STRATEGIC RESPONSES TO THE CHALLENGE OF NON-PERFORMING LOANS BY COMMERCIAL BANK OF AFRICA

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A MANAGEMENT RESEARCH PROPOSAL SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA), SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

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DECLARATION

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

Signed.. Date 17/11/2010.......................

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This research project has been submitted for examination with my approval as university supervisor.

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God bless you all.

DEDICATION

To my family members;

"Education is an ornament in prosperity and a refuge in adversity".

ABSTRACT

Non-Performing Loans are a reflection of problems in the banking and corporate sectors. NPLs create problems for the banking sector's balance sheet on the asset side. They also create a negative impact on the income statement as a result of provisioning for loan losses. In the worst scenario, a high level of NPLs in a banking system poses a systemic risk, inviting a panic run on deposits and sharply limiting financial intermediation, and subsequently investment and growth. The objective of this study was to investigate the strategic responses to the challenge of Non Performing Loans by commercial bank of Africa.

The study sought to find establish the strategic responses which were used by Commercial Bank of Africa to the challenge of Non-Performing Loans. An interview guide was used to guide the researcher in collecting data from ten members of management team who comprised the managing director, two executive directors, four general managers and three employees of the bank who are involved in the disbursement and collection of loans. Content analysis was used to analyze the qualitative primary data which had been collected by conducting interviews and secondary information from the organization.

It was established that the main causes of NPL in the bank were poor credit and risk management practices, use of qualitative methods of debt collection, over reliance on the collateral granted for the loan, long association of the borrower with the bank, and the

historical financial capability, poor monitoring systems, poor management, economic downturn and inadequate government monetary policy.

The study found out that the bank has responded to the challenge by introduction of new policies and procedures, the subjecting of credit proposals to rigorous risk assessment by the lending officers, the use of informal means to get additional information on borrowers, vetting credit proposals by senior management for objectivity and avoiding lending to seasonal or non performing sectors, use of turnaround strategy, restructuring, adoption of new technology, aggressive marketing, change of leadership and organizational culture change.

TABLE OF CONTENTS

LIST OF ABBREVIATIONS

CBA - Commercial Bank of Africa

CBK - Central Bank of Kenya

NPL's - Non-Performing Loans

CHAPTER ONE: INTRODUCTION

1.1 Background of the study

In the 1980's, 1990's and 2000's, several countries in developed, developing and transition economies experienced several banking crises requiring a major overhaul of their banking systems (IMF, 2008). Kenya was not left behind and it has experienced banking problems since 1986 culminating in major bank failures, 37 failed banks as at 1998, (Kithinji and Waweru, 2007). The failures were mainly attributed to NPLs (Murugu, 1998). For example, Daima bank, according to Mullei (2003) was placed under statutory management for failing to meet the minimum core capitalization threshold as well as poor management of loan portfolios. Presently, several developed countries including the USA are experiencing a banking crisis. For example the Citibank group alone, has written off more than $39 billion in losses accruing due to NPLs (Elliot, 2008). It is argued that the non-performing loans are one of the major causes of the economic stagnation problems. Each non-performing loan in the financial sector is viewed as an obverse mirror image of an ailing unprofitable enterprise. From this point of view, the eradication of non-performing loans is a necessary condition to improve the economic status. If the non-performing loans are kept existing and continuously rolled over, the resources are locked up in unprofitable sectors; thus, hindering the economic growth and impairing the economic efficiency

As the banking sector expands at an increasing rate and becomes intensely competitive, every organization needs to adopt some strategies which will enable it to have a competitive edge over the others. As competition intensifies, many businesses continue to seek profitable ways in which to differentiate themselves from competitors. Strategies are at ends and these ends concern the purpose and objectives of the organization. They are the things that organizations do, the paths they follow and the decisions they take in order to reach certain points or level of success. As the banks arm twist each other in wooing customers to take loans from them which some have even gone to the extent of offering non secured loans, the greatest challenge which all the banks faces is the default or nonpayment of the loans by the customers which leads to non performing loans. This therefore calls for a change of tact by employing new strategies, (Mullei, 2003).

One of the challenges influencing the performance of a bank is the non-performing loans. Organizations have to respond strategically to this factor in order to maintain it at a level which it does not affect the profitability of the bank so much at the end of the year. Increased non-performing loans threaten the attractiveness of a bank and reduce its profitability, (Hamel and Prahalad 1993). To succeed in the long term, organizations must ensure that they advance loans to those customers who have a track record on servicing the loans. To accomplish this they must find suitable ways for creating and adding value for their customers as non-performing loans exerts pressure on firms to be proactive and to formulate successful strategies that facilitate proactive response to anticipated and actual changes in the banking industry, (Suri, 1998).

