some of the highlights which this paper has come up with.

To prevent banks owned by the government from frequent collapse, the law needs to be repealed so that all who hold government offices such as ministers and civil servant administrators to declare their wealth and liabilities publicly. This will also contribute to the transparency that supports integrity. Many loans, both active and delinquent, will be disclosed and that disclosure will prompt many debtors to repay on time and with interest. Many of the bad debts inherited from the past will never be collected. The principal concern now must be to put in place appropriate requirements and sanctions to ensure that both borrowers and lenders begin to treat their transactions with respect and integrity.

The role played by the Central Bank of Kenya (CBK) in regulating the banking sector is critical if the sector is to perform up to its potential. The CBK has the responsibility of supervising, regulating and inspecting all commercial banks licensed in Kenya. CBK is responsible for enforcing statutory requirements, such as minimum capital, liquidity ratios and cash ratios, and can establish additional rules and regulations that are consistent with those statutory requirements. It has been decided that CBK should consider enforcing its rules and regulations with somewhat greater force so that greater account can be taken of national and international economic conditions and how these may limit or promote banking activities in Kenya. In future, banks will be required to implement recommendations made in CBK's Inspection Reports and related requirements more conscientiously. It should be noted that monetary penalties and regulatory sanctions will be imposed more infrequently. The goal will be to enhance reputation of CBK as regulator of the banking sector and the protector of depositors (2005).

The backlog of court cases and is the regulatory role of CBK has been put in question recently. As of the 31st of May 2002, 2,385 cases involving debts amounting to Shs.11b were languishing in court (CBK, 2003). The delays in disposing of these cases in court seem to reflect abuses of the judicial system by debtors or weaknesses in the judicial system itself. Many debtors apparently have sought and successfully obtained successive injunctions which have served to postpone definitive court decisions from being reached. Often, when cases have been settled, the implementation of decisions has been further delayed by problems arising in the process of transferring titles or simply cancelled by Land Control Boards. Cases that reach the auction stage may encounter barriers to sale reflecting the absence of bidders from a debtor's clan members or the placement of artificially low rigged bids. The difficulties involved in relying on land as collateral for loans suggests to us that the analyses of loan applicants and the projects being financed should be given much greater attention than the collateral being offered as cover for the loans. Projects being financed should offer reasonable promise of earning a rate of return that will enable loan applicants to repay their loans on time with interest as agreed. If loan officers are not convinced of the viability of the projects being proposed, loans should not be approved regardless of the value of the collateral being offered. If profitability can gradually supplant collateral as the primary reason for the approval of loans, we feel that fewer bad loans will be made, thus reducing a principal cause of Bank losses.

Recent thinking, for example, suggests that centralizing loan approvals of business proposals to loan officers who specialize in specific economic sectors increases the quality of loans and reduces the incidence of NPLs. Such a management structure requires prompt access to extensive data and the quick transmission of questions and decisions. The computerization programme is needed for three reasons: One, to generate the management information required to enable the banks to make informed decisions in a timely fashion, secondly, to improve internal operations efficiency and hence help the banks to reduce overhead costs and lastly to improve the bank's image and customer service.

Confidentiality is apparently established in The Banking Act and is extended to loans in default as well as loans in good standing. It is understandable that a loan arranged by a bank for one of its customers should be treated confidentially so long as both parties are honoring the loan agreement. When a loan is in default, however, the right to make the default public may stimulate repayment or renegotiation of the loan agreement and encourage new applicants for loans to ensure that their applications are bona fide. We can envisage circumstances in which the right to disclose borrowers who are in default might injure innocent parties and understand that if such a right were to be established the circumstances in which it could utilized would need to be carefully defined. The problem would diminish, however, if confidentiality were removed from all loans. If all loans were made transparently, many loans that are questionable from the outset might not be made.

