THE RELATIONSHIP BETWEEN PERSONAL FINANCIAL LITERACY AND LENDING BY COMMERCIAL BANKS IN KENYA

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DECLARATION

STUDENT DECLARATION

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

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DEDICATION

I wish to dedicate this research project to my loving husband Dennis Volemi for his undying support, and faith in me. This would have been impossible without you. I wish to also dedicate this to my adorable son Leo who makes me strive everyday to be the best I can be. You are my strength and reason for living. I also want to give a special thanks to my parents, my sisters Mercy, Joan and Irene for your understanding and being there to give me love, support and encouragement. I am indebted to you all and may God bless you.

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ABSTRACT

Personal finance is a highly deficient area globally and locally. Ideally, every single person should have a long term and short term financial plan guiding their everyday financial decisions. That is not the case. In Kenya today, the average person is financially illiterate even at the highest levels of education. This is mainly because the education system is not tailored to the needs of financial literacy. Even at the undergraduate and graduate levels, financial literacy is limited.

This was an explanatory study where the research sought to establish a relationship between the use of personal financial literacy and commercial bank lending by Kenyan banks. A census survey was conducted involving all 43 Commercial Banks in Kenya registered and licensed under the banking act as at 31st December 2009 as per the Central Bank of Kenya. This study used primary data that was collected from the respondents of the survey. Data was collected through the use of detailed questionnaires issued to banks. Data was captured and analyzed using Statistical Package for the Social Sciences (SPSS) version 17. The data was analyzed using descriptive statistics where frequency tables, percentages, means and standard deviations, Graphs and charts were used to provide conclusions on findings.

Based on findings, personal financial literacy does influence the lending decision by increasing the chances of approval of the loan facility, client understanding of the decisions and consequences is key and demonstrating serviceability. In addition those with better understanding of loans interests and repayment are more likely to get the loan The level of education also plays a role.

However, personal finance information in banks usually revolves around the products and services they offer. Customers therefore have little or no access to personal financial information from banks beyond the scope of the products. Most banks interviewed stated that to do otherwise would be time consuming and likely unprofitable hence the trend in the industry is to sell products but they strive to sell the most appropriate product or service to the customer.

Most banks also have a variety of products and services tailored towards the key personal finance areas: Financial Position(Net worth), Protection, Tax planning, Investment and accumulation goals, Retirement planning and Estate planning.

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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background to the study

Personal financial planning is the development and implementation of total coordinated plans for achieving one's overall financial objectives. The term Private Wealth Management also is increasingly being applied to this process, particularly when it involves larger investment portfolios and estates (Hallman& Rosenbloom 2003).

Financially capable and confident consumers are not only better able to look after their own interests, but are also able to act as a strong force to promote a genuinely competitive market for retail financial products and services (Briault, 2007).

FSD (2007) conducted a survey on the access to financial services and found that the Kenyan marketplace is characterized by a lack of clear information and complicated price structures coupled with an environment in which demand exceeds supply and products rather than the market drive the industry. Consequently the Kenyan consumer is largely unaware of price differences among banks. The CBK Survey carried out a comparative analysis across all banks to establish the most expensive and the least expensive banks.

The survey identified the following as the barriers that affect the customers in accessing banking services: mistrust and lack of awareness by the consumer, lack of clear information by banks to customers, high bank charges, lack of transparency in costs, poor branch networks and a product driven rather than a market driven approach.

Personal loans are a key component of commercial bank lending in Kenya. Personal financial literacy would enhance the lending by commercial banks because the customers would be better informed and therefore the mistrust and lack of awareness by the customer would no longer be a barrier to accessing banking services.

Many American homes suffer from lack of financial education and awareness, and this causes them to make poor decisions about managing their finances (Michele and Herman 2007). These poor decisions and lack of knowledge lead children in these households to being unexposed to correct financial behaviors and then those children grow up making poor financial decisions. This study goes to further the argument on the importance of personal finance and its impact in society.

There is a vicious cycle of lack of personal financial literacy that is seen in Kenya today. These poor financial decisions have consequences and more often than not, the individuals remain financially dependent in one way or another. The banks in Kenya need to play a more significant role in availing personal finance information to their clients especially during the lending process. This is because, the individuals will be better equipped to understand the financial implications of their decisions and how best to maximize return on investment.

The job status of a respondent is the primary factor in influencing attitudes towards personal financial planning and the frequency in managing for various aspects of personal financial planning (Tan & Ming-Ming, 2009). Demographic characteristics such as age, race, marital status, gender, and education level are the secondary factors. This paper has implications on financial planners in formulation strategies on how to successfully deploy a personal financial planning programme for their customers. This study has implications on the practice of personal finance in emerging economies.

A look at the websites of most major commercial banks in Kenya shows that their personal finance section mainly deals with the different kinds of personal accounts offered by the bank. No personal financial education is offered at banks. Neither is it available at other mainstream financial institutions This service therefore is rendered an elitist service only available to a few who probably have multiple access points to this information leaving a majority of Kenyans financially illiterate.

As at 2009, 7.6 million of 18.7 million adults are formerly served (CBK, 2009). This represents more than 40% of the Kenyan adult population and working class. This is the population that is responsible for personal financial decisions at the household level. Kenyan commercial banks would serve this population even better by informing them better especially in matters of personal finance. This would in turn increase the savings rates and enhance the outcomes of borrowed funds which would be invested in positive NPV projects. Kenyan commercial banks therefore need to formulate, implement and monitor strategies for personal financial planning programmes for their customers.

Households classified as low on the cash-flow management index had lower average financial knowledge scores than households classified as medium or high (Hilgert, et. al 2003). This study goes further to show that there is a connection between knowledge and behavior in personal finance and hence personal finance education is crucial for financial security.

The importance of personal finance and possible impact on the economy can therefore not be underestimated. Simple principles such as budgeting, saving and investing need to be clearly understood by all. There is a great opportunity to rectifying the information gap through the banking system. Personal finance is related to banks at least in the sense that the 40% of the Kenyan adult population uses bank to achieve many of their personal financial goals. This means that by enhancing access to personal financial information, banks can enhance their lending processes. Therefore, both the banks and the individuals stand to gain significantly from personal financial literacy. There is an economic reward for financial institutions in embracing child financial literacy programs in elementary school grades and in extending the learning and implementation components through integration of age appropriate online banking services and socialization websites (Grody et. al 2008).