1.1.1 Strategic responses

According to Pearce and Robinson (1988) strategic responses are a set of decisions and actions that result into formulation and implementation of plans designed to achieve a firm's objectives. In order to effectively achieve the firm's objectives, these set of plans and actions must be strategically fit to the complexities and dynamism of a rapidly shifting environment. Firms largely are open systems where there is continuous interaction and interfaces with the external environment. Strategic responses are the strategies that firms take and largely triggered by continuous changes in the external environment. Johnson and Scholes (1997) defined strategy as the direction and scope of an organization over the long term which achieves advantage for the organization over the long term through its configuration of resources within a changing environment to meet the needs of the markets and fulfill stakeholders expectations.

Timely response is critical to avoid adverse effects or missed opportunities. Costs of none response could be lost accumulative profits and cost of reversing the loss. Strategic response may include development of new products, new markets, new process, new services, and new strategies for attaching the market, restructuring, marketing, information technology, leadership and culture change. Firms need strategy to sustain and grow profitability, revenues, market share and most importantly-acceptance. Considering that performance is the major objective of an organization, it is generally accepted that the structure and decision making in an organization is influenced by environmental complexity and volatility, (Miles and Snow1978). It is further argued that the alignment of strategies of organizations with the requirements of their environment outperform organizations that fail to achieve such an alignment, (Beal 2000).

1.1.2 Non-performing loans

When a borrower cannot repay interest and/or installment on a loan after it has become due, then it is qualified as default loan or non-performing loan (Chowdhury and Adhikary, 2002). It is known as non-performing, because the loan ceases to "perform" or generate income for the bank. The default/ non-performing loan is not a "uniclass", rather a "multiclass" concept. The problem of NPLs is not unique to Kenya alone. Gupta (1998) observed that banking problems precipitated by NPLs are not confined to the developing world alone. Japan, Sweden, Bangladesh, Taiwan, Philippines and USA have at one time faced severe banking crisis. However, he pointed out that it is in the developing world that the problem wrecks the greatest havoc. This undermines the banks' financial intermediation.

Collapse of commercial banks in Kenya is attributed to various risks but the major ones are credit and liquidity risks. 'Credit risks arise from the possibility of default by borrowers. Credit looses cannot be fully eliminated with credit appraisals except in case of lending to government through purchase of government securities''. Only maintaining a diversified portfolio of lending can mitigate this risk. On the other hand 'liquidity risk refers to an institution's inability to meet unexpected cash withdrawals. To hedge against this risk, banks are required to hold an adequate level of liquid assets' (CBK, 2000 P. 40). These diverse risks may render a bank illiquid, thereby causing instability in the whole industry. The collapse of one bank usually has a ripple effect on the stability of other banks.

When a bank classifies a facility as non-performing, CBK guidelines indicate that banks should start to make specific provisions (CBK, 2002). The specific provisions require banks to forego interest received besides allocating provisions for the NPLs from their own resources. Provisions for bad debts eat into banks profits. Njuguna an Ngugi (2000) observed that to reduce credit risk, Kenyan banks charge a premium. This tends to increase the interest rate to borrowers, and in turn reduces the demand for loans. These factors produce an unstable macro-environment, which serves to widen the interest spread between the deposit taking and lending rate. NPLs therefore have repercussions for national economies. The problem of NPLs in Kenya has risen to a level where in the budget speech in June 2003, the Minister for Finance indicated that 'the government was exploring the possibility of setting up a non-performing loan agency with judicial powers to deal with the issue of bad debts' (Oloo, 2003 p.9). Additionally, the minister also proposed the introduction of the 'in-duplum' rule, providing that interest on NPLs be stopped from accruing further interest, as soon as the interest already levied equals the principal sum borrowed. However, the bill was not enacted until the banking (Amendment) Act, 2006 was assented by the President at December 2006 (CBK, 2006).

1.1.3 Commercial Bank of Africa

CBA is the largest privately owned Kenyan bank. Commercial Bank of Africa Limited (CBA) was founded in 1962 in Dar-es-Salaam, Tanzania and quickly established branches in Nairobi and Mombasa in Kenya, and also in Kampala, Uganda. With the nationalization of banks in Tanzania, CBA reincorporated itself in Kenya in 1967. In light of developments in Uganda in 1971, it subsequently sold the Kampala branch.

CBA originally commenced business as a subsidiary of Societe Financiere pour les pays D'Outre Mer (SFOM), a Swiss-based consortium bank with interests in financial institutions throughout Africa. Original consortium members included Bank of America, Commerz Bank (later on sold to Dresdner Bank), Bank Bruxelles Lambert, and Banque National de Paris. In 1980, Bank of America acquired all the shares of the other SFOM partners, and CBA became a subsidiary of Bank of America, with 16% of shares held by Kenyan investors.