This research believes that the conditions under which borrowers are allowed to hide under the umbrella of confidentiality merit very careful review and should be modified. The way out of this is to set up various CRBs to act as information providers to banks involved in lending. This will lead to an important break in the confidentiality barrier in which banks will be able to share information on NPLs so that a bank being approached by a prospective client for a loan can clear with other banks that the client is or is not in arrears on loans the client had earlier arranged with other banks in the net. This is a promising development to taming Loan defaulters. Fear of disclosure should encourage potential borrowers to avoid seeking loans with little, if any, intention of repaying, and strengthen management's ability to refuse doubtful loan applications. The issue of a bank's right to disclose its business dealings with a customer to a third party may, in future, needs to be addressed effectively by the bank including in its new account opening documentation and loan application documentation a consent from the customer that the bank may disclose at its sole discretion information concerning its business dealings with the customer. Such consent should be included in new account opening documentation and loan application documentation (CBK, 2005).

The mindset of banks management and staff will need a radical change in order to attune the bank to modern techniques of doing business. This is particularly so with regard to lending. Firstly, the philosophy of banks must move away from dependence on captive business of parastatals to the more open and competitive market. Secondly, the management must shift emphasis away from reliance on collateral to viability of projects in assessing credit. This approach would entail changing reporting lines and role of branches from being a microcosm of the bank to mere sales and service outlets tailored to the needs of the locality. The branch managers would become more of salesmen and saleswomen rather than lending managers. Large credit risks and other specialized services would be undertaken at the Head Office where expertise would be concentrated. This would reduce costs of running branches and enable the bank to help the government in extending and reducing cost of financial services to wananchi. In order to achieve this objective: First, bank staff would need to be provided with relevant training and motivation courses. Second, communication between the branches and the Head Office will need to be made more efficient and reliable than at present. Unless these enabling conditions are addressed simultaneously with recapitalization of the bank there is a high likelihood of the bank reverting to making losses in the near future (CBK, 2003).

If the above issues can be addressed promptly and effectively, public confidence in the financial system as a whole will begin to return. Confidence in the integrity of the system will not, however, be fully restored the financial system as a whole have demonstrated a consistent record of integrity and efficiency. That demonstration will not be easily achieved because it requires not only integrity among officials in top management but also integrity throughout the lower levels of employment in the Bank. Even that is not enough. Integrity must be practiced, and seen to be practiced, by the Bank's shareholders and by the Bank's Board of Directors. It would also help if the influence of powerful citizens and non-citizens could be contained at levels significantly lower than those experienced in the past. Finally, the courts and the system should dispense justice promptly and both must be seen to be even handed, which would suggest a less "debtor friendly" attitude.

Factors contributing to NPL may be thought to be three faced; First and foremost, are the factors specific to the internal operation of the organization. These are dependent on the credit policy of the bank as well as how the bank manages its relationships with the customers in order to identify any problems at the formative stages. With a strong internal environment, the bank is able to mitigate against such factors as misrepresentation of projects, exchange rate fluctuations, delays in approval, under financing and security based lending among others. Secondly is the issue of legislation enactment. This has to be spearheaded by parliament. The parliament needs to chart supportive policies to curb loan defaulting. There is urgent need to come up with stringent laws to address NPLs too. Thirdly and lastly, is the need to address poor management of businesses. Loan processing staff needs to lay emphasis on the management of businesses as poor management of funds contributes a great deal to NPL. The problem of NPLs in Kenya is real and if not urgently checked, could ultimately bring down the financial sector. The solution to this menace lies with the different players in the economy. All these players are interdependent on each other. The following are some of the ways in which NPL issue can be checked. Banks need to develop sufficient internal capacities in order to ensure existence of sound credit policies and adherence to such policies. This can be achieved through acquisition of appropriate skills in the credit departments and a prudent management which constantly monitors the portfolio and is proactive in its decision making. This will ensure a near-flawless appraisal system which will nip the problem at the bud. The treasury, parliament and CBK need to constantly seek the opinion of various players in the market before putting in place any policies that affect the financial sector. Such consultations should form critical input into any of the policies. The government should stop being a player in the market by privatizing all banks in which it has stake. This will eliminate political lending. Businesses should be scrutinized in terms of their management especially of funds so as to ensure before issuing loans; these businesses put forward a solid management of funds to forestall any future mismanagement after lending. These concerted efforts will ultimately tame loan defaulters hence bring back glory into the banking industry.