The prevailing concern is that consumers lack a working knowledge of financial concepts and do not have the tools they need to make decisions most advantageous to their economic wellbeing. However, a complex and specialized financial services marketplace requires consumers to be informed and actively engaged if they are to manage their finances effectively. Under these circumstances, there is a renewed attention to personal finance education. This subject matter is currently gaining attention from various quarters of society, such as academia, government, corporations and nonprofit organizations.

1.2 Problem Statement

Personal finance is a highly deficient area globally and locally. Ideally, every single person should have a long term and short term financial plan guiding their everyday financial decisions. That is not the case. In Kenya today, the average person is financially illiterate even at the highest levels of education. This is mainly because the education system is not tailored to the needs of financial literacy. Even at the undergraduate and graduate levels, financial literacy is limited.

There exists a relationship between personal financial literacy and lending by commercial banks because a financially literate personal is better equipped to make sound financial decisions. These decisions would include saving more and investing better. By saving more, the bank would increase the supply of funds for the lending demand. The customer would also make better decisions when borrowing from the bank and therefore, default rate would be significantly decreased. Therefore, by enhancing access to personal financial literacy, both banks and customers stand to gain significantly.

The long term solution to this deficit is to introduce personal finance education right from basic education. However, commercial banks in Kenya today can play a major role in financial planning. As at 2009, 7.6 million of 18.7 million adults are formerly served. This means that commercial banks have a great reach.

Proper use of personal financial information would make the lending process more secure by decreasing default rates. If both the commercial banks and customers stand to gain significantly from personal financial literacy, why is this information not more accessible.

Internationally, many studies have been done in the area of personal finance. Hira (2009) argues that in recent years, the need for financial education has gained the attention of a wide range of entities including banking companies, government agencies, grass-roots consumer and community interest groups, universities, schools, and other organizations. However, the relationship between personal financial literacy and lending by commercial banks has not been explored.

Mutie (2006) conducted a study to establish the relationship between credit scoring practices by Kenyan banks and the level of Non Performing Loans. No local study known to the researcher has explored the relationship between personal financial literacy and lending by commercial banks in Kenya hence the need for this study.

1.3 Objectives of the study

To determine the extent of use of personal finance information in the lending process

1.4 Importance of the Study

To the banking industry, this study will enable them to identify key factors to consider in the use of personal finance information in the lending process

To the individual customers, this study will guide them in their utilization of banking services especially in borrowing.

The study will benefit management consultants who endeavor to advice commercial banks and government on the use of personal finance information

To the regulators, this study will avail critical information as they formulate policies and regulations in personal finance

To academicians, this study will be useful in enriching the body of knowledge and would also help them in carrying out further research.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This section summarizes the literature that is already in existence regarding personal finance and commercial bank lending. Relevant theories and empirical evidence is reviewed in this chapter.

2.2 Theoretical review

2.2.1 Life Cycle Saving and Human Capital

Franco Modigliani received the Nobel Prize in 1985 in part for the construction and development of the life cycle hypothesis of household saving. The underlying idea of the life-cycle hypothesis is that people save for their old age. His achievement lies primarily in the rationalization of the idea into a formal model, which he developed in different directions and integrated within a well defined and established economic theory. This model assumes the following assumptions about human behavior: They are forward-looking across the span of their lifetimes, they can predict the financial resources they will have over their lifetime, they understand something about the financial resources they will need in successive periods of their lives, they make informed choices about the use of their financial resource. (Hogan, 2009)

2.2.2 Unified Theory of Personal Finance by Scotts Adams

Scott Adam's nine-point formula for all personal finance decision states individuals and households would manage their resources best if they adopted the following procedure:

Make a will; Pay off your credit cards; Get term life insurance if you have a family to support; Fund your 401k to the maximum; Fund your IRA to the maximum, Buy a house if you want to live in a house and can afford it; Put six months worth of expenses in a money-market account; Take whatever money is left over and invest 70% in a stock index fund and 30% in a bond fund through any discount broker and never touch until retirement; If any of this confuses you, or you have something special going on (retirement, college planning, and tax issues), hire a fee-based financial planner, not one who charges a percentage of your portfolio. (Adams, 2002)

2.2.3 Prospect Theory

The theory was developed by Daniel Kahneman, and Amos Tversky in 1979 as a psychologically realistic alternative to expected utility theory. It allows one to describe how people make choices in situations where they have to decide between alternatives that involve risk, e.g. in financial decisions. Starting from empirical evidence, the theory describes how individuals evaluate potential losses and gains. In the original formulation the term prospect referred to a lottery. (Kahneman & Tversky, 1979)

2.3 Empirical evidence in Personal finance

Rutledge (2010) in the World Bank working paper 5236 states that the recent turmoil in financial markets worldwide has emphasized the need for adequate consumer protection and financial literacy for long-term stability of the financial sector. This Working Paper aims to summarize key lessons from reviews of consumer protection and financial literacy in nine middle-income countries of Europe and Central Asia (Azerbaijan, Bulgaria, Croatia, the Czech Republic, Latvia, Lithuania, Romania, the Russian

Federation and Slovakia). All the country assessments used a systematic common approach, based on a set of Good Practices for Consumer Protection and Financial Literacy developed by the World Bank's Europe and Central Asia Region. The objective of the Working Paper is to contribute to the international dialog on strengthening financial consumer protection and financial literacy in emerging markets. She suggests that consumers should be able to receive financial education when and how they want it. A common challenge among the nine countries is the need of an adequate institutional structure for financial consumer protection. However independent of the specific institutional structures, financial consumers should have one single agency where to submit complaints and inquiries (Rutledge, 2010).

Hira (2009) argues that in recent years, the need for financial education has gained the attention of a wide range of entities including banking companies, government agencies, grass-roots consumer and community interest groups, universities, schools, and other organizations. Numerous factors have led to a complex, specialized financial services marketplace that requires consumers to be actively engaged if they are to manage their finances effectively. The prevailing concern is that consumers lack a working knowledge of financial concepts and do not have the tools they need to make decisions most advantageous to their economic wellbeing. However, a complex and specialized financial services marketplace requires consumers to be informed and actively engaged if they are to manage their finances effectively. Under these circumstances, there is a renewed attention to personal finance education. This subject matter is currently gaining attention from various quarters of society, such as academia, government, corporations and nonprofit organizations; however, many are not aware of the rich history and sources of literature in the field. This paper briefly reviews the history of personal finance and then looks at the current status of the personal financial discipline and education before identifying challenges and opportunities for the future. She notes that there is a critical need for a national (USA) forum to bring about an agreement on the one name, core content and competencies, and professional qualifications for the personal financial field. This is necessary for future growth and development of the profession.