During the period 1980 to 1984, Bank of America re-organized CBA, developing and installing Bank of America's global systems and disciplines. In late 1984 Bank of America agreed to sell the majority of its shares to local investors while retaining a minority interest and continuing to provide management to the bank via a management agreement. Bank of America eventually sold the remainder of its shares - and CBA is now wholly Kenyan owned. The bank's Head Office is located at CBA building along Mara Ragati roads Upperhill. It has a branch network of 14 branches. NPLs have of late become one of the major challenges to the bank. The annual report and financial statement (2010) indicates that approximately Kshs 3.7 billion was non-performing loans in the period ending 2009, out of which the bank had made specific provisions of approximately Kshs 2.1 billion.

1.2 Problem statement

Organizations have been described as organizations serving and they depend on the environment for inputs, which they add value, and thereafter output value added products or services into the environment (Ansoff and McDonnell 1990). Consequently, for any firm to be successful, they have to adapt their strategies to the environment. Successful firms constantly scan the environment in order to identify threats and opportunities that could affect their operations (Porter, 1990). The recent challenges the banking industry has faced including the financial sector liberalization, intense competition, monetary policy changes and worsening economic conditions warrants new strategies to counter all of them.

Non-Performing Loans are a reflection of problems in the banking and corporate sectors. NPLs create problems for the banking sector's balance sheet on the asset side. They also create a negative impact on the income statement as a result of provisioning for loan losses. In the worst scenario, a high level of NPLs in a banking system poses a systemic risk, inviting a panic run on deposits and sharply limiting financial intermediation, and subsequently investment and growth. In addition, it could be further exacerbated if it is combined with external shocks, an unfavorable phase of the macroeconomic cycle, or inadequate political or legal support. According to the CBK (July, 1999) the level of NPLs in 1998 was estimated at Shs. 80 billion or 30% of advances, up from 27% in 1997 as compared to 81.3 billion or 33.4% of total loans in November 2001. This can be compared with levels of NPLs in other countries. According to Taiwan News (2002), the NPL ratio among Taiwanese banks was estimated at 7.7 percent by the end of 2001, while the ratio among grassroots financial institutions was 16.37 percent. In the Philippines non-performing loans ratio as at July 15, 2001 stood at 16.81 percent of the total loan portfolio, up from 16.76 percent a month before, (Batino, 2001). Comparing, the ratio of non-performing loans in Kenya of 33% to similar African economies as at the end of 2000, the ratio is much lower in Zimbabwe (24%), Nigeria (11%) and South Africa (3%) (CBK 2001)

Several studies on non-performing loans have been done and this include; Mathara (2007) who did response of National Bank of Kenya to the challenge of Non-performing loans and found out that the challenges the NPLs pose to the bank are liquidity problems, low profitability, bad public image and problems with debt collection. The response to the challenges include, leadership change, turnaround strategy comprising both retrenchment and restructuring of the bank, culture change, re-capitalization of the bank, technology enhancement and marketing initiatives. Kanyiri (2005) did strategic response of commercial banks in Kenya to the challenge of Non-performing loans and the results were that banks introduced new policies and procedures to disburse loans, subjecting of credit proposals to rigorous risk assessment by the lending officers, vetting of credit proposals by senior management for objectivity and avoiding lending to seasonal or non performing sectors.

No two organizations are perfectly similar and thus whatever works for one company may not work for the other. This is because the strategies employed by one bank may not suit employment by another bank and also the strategies being applied by the banks are different in the sense that the studied banks are public and therefore their response to non-performing loans will be different to commercial bank of Africa response as it's a private bank. This research will therefore seek to identify the strategic responses being used by Commercial Bank of Africa to the challenge of Non-performing loans. This problem statement leads to the following question: what are the strategies used by Commercial Bank of Africa to counter the challenge of Non-performing loans?

1.3 Objective of the study

To establish the strategic responses of Commercial Bank of Africa to the challenge of Non-performing loans.

1.4 Significance of the study

It assisted CBA management to evaluate how effective they have been in responding to the challenge of NPLs. This enabled them identify gaps in their responses which may enhance their strategic response.

The study benefited the government and especially the Ministry of Finance for making policy decisions whose overall objectives are to reduce the amount of non-performing loans and at the same time accelerate the rate of growth in the banking industry sector and take advantage of the improved economy thus more lending to individuals and institutions. It was useful to the shareholders of the bank in evaluating the effectiveness of the banks management response to the challenge of non-performing loans as they try to reduce the loans to a manageable level.