5.2 Limitations of the Study

The research was limited by time. This led to the limitation of the research objectives to challenges and responses of loan defaulting within the local commercial banks. More time would have been required to also look at strategies that banks can use to tame loan defaulters.

5.3 Recommendations for further Research

A research to implement the recommendation of this research would be a welcome idea. Researchers may choose to design information system – Decision Support Systems – DSS to act as CRBs. These systems should be under the custody of Kenya Bankers Association – KBA or CBK to offer credibility and control. This will enhance the findings of this study hence its operationability.

5.4 Implications for Policy and Practice

By putting in practice the findings of this research, CBK and parliament need to put measures of addressing public asset and liability declaration. Banks will also have to re-look their policies with regard to confidentiality as the outcome of this research perceives the confidentiality clause within the bank policies as a hindrance and a contribution towards loan default growing numbers. Usage of CRBs will go a long way to helping banks cope with loan default.

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APPENDICES

Appendix I: List of Kenyan Banks

NO.	BANK NAME
1	AFRICAN BANKING CORPORATION LIMITED
2	AKIBA BANK LIMITED
3	BANK OF AFRICA LIMITED
4	BANK OF BARODA
5	BANK OF INDIA
6	BARCLAYS BANK OF KENYA
7	COMMERCIAL BANK OF AFRICA
8	CFC BANK LTD
9	CHARTERHOUSE BANK
10	CHASE BANK
11	CITIBANK N.A. (Citigroup)
12	CITY FINANCE BANK
13	CONSOLIDATED BANK
14	CO-OP BANK OF KENYA LTD
15	CREDIT BANK LTD
16	DEVELOPMENT BANK
17	DIAMOND TRUST
18	DUBAI BANK
19	EABS BANK LIMITED
20	EQUATORIAL COMMERCIAL BANK
21	EQUITY BANK
22	FAMILY BANK
23	FIDELITY COMMERCIAL BANK
24	FINA BANK
25	GIRO COMMERCIAL BANK

NO.	BANK NAME
26	GUARDIAN BANK LTD
27	HABIB BANK AG ZURICH
28	HABIB BANK LTD
29	I & M BANK LTD
30	IMPERIAL BANK LTD
31	KENYA COMMERCIAL BANK
32	K-REP BANK
33	MIDDLE EAST BANK
34	NATIONAL BANK OF KENYA
35	NIC BANK
36	ORIENTAL BANK
37	PARAMOUNT BANK LTD
38	PRIME BANK
39	SOUTHERN CREDIT
40	STANBIC BANK
41	STANDARD CHART ERED BANK
42	TRANS-NATIONAL BANK
43	VICTORIA BANK

Appendix II: Sample Frame of Commercial Banks in Kenya

NO.	BANK NAME
1	AFRICAN BANKING CORPORATION LIMITED
2	BANK OF AFRICA LIMITED
3	BANK OF INDIA
4	COMMERCIAL BANK OF AFRICA
5	CHARTERHOUSE BANK
6	CITIBANK N.A.
7	CONSOLIDATED BANK
8	CREDIT BANK LTD
9	DIAMOND TRUST
10	EABS BANK LIMITED
11	EQUITY BANK
12	FIDELITY COMMERCIAL BANK
13	GIRO COMMERCIAL BANK
14	HABIB BANK AG ZURICH
15	I & M BANK LTD
16	KENYA COMMERCIAL BANK
17	MIDDLE EAST BANK
18	NIC BANK
19	PARAMOUNT BANK LTD
20	SOUTHERN CREDIT
21	STANDARD CHARTERED BANK
22	VICTORIA BANK

Appendix III: LETTER OF INTRODUCTION

UNIVERSITY OF NAIROBI

School of Business
Telephone: +254-2-318262
Telegrams: "Varsity", Nairobi
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Samwel Nyaoke
P.O.Box 30711 00100
Nairobi, Kenya

Dear Sir/Madam,

<u>RE: REOUEST OF PARTICIPATION IN MBA RESEARCH PROJECT</u>

The bearer of this letter, Sam Nyaoke is a Postgraduate student undertaking a Master of Business Administration (MBA) degree at the School of Business, University of Nairobi. He is Majoring in Strategic Management. As part of his course work assessment, he's required to submit a research project report on responses of commercial banks in Kenya to the challenge of loan defaulting.