Bell et al (2009) found that financial education does seem to have an effect on specific financial management behaviors. Simple bivariate analyses revealed several behavior impacts. With more robust mulitvariate analysis, soldiers taking the financial education program were more likely than the comparison group to report using informal spending plans and less likely to report using formal spending plans. We also found that high school financial education programs made a difference in selected behaviors: those who had a high school financial education course were more likely to have a savings account for short-term savings goals and to save regularly. Having taken a high school course was also associated with having paid an overdraft fee in the past six months. Early financial management experience also seems to matter: soldiers who had a high school savings account were more likely to have an emergency fund, more likely to read money management articles, and less likely to "never" pay off their credit card balances.

Bikker et al (2009) examined the impact of participants' age distribution on the asset allocation of Dutch pension funds, using a unique set of pension fund investment plans for 2007. Theory predicts a negative effect of age on (strategic) equity exposures. They observed that pension funds do indeed take the average age of their participants into account. However, the average age of active participants has been incorporated much more strongly in investment behaviour than the average ages of retired or dormant participants. This suggests that both employers and employees, who dominate pension fund boards, tend to show more interest in active participants. A one-year higher average age in active participants leads to a significant and robust reduction in the strategic equity exposure by around 0.5 percentage point. Larger pension funds show a stronger age-equity exposure effect than smaller pension funds. This age-dependent asset allocation of pension funds aligns with the original life-cycle model by which young workers should invest more in equity than older workers because of their larger human capital. Other factors such as fund size, funding ratio, and average pension wealth of participants, influence equity exposure positively and significantly, in line with theory. Pension plan type and pension fund type have no significant impact. (Bikker, Broeders, Hollanders, & Ponds, 2009). This study indicates that the individual's stage in the life-cycle impacts the financial decisions they make.

Grody et al. (2008) examined the effectiveness of teaching financial literacy to elementary schoolchildren and extending such learning into an age-appropriate digital world of online support services. They utilized a picture book and a story relevant to the students 'real life' experiences and conceptual understanding of future rewards. They hypothesized that using materials geared toward developmental levels of cognitive ability and psychological readiness would readily engage students' understanding of delaying gratification, saving, earning or paying interest, and other fundamentals of personal finance. They speculate on the implications of the study result's positive outcome on future financial literacy programs in elementary school grades, and on into secondary education levels, combining elements found in the curriculums of math, economics and social studies. They postulate a role for financial institutions in the reinforcement of the learning experience and, more importantly, in the delivery of age-appropriate financial products and services. They demonstrate an economic reward for financial institutions in embracing child financial literacy programs in elementary school grades and in extending the learning and implementation components through integration of age appropriate online banking services and socialization websites.

Lerman and Bell (2006) note that financial services have become especially free and accessible, but also increasingly complex. For the new financial freedom to help most people, they must understand their choices and the likely implications of alternative decisions. Unfortunately, many Americans have a weak grasp of basic personal finance principles. This paper emphasizes the importance of financial literacy in an increasingly complex market economy and examines the current state of financial education in the U.S. and abroad. They explore two methods of delivering financial knowledge—through broad financial curriculums and through more focused "teachable moments." After examining the pros and cons of each, along with the evidence about their effectiveness, they suggest that a combination of the two perspectives, with the specific topics and behavioral strategies varying by target audience. They conclude by calling for a more rigorous evaluation of the effects of existing programs.

Zainhofer, (2006) conducted a study in Switzerland using panel data from the Swiss Labor Force Survey to estimate age-earnings profiles as well as transitory and permanent income shock variances for investor groups distinguished by gender, education and activity rate. Estimation results were then used to stylize several different Swiss investor types. Finally, they determined optimal life cycle consumption, savings and risky asset share for these investor types using a recent computational life cycle model of portfolio choice. They were particularly interested in the allocation differences between the investor types and their normative implications. They conclude that temporary partial employment of women can have significant effects on lifecycle portfolio choice for both single and couple investors. A pronounced earnings trough during the thirties combined with a high permanent variance, both characteristic of a female investor who reduces her labor supply as a result of parenting, requires substantial savings already early in life and leads to conservative and differently shaped age-equity profiles. In those couples where the female partner is of the just mentioned type, investment differs substantially from that of couples where the female partner is constantly fully employed, independent of the exact distribution of education in the couple. (Zainhofer, 2006)

Laury and Holt (2005) conducted an experimental test of prospect theory's reflection effect. They conducted a sequence of experiments that allowed them to directly compare choices under reflected gains and losses where real and hypothetical payoffs range from several dollars to over $100. Lotteries with positive payoffs are transformed into lotteries over losses by reflecting all payoffs around zero. When they used hypothetical payments, more than half of the subjects who are risk averse for gains turn out to be risk seeking for losses. This "reflection effect" is diminished considerably with cash payoffs, where the modal choice pattern is to exhibit risk aversion for both gains and losses. However, we do observe a significant difference in risk attitudes between losses (where most subjects are approximately risk neutral) and gains (where most subjects are risk averse). Reflection rates are further reduced when payoffs are scaled up by a factor of 15 (for both real and hypothetical payoffs)

2.4 Local studies

Kegode (2006) conducted a study to establish factors that determine credit worthiness of visa card holders: a case study of Kenya Post Office Savings bank. Secondary data comprising of 30 defaulters and 30 non-defaulters was collected from existing customers application forms. Analysis was done by scoring of the card holders and their subsequent performance in relation to the variables: age, marital status, average monthly income. Younger customers were found to be good payers. Married customers were more credit worthy and the longer a customer had stayed at their current employment, the more credit worthy they were.

Mutie, (2006) analyzed the credit scoring practices and non-performing loans in the Kenyan commercial banks. The objective was to evaluate the credit scoring practices in Kenyan commercial banks and to assess the relationship between these credit scoring practices and non-performing loans. Questionnaires were used across the 43 commercial banks as at the end of 2004. 62% used credit scoring practices and 38% didn't. Results indicated a negative relationship between credit scoring practices and non-performing loans with a correlation coefficient of -0.773.

Okumu (2004) analyzed the factors considered important by individual investors in investing in shares of quoted companies at the NSE. Convenience sampling was used and questionnaires were administered. Data was analyzed through descriptive statistics. Findings showed that the average investor was educated at a technical level and some to university level. Factors considered important included: managerial forecasts, risk of investment and industrial factors. This study did not satisfy all the elements of personal finance and more needs to be done locally to ensure that all elements of personal finance are exhausted empirically.