Kindly assist him by completing the attached questionnaire. We assure you that the information provided is purely for academic purpose only and will be treated with utmost confidentiality.

Should you be interested in the findings of the research, a copy will be availed to you on request by the student. In addition a copy will also be availed at the University of Nairobi Library.

Thanks you for your Co-operation.

Dr. Martin Ogutu	Sam Nyaoke
Chairman MBA Department	MBA Student
Tel 318262	0722808198/2711221 ext 4036

Appendix IV: Questionnaire

RESPONSES OF COMMERCIAL BANKS IN KENYA TO THE CHALLENGE OF LOAN DEFAULTING

Where applicable, please mark the relevant box with a tick ☑.

SECTION A: Respondents and Company Profile

Respondent's profile

1. Which of the following best describe your function?

   a.) Risk Officer [ ]   b.) Loans Officer [ ]   c.) Loans Manager [ ]

   d.) Credit Controllers [ ]   e.) Other ....

2. For how long have you held your current position?

   a.) Below 2 Year [ ] b.) 2-5 Years [] c.) 6-10 Years [ ] d.) Above 10 Years [ ]

Company's Profile

1. How many years has your Bank been in existence? ....

2. Do you offer loans to your clientele?

   a.) Yes [ ]   b) No [ ]

   If yes how would you rate your loans?

   a) Secured [ ]   b) Non- Secured [ ]   c) Both [ ]

3. Do you have a loan processing department?

   a) Yes [ ]   b) No [ ]

4. What is the approximate number of employees at the loans department? ....

5. How can you describe the ownership of your Bank?

   a.) Public [ ] b.) Private [ ] c)Both [ ]

6. How can you describe the management of your Bank?

a) Indigenous [ ] b) Foreign [ ] c) Mixed [ ]

7. How would you categorize your Bank?

a) Corporate Banking [ ] b) Personal Banking [ ] c) Both [ ]

Challenge of Loan Defaulting

1. How would you rate the seriousness of Loan Default as a threat to your Bank?

a.) Not at all [ ] b.) Limited extent [ ] c.) Moderate extent [ ] d.) Great extent [ ] e.) Critical [ ]

2. In terms of percentage how would you rate the degree of Loan Default above?

a.) (1-5)% [ ] b.) (6-10)% [ ] c.) (11-15)% [ ] d.) (16-20)% [ ]

e.) Other Please specify...

3.) How would you rate your loan recovery process?

a.) Easy [ ] b.) Fairly Complicated [ ] c.) Very Complicated [ ]

d.)Other. Please specify...

4.) How would you rate your extent of Loan recovery in percentage?

a.) (1-5)% [ ] b.) (6-10)% [ ] c.) (11-15)% [ ] d.) (16-20)% [ ]

e.) Other Please specify.......

5. Does competition contribute to Loan Default?

a.) Yes [ ] b.) No [ ]

If Yes (above) please explain how?

....

....

....

....

6. Identify the challenges your bank face as a result of Loan Defaulting?

a.) Accountability to shareholders [ ]
b.) Loss of fund [ ]
c.) Liquidity problems [ ]
d.) Problems with CBK [ ]

Other(s) please specify

e.) ....[ ]

f.) ....[ ]

g.) ....[ ]

h.) ....[ ]

7. What are your clients' alternative sources of borrowing?

a.) Friends [ ] b.) Saccos [ ] c.) NSE d.) Development Partners [ ]

d.) Other(s)...