Juma (2003) investigates the reasons why bank customers fail to service their loans in Kenya. He does a data survey of Standard Chartered Bank. Measures of central tendency were used to analyze data factors were found to include: high interest rate, economic decline, job loss, poor management, system errors, lack of knowledge among others. The conclusion was that banks needed to train their staff on the basic principles of credit and implement Know Your Customer (KYC) Project

2.5 General overview of Kenyan commercial banks

The banking sector comprised the Central Bank of Kenya, as the regulatory authority, Commercial Banks, Non-Bank Financial Institutions, Forex Bureaus and Deposit Taking Microfinance Institutions as the regulated entities. As at 31st December 2009, the banking sector was composed of 46 institutions, 44 of which were commercial banks and 2 mortgage finance companies. In addition, there was 1 licenced deposit taking microfinance institution and 130 foreign exchange bureaus. Commercial Banks and Mortgage Finance Companies are licensed and regulated under the Banking Act, Cap 488 and Prudential Guidelines issued thereunder (CBK, 2009).

Based on assets size, institutions were classified into three peer groups comprising; large with assets above Ksh. 15 billion, medium with assets valued at between Ksh. 5 billion and Ksh. 15 billion and small with assets valued at less than Ksh. 5 billion.Nineteen (19) financial institutions were classified as large, fourteen (14) institutions were medium and twelve (12) institutions were small (CBK, 2009).

As at 31st December 2009, nineteen (19) institutions which represented 42 percent of the total financial institutions were classified as large and accounted for 88.1 percent of net assets, 88.6 percent of net advances, 88.0 percent of customer deposits and 87.7 percent of capital & reserves as shown in chart 4 below. However, the 12 institutions in the small peer group collectively registered a loss before tax of Ksh. 530 million with 8 institutions reporting profits while 4 registered losses. Similarly, of the 14 institutions in the medium peer group, 3 registered losses (CBK, 2009).

Further, a total of 40.5% of the population are formally served, representing approximately 7.6 million of an estimated adult population of 18.7 million in Kenya in 2009. Dependence on only informal financial services also declined from 32.7% in 2006 to 26.8% in 2009. The growth in number of people being reached by banking services is therefore encouraging. Financial institutions continue to offer innovative products and services that are expanding financial access. In particular, the use of new technologies such as M-PESA and ZAP has been significant to the development of the financial sector and has greatly contributed to the expansion of financial services. Information available from Safaricom indicates that MPESA had over 9 million registered users by December 2009 with over 16,000 Agents. Further, the amendments to the Banking Act through the Finance Act, 2009 is expected to enhance financial inclusion by enabling banks to offer financial services through third party agents cost effectively. The Central Bank is also reviewing the current regulations and guidelines relating to branch outlets with a view to making delivery of banking services cost effective (CBK, 2009).

A bank loan is a set amount of money which the bank has agreed to lend you for a set period of time. Payments and interest rates are agreed at the time of the loan. Different banks offer different types of loans. Speaking with bank branch staff should help you to work out the loan best suited to your needs. You will be asked to complete a loan application. It is very important to complete any loan application forms accurately and truthfully to make sure that you can afford to pay the loan that you are applying for and to ensure that the bank gives you the right type of loan. Before taking out a loan you should ask the bank branch staff enough questions to make sure you understand the terms and conditions of the loan. (FSD & CBK, 2007)

Non-performing loans, net of interest in suspense, rose by 5 .6 percent to Ksh. 50.9 billion in December 2009 from Ksh. 48.2 billion in December 2008. However, the asset quality, which is measured by the ratio of net non-performing loans to gross loans improved marginally from 3.4 percent in December 2008 to 3.2 percent in December 2009. Gross Non-Performing Loans (NPLs) declined by Ksh. 1.1 billion or 1.8 percent from Ksh. 61.87 billion in December 2008 to Ksh. 60.74 billion in December 2009. As a result, the ratio of gross non-performing loans to gross loans stood at 8.0 percent as at December 2009, compared with 9.2 percent registered in December 2008. The decline in gross NPLs was largely attributed to enhanced credit appraisal standards adopted by the financial institutions in 2009 (CBK, 2009)

2.6 Pet^onal Financial Decision Making

Personal financial planning is one of the most important aspects of personal finance. Personal financial planning can be done in the following 5 steps:

Assessment: The financial condition of an individual can be gauged by formulating balance sheets and income statements. The personal balance sheet calculates the assets on the one hand and liabilities on the other. Assets include car, house, stocks, and bank account. Personal liabilities include credit card debt, bank loan, mortgage etc. Information regarding personal income and expenses is listed under the personal cash flow statement.

Goal setting: After having done a proper assessment of the financial situation, an individual can set up long term as well as short term goals.

Constructing a plan: Once the goals are set, appropriate strategies should be formulated in order to fulfill the goals. This could be achieved by curtailing unnecessary expenditure or by expanding the income level by investing in stocks, real estate or other interest earning assets.

Execution: For proper implementation of the financial plans individuals lack patience and perseverance and hence seek professional help from financial planners, investment advisors and lawyers.

Monitoring and reassessment: The financial plan of an individual should be monitored from time to time for reevaluation (Hallman & Rosenbloom, 2003).

2.7 **Conclusions from Literature Review**

Research findings show that personal financial literacy has great value on the financial decisions individuals make. A financially literate individual is more prudent in spending, consistent in saving and wise in investing (Hallman & Rosenbloom, 2003). Research both in developed and emerging economies shows that the average consumer is financially challenged and therefore unprepared to make financial decisions. Studies have also gone further to show that the best solution to financial literacy is ensuring access to personal financial literacy to the greatest number of people at the earliest possible age (Hallman & Rosenbloom, 2003).

Despite these findings, efforts to ensure greater personal financial access have been limited. There are gaps in establishing what relationship exists between personal financial literacy and commercial bank lending; what role banks can play in personal financial literacy if any and the value that this would add to the lending process. Would greater utilization of personal financial literacy enhance the credit quality of the borrowers? Would this in turn reduce the default rate? Can this in turn make lending cheaper and hence reduce the interest rates on loans? These are research gaps that call for further research.

Past studies have focused on personal finance literacy and commercial bank lending as separate subjects. This study aims to establish what relationship exists between personal finance literacy and commercial bank lending

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This section outlines how the study will be conducted to show the relationship between personal financial literacy and commercial bank lending in Kenya as well as establish what the current personal finance practices in banks in the country are. The research design, sample and data collection methods will be described to map out the direction of the research.