....

8. What motivates your clients to borrow from you? Please tick all which apply.

a.) Low interest rate [ ]

b.) Long repayment period [ ]

c.) Aggressive advertising [ ]

e.) Speed of loan processing [ ]

f.) Less scrutiny of the client history [ ]

g. Other Specify...

9. Between large and small borrowings, which category of stands a higher chance of defaulting?

a.) Corporate [ ] b.) Retail [ ] c.) Both [ ]

10. What would be the reasoning behind above? Please explain.

....

....

SECTION B: Responses to Loan Defaulting

1. Which category of loan has the highest default rate?

a.) Secured [ ] b.) Non secured [ ] c.) Both [ ]

2. In your view, what percentage of income to the bank is generated from loans?

a.) 5-10 % [ ] b.) 11-15% [ ] c.) 16-20% [ ] d.)21-25% [ ] d.)26-30% [ ]

3. How would you rate your banks' assessment of loan requests before lending?

a.) Excellent [ ] b.) Satisfactory [ ] c.) Average [ ] d.)In adequate [ ]

4. How long does it take your bank to considers a loan bad?

a.) 1 -3 Months [ ] b.) 4-6 Months [ ] c.) 7 Months – 1 year [ ] d.) Other. Please specify ....

5. Is there any concerted collaboration between your bank and external sources with regard to preventing loan default? a.) Yes [ ] b.) No [ ]

If yes above. Please specify how?...

....

....

6. Please indicate your level of agreement or disagreement with the following factors they contributing to Loan Default.

Note: - 1=Strongly Disagree, 2 = Disagree, 3 = Indifferent, 4 = Agree, 5 = Strongly Agree

	1	2	3	4	5
1. Job Loss	[ ]	[ ]	[ ]	[ ]	[ ]
2. Inadequate loans application assessment	[ ]	[ ]	[ ]	[ ]	[ ]
3. Personal choice/unwillingness to repay.	[ ]	[ ]	[ ]	[ ]	[ ]
4. Poor Economy	[ ]	[ ]	[ ]	[ ]	[ ]
6. Stringent measures	[ ]	[ ]	[ ]	[ ]	[ ]
7. Inadequate Training	[ ]	[ ]	[ ]	[ ]	[ ]
8. Inappropriate Laws	[ ]	[ ]	[ ]	[ ]	[ ]
Other. Please specify					
9...	[ ]	[ ]	[ ]	[ ]	[ ]
10.	[ ]	[ ]	[ ]	[ ]	[ ]

7. How does the bank deal with Loan Defaulters?

a.) Take them to court [ ]

b.) Auction their security [ ]

c.) Write off their Loans [ ]

d.) Do nothing [ ]

e.) Other. Please specify..

....

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....

8. Does your banks use any of the following responses to address the challenge of Loan Defaulting? Please tick all which apply.

	Yes	No
a.) Usage of Bank Policies	[ ]	[ ]
b.) Use of Technology for Loan Application Assessment	[ ]	[ ]
c.) Use of Credit Reference Bureau	[ ]	[ ]
d.) Training Loan officer	[ ]	[ ]
e.) Setting up Loans Departments	[ ]	[ ]
f.) Banks Exchanging information about borrower	[ ]	[ ]
g.) Obtaining information about defaulters CRBs	[ ]	[ ]
h.) Loans Officers insisting on interviewing the borrower	[ ]	[ ]
i.) Imposing serious penalties to defaulters	[ ]	[ ]
j.) All borrowers must be introduced by a guarantor	[ ]	[ ]
k.) Outsourcing Loan Recovery	[ ]	[ ]
Others please specify		
j.)	[ ]	
k.)	[ ]	

9. How effective are these responses? Please tick all which apply.

On a scale of 1-5 where 1-Least effective and 5-Most effective

	1	2	3	4	5
a.) Usage of Bank Policies	[ ]	[ ]	[ ]	[ ]	[ ]
b.) Use of Technology for assessment	[ ]	[ ]	[ ]	[ ]	[ ]
c.) Use of Credit Reference Bureau	[ ]	[ ]	[ ]	[ ]	[ ]
d.) Training Loan officer	[ ]	[ ]	[ ]	[ ]	[ ]
e.) Setting up Loans Departments	[ ]	[ ]	[ ]	[ ]	[ ]
f.) Banks Exchanging information about borrowers	[ ]	[ ]	[ ]	[ ]	[ ]
g.) Obtaining information about defaulters CRBs	[ ]	[ ]	[ ]	[ ]	[ ]
h.) Loans Officers insisting on interviewing borrowers	[ ]	[ ]	[ ]	[ ]	[ ]
i.) Imposing serious penalties to defaulters	[ ]	[ ]	[ ]	[ ]	[ ]
j.) All borrowers must be introduced by a guarantor	[ ]	[ ]	[ ]	[ ]	[ ]
k.) Outsourcing Loan Recovery	[ ]	[ ]	[ ]	[ ]	[ ]

Other (s) please specify

l.) .... [ ] [ ] [ ] [ ] [ ]

m.) .... [ ] [ ] [ ] [ ] [ ]

10. How often do you carry out the following?

(Note A =Annually, S= Semi annually, Q=Quarterly, M=Monthly, N=Never)

	A	S	Q	M	N
Change Loan Policies					
Analyze loans at the verge of defaulting					
Consider legal action for defaulters					
Keep in touch with borrowers					
Review/Replace your loan assessment systems					

11. To what extent are the insurance firm's contributing to curbing loan defaulting?

....

....

....

....

12. How would you rate your banks dependence on the following to determine credit-worthiness clients when assessing loans?

(Note 1= Least effective 5 = Most effective)

	1	2	3	4	5
Using certified copies of a pay slip					
Using letters of introduction from employer					
Permanence/temporal nature of employment					
Credit rating (Income less expenditure)					
Other. Please specify					

13. What strategies would you employ to curb chronic loan defaulters?

....

....

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....

14. Please gauge the effect that the following may have in curbing loan default:

(Note 1= Least effective 5 = Most effective)	1	2	3	4	5
a) CBK increased regulatory responsibilities e.g. Setting up CRBs	[ ]	[ ]	[ ]	[ ]	[ ]
b) Banks use of IT Strategies to centralize loan analysis process	[ ]	[ ]	[ ]	[ ]	[ ]
c) Shift from reliance on collaterals to viability as a credit criterion	[ ]	[ ]	[ ]	[ ]	[ ]
d) Enhance of legal and judicial systems to assist banks recovery	[ ]	[ ]	[ ]	[ ]	[ ]
e) Restoring public confidence through integrity of bank loan staff	[ ]	[ ]	[ ]	[ ]	[ ]
f) Removal of confidentiality clause from bank loans	[ ]	[ ]	[ ]	[ ]	[ ]
g) Declarations of assets and liabilities by all civil Servants	[ ]	[ ]	[ ]	[ ]	[ ]

15. Please provide any other mean/measure you think can be helpful to the banking industry in regards to curbing loan default.

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~Thank You~

Table 3: Summary of Banks in Kenya

Type of institution/Bureau	Nov 2002	Nov 2005
Commercial Banks	**45**	**43**
(a) Operating	44	42
(b) Under CBK statutory management.	1	1
Building Societies	**4**	**4**
(a) Operating	4	3
(b) Under CBK statutory management.	-	1
Mortgage and finance companies	2	2
Non Bank Financial Institutions	3	2
Total	**54**	**51**
Foreign Exchange Bureaus	48	52

Source: Central Bank of Kenya- 2006

State-owned Commercial Banks

1. Consolidated Bank of Kenya Limited
2. Cooperative Bank of Kenya Limited
3. Kenya Commercial bank Limited
4. National Bank of Kenya Limited

Financial Institutions

1. Prime Capital and credit Limited

Mortgage Finance Companies

1. Housing Finance Company Kenya Limited
2. Saving and Loan Kenya Limited