3.2 Research design

This was an explanatory study where the research sought to establish a relationship between the use of personal financial literacy and commercial bank lending by Kenyan banks. The study was a census survey which was conducted using a survey questionnaire to be analyzed using statistical methods. The study used mono-method technique to collect and analyze the data. This was a cross sectional study that will give a snapshot of the current relationship of the data.

3.3 Population

A census survey was conducted involving all 43 Commercial Banks in Kenya registered and licensed under the banking act as at 31st December 2009 as per the Central Bank of Kenya.

3.4 Data collection

This study used primary data that was collected from the respondents of the survey. Data was collected through the use of detailed questionnaires issued to banks. The survey questionnaire had open ended questions where the respondent filled out short descriptive or explanatory responses. The questionnaire also had some questions requiring them to pick out a choice from given selection or fill in a response if none of the responses suited them.

The respondents were mostly personal bankers, credit officers and relationship officers at the various banks. However, for some banks the researcher was asked to leave the questionnaire with the HR department and these officers would then allocate the most appropriate individual to fill the questionnaire based on the information needed. The data collected focused on the major areas of banking activity, the types of lending, personal finance practices at the banks and products and services tailored to the personal finance needs of their customers. 40 questionnaires were accepted by banks, 3 banks stated that they could not give out such information but only 31 banks filled the questionnaires.

3.5 Data Analysis

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Content was analysed. Data was captured and analyzed using Statistical Package for the Social Sciences (SPSS) version 17. The data was analyzed using descriptive statistics where frequency tables, percentages, means and standard deviations, Graphs and charts were used to provide to draw conclusions on findings.

3.6 Data Reliability and Validity

Reliability is synonymous with repeatability or stability where a measurement that yields consistent results over time is said to be reliable. Reliability therefore is the degree to which measures are free from error yielding consistent results (Zickmund, 2003). One way to address the issue of reliability is to use the split half method defined as a method of measuring the degree of internal consistency by checking one half of the results of a set of scaled items against the other half The results were numbered as the surveys are sent out and then grouped into two groups where one was odd numbered surveys and the other even. From the two groups, the results were evaluated for internal consistency. Due to time constraints while undertaking the study it was difficult to repeat the surveys to determine repeatability of the study, however, some of the questions in the survey were repeated with slight changes in the wording to evaluate the repeatability of the survey.

Validity refers to the accuracy or truthfulness of a measurement. Are we measuring what we think we are measuring is a question the researcher has to answer. There are three issues to address when evaluating the validity of a study (Zickmund, 2003). These include face, content and construct validity. Face validity refers to the likelihood that a question will be misunderstood or misinterpreted. To counter this, a pretest of the survey will be caijied out. Content validity refers to whether an instrument provides adequate coverage of a topic. An expert opinion was sought to verify the validity of the content.

CHAPTER FOUR

4.0 DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter discusses the data analysis, findings, interpretation and presentation. The objective of the study was to determine the extent of use of personal finance information in lending process. Data was analyzed using an analytical tool, presented by tables, and bar graphs and interpreted with frequencies and percentages. Likert-type findings were further processed to yield meaning interpretation using mean and the standard deviation. The chapter is organized into three sections where the first section is presentation of the demographic outlook of the respondents while the second one discusses the main objectives. The last section gives the conclusion of the objective findings in brevity.

4.2 Major Areas of Activities

Figure 4.1: Bank Products

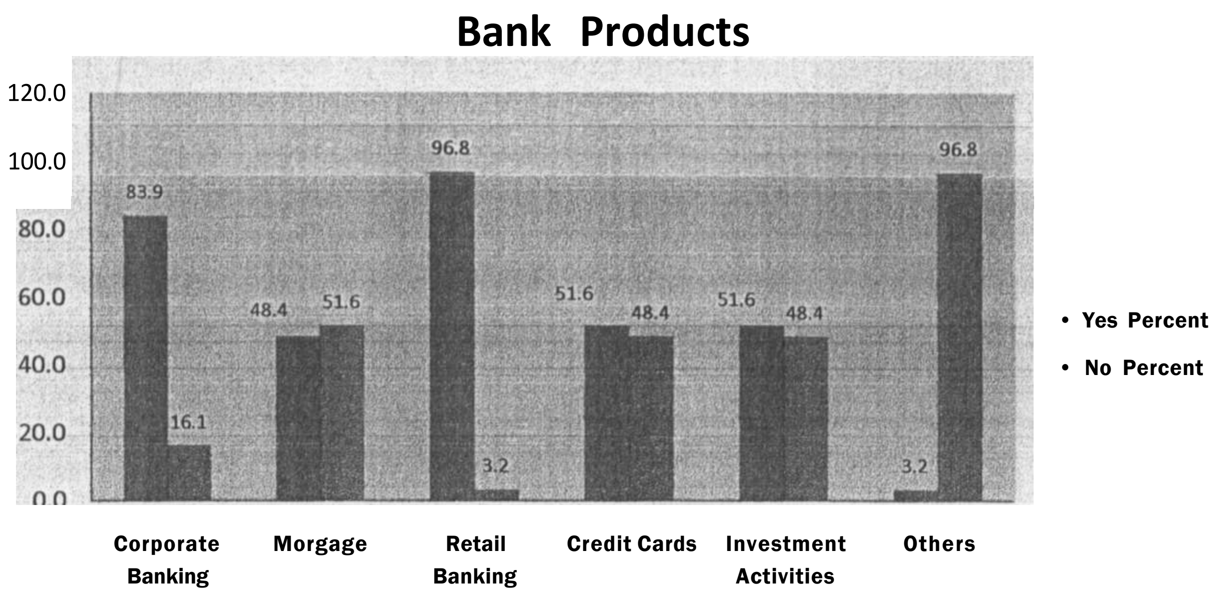


Figure 4.1 illustrates the Bank products where majority of the banks (83.3 percent) offer corporate banking 96.8 percent of the banks offer retail banking, 51.6 percent of the banks offer credit cards, 51.6 percent of the banks offers Investment activities, while majority of the banks 51.6 percent don't offer mortgage products. In addition majority of the banks 96.8 percent don't offer other products. This indicates that majority banks have highly developed corporate banking and retail banking making the two products to be the core business activities for most banks. As indicated by Briault, (2007), financially capable and confident consumers are not only better able to look after their own interests, but are also able to act as a strong force to promote a genuinely competitive market for retail and corporate financial products and services.

4.3 Type of Lending

The researcher also analyzed the type of lending, percent of lending for each of the products and the interest rate. All banks were found to have personal loans. Other prevalent products offered by the banks were business loan, asset finance as well as mortgages with 80.6%, 58.1% and 54.8% respectively.

Table 4.1: Type of Lending

Type of Lending		
	Frequency	**Percent**
Personal Loans	31	100.0
Overdraft Facilities	12	38.7
Asset Finance	17	54.8
Insurance Premium Finance	3	9.7
Invoice Discounting	5	16.1
Mortgage	18	58.1
Business Loan	25	80.6
Car Loan	5	16.1
Trade finance	10	32.3

Table 4.2: Interest Charged

Interest Charged		
	Frequency	**Percent**
Less than 5%	3	9.7
5 to 10%	5	16.1
13 to 15%	25	80.6
16 to 18%	30	96.8
19 to 21%	5	16.1

From the findings, majority (96.8%) lend money for different products at 16% to 18%

Figure 4.2: Average number ofpersonal loan applications received monthly

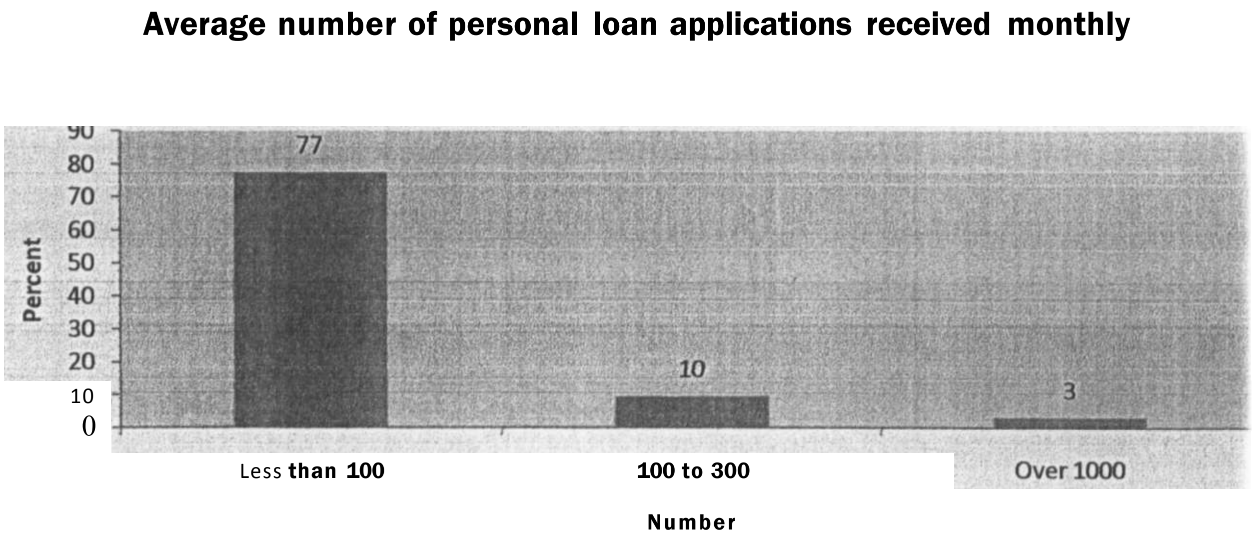


Figure 4.2 illustrates the average number of personal loans received monthly by banks, majority (77 percent) receives less than 100 applications followed by (10 percent) 100 to 300 applications received monthly, while (3 percent)of banks receives over 1000 applications. This indicates that most banks receives less than one hundred loan application every month with only a few 10 percent receiving 100 to 300 applications while 3 percent have receives over 1000 loan applications.

Table 4.3: Average number of personal loan applications approved monthly

Average number of personal loan applications approved monthly		
	Frequency	**Percent**
Less than 100	27.0	87
100 to 300	1.0	3
No Response	3.0	10
Total	**31.0**	**100**

Figure 4.3 regarding the average number of personal loan application approved monthly. Majority (87 percent) of commercial banks approve less than 100 loan application monthly while only 3 percent receives 100 to 300 loan application every monthly. This indicates that most personal loan application are less than 100 in a month.

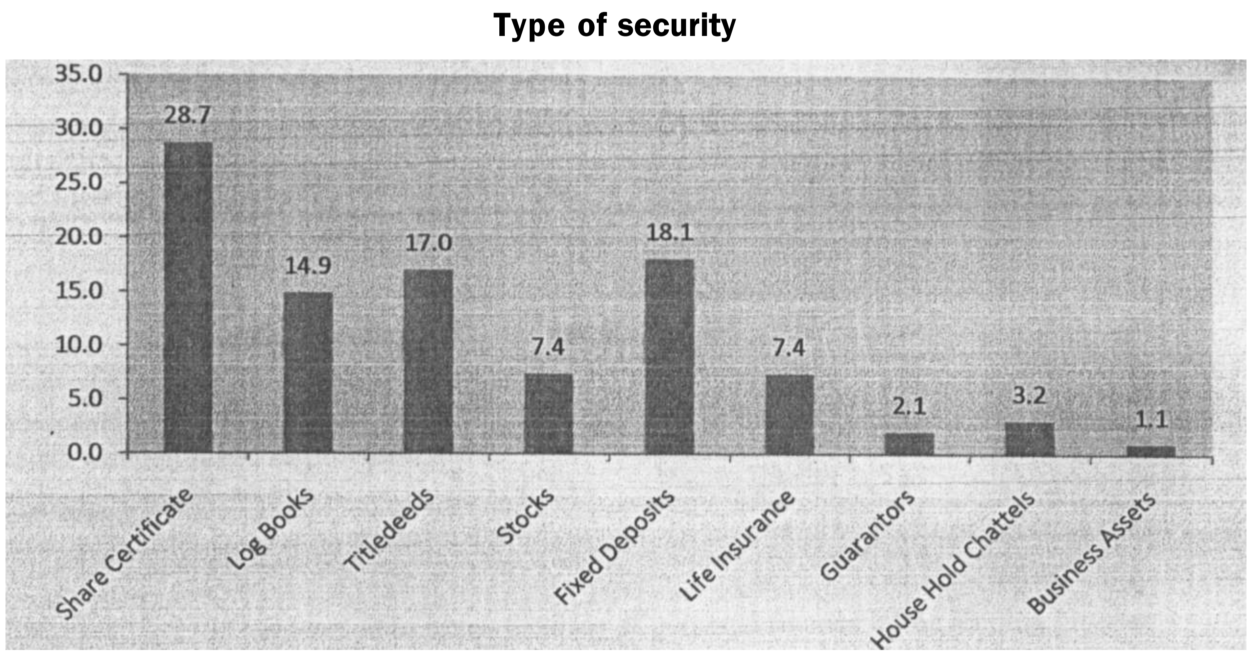
Table 4.4: Proportion of Individual Lending

Proportion of individual lending		
Unsecured	**Frequency**	**Percent**
None		
Less than ten percent		
Twenty percent		
Fourty percent		
Sixty percent		
Ninety percent		
One hundred percent		
Not Applicable		
Total		

Figure 4.4 regarding proportion of individual lending that is unsecured Majority (22.6%) of the individual lending is hundred percent unsecured, 19.4 % of individual lending is

ninety percent unsecured and 19.4 % of individual lending is twenty percent unsecured, 16.1 % of individual lending is Less than ten percent unsecured while only 6.5 percent of individual lending is secured and 6.5% of individual lending is fourty percent unsecured.

Figure 4.3: Type of Security



In addition, the researcher wanted to know the type of security required by banks and the most preferrechwhere majority (28.7%) of prefer Share certificates, 18.1% prefer fixed deposits, 17% prefer title deeds, 14.9% prefer car log books while only 7.4%, 7.4%, 3.2%, 2.1%, 1.1%, prefer Stocks, life insurance, house hold chattels, guarantors, business assets respectively as illustrated by figure 4.5

4.4 Personal Finance

Table 4.5: Uses of personal Finance in the Lending process

Uses of personal Finance in the Lending process				
	Yes		**No**	
	Frequency	**Percent**	**Frequency**	**Percent**
Existing personal finance department	30	96.8	1	3.2
Personnel have necessary Qualification	27	87.1	4	12.9
Personal financial advisor	27	87.1	4	12.9
Collaboration with newly Licensed credit Reference bureau	28	90.3	3	9.7
Vetting process efficient	28	90.3	3	9.7
Personal information availed to borrowers and customers readily	24	77.4	7	22.6
Advice availed free of charge	30	96.8	1	3.2
Banks well equipped to provide personal financial advice	23	74.2	8	25.8

The researcher further wanted to know the uses of personal finance in the lending process where various factors were considered where Majority (96.8%) of banks have an existing personal finance department of where 96.8% of banks offer advice free of charge while 90.3% of the banks were in collaboration with newly Licensed credit Reference bureau * where in contrast 90.3% of banks say it has made the vetting process for borrower efficient. In considering the products and services (74.2%) of banks are well equipped to provide personal financial advice to individuals.

4.5 Qualitative Findings

4.5.1 How the personal Financial literacy influences the lending decision

Personal financial literacy influences this decision through increasing the chances of approval of the facility, client understanding of the decisions and consequences is key and demonstrating serviceability. In addition those with better understanding of loans interests and repayment are more likely to get the loan. The customer's level of education also plays a role.

The key problems that exists in the creation recording (registration) and enforcement of security and collateral include

- Not readily available
- Security provided by a client might be of a lower value than anticipated
- Time consuming
- Delays in registering the charge at the lands ministry.
- Inter agency dependency
- Valuation costs are high- legal fees, processing fee
- Not all employers comply with the need for the employee's salary to be channeled through the lending bank's customer account and therefore deserving borrowers are^denied funds.
- Non payment of land rent and rates
- Lack of other related documents
- Realization of security when loans are in arrears.
- Mistrust

4.5.2 Products and Services

Products and services are as tabulated below

AREA	PRODUCTS OR SERVICES
Financial position (Net worth)	Savings and current accounts, credit cards, personal loans, car loans, overdrafts Fixed deposit accounts, remittances, call deposits, move account, asset finance, gold account
Protection	Credit protection cover on personal loans, insurance premium financing
Tax planning	Mortgages, overdrafts, construction loans,
Investment and accumulation goals	Fixed deposits accounts and call deposits Advisory and custodial services, (Malkia products for growth oriented women entrepreneurs), long term loans, Equity loans for longer terms 60 months to buy assets like cars and mortgages, brokerage service, investment advisory.
Retirement planning	Savings products pension loan
Estate planning	Trustee services

Before any loan is granted, the bank reviews the documents provided and also contact the borrowers' employer to verify the employment terms (contract temporary or permanent) in addition, the bank asks for assumptions used in preparing cash flows statements budgets to understand the underlying figures submitted. Moreover, the information is reviewed by a relationship officer, then it is forwarded to the credit analyst, then to the decision makers the to relationship officers.

4.6 Conclusion

From the findings, both the banks and the individuals stand to gain significantly from personal financial literacy. There is an economic reward for financial institutions in embracing child financial literacy programs in elementary school grades and in extending the learning and implementation components through integration of age appropriate online banking services and socialization websites.

Major products provided by commercial banks in Kenya include savings and current accounts, credit cards, personal loans, car loans, overdrafts. Accounts provided are fixed deposit accounts, remittances, call deposits, move account, asset finance, and gold account. In addition, credit protection cover on personal loans, insurance premium financing are also provided including mortgages, overdrafts, construction loans.

Advisory and custodial services, (Malkia products for growth oriented women entrepreneurs), long term loans, Equity loans for longer terms 60 months to buy assets like cars and mortgages, brokerage service, investment advisory.

Personal finance advice is availed to bank customers in Kenya readily and free of charge. However, this advice is tailored to the bank product and services rather than to the personal finance needs of the customer.

CHAPTER FIVE

5.0 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary and Conclusion

This study sought to determine the extent of use of personal finance information in lending process. The study will aid banks management in the steps towards developing strategies to enhance use of personal literacy to simplify the lending process. Majority of the banks (83 .3 percent) offer corporate banking 96.8 percent of the banks offer Retail banking. Majority of the banks (77 percent) receives less than 100 applications followed by (10 percent) 100 to 300 applications received monthly. Majority (87 percent) of commercial banks accepts less than 100 loan application monthly while only 3 percent accepts 100 to 300 loan application every month.

Majority (22.6 percent) of the individual lending is hundred percent unsecured, 19.4 percent of individual lending is ninety percent unsecured. Regarding security majority of the banks (28.7 percent) of prefer Share certificates, 18.1 percent prefer fixed deposits, and 17 percent prefer title deeds. Regarding personal finance majority (96.8 percent) of banks have an existing personal finance department, 96.8 percent of banks offer advice free of charge while 90.3 percent of the banks were in collaboration with newly licensed credit reference bureau.

Conclusion

Personal financial literacy influences the lending decision by increasing the chances of approval of the facility, client understanding of the decisions and consequences is key and demonstrating serviceability. In addition they include better understanding of loans interests and repayment the more likely they are to get the loan level of education also plays a role by the customers.

Generally, personal financial literacy has great value on the financial decisions individuals make. Banks require a range of securities where most banks require share certificate, as well as fixed deposits, title deeds and log books. This implies that they are more acceptable type of securities. Regarding personal finance almost all banks have personal finance department while most banks offers free advice and are in collaboration with newly licensed credit reference bureau, in considering. Nonetheless, efforts to ensure greater personal financial access have been limited in Kenya,

Recommendations

Personal finance information is used extensively in the lending process of the banks. Banks should realise that personal finance information and process affects their day to day running of their businesses. Towards this end and from the findings,

- Banks need to increase the availability of personal finance information to their customers beyond the scope of products and services that they have to offer. Key areas of financial planning should be accessible to customers to increase the level of trust between the two parties.

- Banks should actively increase the type of products and services they offer so as to increase their number of customers. Banks should employ effective mechanism in their verification process by actively collaborating with credit reference bureau. Payments and interest rates are agreed at the time of the loan. Different banks offer different types of loans. In addition staff should help out the customer in completing loans forms. It is very important to complete any loan application forms accurately and truthfully to make sure that you can afford to pay the loan that you are applying for and to ensure that the bank gives you the right type of loan.

- The banks should also train their staff on process when a client walks in a bank so as to effectively minimise the time taken to process the loan.

- The banks should clearly spell out their loan products as some of them use complicated language hence they should invest more on clarity as information is vital in decision making.

- For proper implementation of the financial plans individuals lack patience and perseverance and hence seek professional help from financial planners, investment advisors and lawyers.

- Personal finance gaps need to be identified where personal advice should go beyond available products and services.

5.2 Limitations of the Study

To carry out the study there were a lot of barriers associated with it, which included the following:-

Inadequate time: To carry out research, it required a lot of time and energy which is mainly consumed by conducting interviews and duration taken for response from questionnaires to reach back from respondents. In a bid to balance the little time to accomplish other academic and personal commitments proves to be a problem.

Cost: Printing questionnaires and making calls to respondents to follow up on progress and transport costs especially because most respondents were seen more than twice in order to get back the filled questionnaires proved rather costly

Lack cooperation: Some Managers were not willing to give out information that can portray loop holes in the side of management for fear of victimization, which if it is leaked out, they might lose their job. Others failed to cooperate in fear of exposure of their practices despite being informed that the actual bank details such as name would not be included in the final report.

Lack of interest and commitment: Some of the Managers in organizations were not willing tongive information during the interview. Some said they are busy, you are disturbing them thus some of the questions were not answered.

Choice of sample: Due to the fact that this was a census survey, the sample was large and hence data collection was an expensive and time consuming process. The choice of obtaining data from banks also was a major limitation because of the confidentiality practices in banks which limit the scope of readily available information.

5.3 Suggestions for Further Research

The study also suggested areas for further study:

There is need to carry the same study in other parts of the country to find out whether the same results will be obtained.

A research could be carried out on the strategies adopted to enhance the speed of verification and enforcement of security.

A research could be carried out on banks customers to find out the impact and effectiveness of lending process.

Data was analyzed by content analysis, a research could be carried out where data is analyzed using a different model

Only 31 out of the 43 licensed commercial banks in Kenya responded, a research could be carried out with a higher response rate to find out whether the same results will be obtained

A loader research could be carried out to measure the impact of personal finance education on an individual's net-worth. This is a study that would require greater resources and would also require at least three years in order to educate individuals and measure the impact.

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APPENDICES

APENDIX I: QUESTIONNAIRE

INSTITUTION DATA

NAME

ADDRESS

POSTAL CODE

PHONE NUMBER

EMAIL

DATE LICENCED

MAJOR AREAS OF ACTIVITY

Corporate banking:

- YES
- NO

Mortgaging:

- YES
- NO

Retail banking:

- YES
- NO

Credit cards:

- YES
- NO

Investment activity:

- YES
- NO

Other:

- YES
- NO

TYPES OF LENDING

Describe the types of lending provided by your institution, percentages of lending and the interest rate charged in each category

TYPE OF LENDING	PERCENTAGE OF TOTAL LENDING	INTEREST RATE CHARGED

What is the average number of personal loan applications are received on a monthly basis?

What is the average number of personal loan applications accepted on a monthly basis?

How does personal financial literacy influence this decision[9]

What proportion of individual lending is secured[9]

What types of security/collateral does the Bank require and what is the preferred (or most common) form used?

Describe the key problems that exist in the creation, recording (registration) and enforcement of security and collateral?

How would you describe the quality of the information provided by the debtors in each of the above instances?

What steps does your institution follow to verify the integrity and accuracy of information provided by borrower (and borrowers in default)?

PERSONAL FINANCE

Do you have an existing personal finance department in your institution?

- YES

- NO

Does the personnel have the necessary qualification?

- YES

- NO

Is there a personal financial advisor available during normal working hours?

- YES
- NO

What role do they play in the vetting of potential borrowers during the lending process?

What type of information do you look for when vetting potential borrowers?

How long does the vetting process take?

Do you work in collaboration with the newly licensed Credit Reference Bureau?

Has this made the vetting process any more efficient?

Is personal finance information availed to borrowers and customers readily[9]

- **YES**
- **NO**

What key areas of personal finance information are most commonly sort after by borrowers and customers?

Is the advice availed free of charge?

- **YES**
- **NO**

If no, what is the fee to access personal financial planning services?

What is the process when a client walks in and has a financial problem and they require financial advice?

If assistance is availed, is a follow up made to ensure that the customer found the advice useful?

PRODUCTS AND SERVICES

What products or services does your institution offer tailored towards the key areas of personal finance:

AREA	PRODUCTS OR SERVICES
Financial Position(Net worth)	
Protection	
Tax planning	
Investment and accumulation goals	
Retirement planning	
Estate planning	

In your opinion, are banks well equipped to provide personal financial advice to individuals?

- YES
- NO

If yes, what mechanisms need to be put in place to ensure greater accessibility an(j availability?

If no, what is the best place for individuals to access personal financial advice?