Other organizations used the response strategies employed by the bank to manage the challenge of non-performing loans. It was useful to other researchers and scholars as it will contribute to the body of knowledge in the area of non-performing of loans.

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CHAPTER TWO: LITERATURE REVIEW

2.0 Introduction

This chapter reviews pertinent literature relating to the strategic responses, empirical review of strategic responses by organizations, causes of non-performing loans, strategic responses to the challenge of non-performing loans, and changing nature of strategic responses.

2.1 Strategic Responses

Strategic responses involve changes to organization's strategy behavior to assume success in transforming future environment. It incorporates the competitive moves and approaches to deliver the best performance and satisfaction to all stakeholders. The choice of the responses depends on the speed with which a particular threat or opportunity develops in the environment. Well developed and targeted strategic responses are formidable weapons for a firm in acquiring and sustaining competitive edge. Some of the strategic response includes the development of; new products, new markets, new process, new service, new strategies for entering the market, restructuring, marketing, information technology, leadership and culture change.

Strategies which are implemented within an organization should support the culture associated with the firm. The proposed strategy should preserve, emphasize, and enhance the culture, in accordance with the culture supporting the proposed strategy. The fast food industry has of late been under intense competition from the other eating points within the town and therefore for them to sustain the competition they should develop strategies that can enable them to survive. Environment is a key factor to a firm's success. Environment can be relatively stable or highly turbulence. Each level of environmental turbulence; has different characteristics, requires different strategies and requires different firm capabilities (Ansoff and McDonell, 1990). Thus there is need for continuous strategic diagnosis. Strategic diagnosis is a systematic approach to determining the changes that have to be made to a firm's strategy and internal capability in order to assure the firm's success in the future environment. Based on appreciation that periodic planning systems are not able to perceive and respond to threats and opportunities in a turbulent/chaotic environment.

Strategic responses to the NPL are normally long term ventures. These take over one year and the responsibility lies in the corporate and business level of management. They are companywide and huge amounts of resources are required to enforce them. Strategic responses according to Pearce and Robinson (1999) are a set of decisions and actions that result in the formulation and implementation of plans designed to achieve a firms objectives. Strategic responses are part of competitive strategies that organizations develop in defining their goals and policies. They are reactions to what is happening on the environment of the organization. Strategic responses are concerned with the long term strategy of an organization involving high investments and embracing the organization as a whole. According to Ansoff and McDonnel (1990) strategic responses involve changes in the organizations strategic behavior. Such responses may take many forms depending on the organizations capability and the environment in which it operates. Well developed and targeted strategic responses are formidable weapons for the firm in acquiring and;

sustaining a competitive edge. Senior (1997) notes that there are various catalysts for organizational changes such as restructuring. These triggers may include the purchase of new IT equipment or systems, business process intensification/ extensions, the re-design of group jobs, staff right sizing and subsequent staff cutbacks as well as redundancies.

2.2 Empirical review of strategic responses in organizations

Decisions on competitive factors require a careful evaluation of resources and environmental variables. Resources include all assets, capabilities, organizational processes, attributes, information, and knowledge that enable a firm to define and implement strategies to compete, Porter (1981). Barney (1991) classified these resources into three major categories: physical capital resources, human capital resources, and organizational capital resources. Because of resources limitations, Skinner (1974) suggested that it would be difficult to focus on more than one competitive factor at a time in any particular firm or manufacturing facility. Limiting a firm to a single competitive factor is similar to Porter's (1980) assertion that a firm can only choose either cost or differentiation as a basis for competition. The implication of Porter (1980) is that any firm attempting to achieve both cost and differentiation as its competitive factors is almost guaranteed low profitability, Kotha and Orne (1989). However, this proposition has been challenged by many world-class manufacturing firms as they simultaneously maintain many competitive factors.

The perception of competitive factors can vary from one level of management to another. Swamidass (1986) found that while chief executives emphasized quality and technology, manufacturing managers focused on reducing cost and keeping delivery promises. A mismatch of competitive factors between chief executives and manufacturing managers in the same firm could be a potential problem in the effective use of the manufacturing function. Porter's (1980) strategic positioning model builds upon the assumption that five forces determine industry attractiveness, i.e, the potential to earn rents. Three forces represent the "horizontal" competitive relationships, namely the rivalry among competing firms, the threat of new entrants and the threat of substitutes. Two other forces reflect the firm's "vertical" linkages with external actors, namely buyer and supplier power.

Bloem and Gorter (2001) suggested that a more or less predictable level of NPL, though it may vary slightly from year to year, is caused by an inevitable number of 'wrong economic decisions' by individuals and plain bad luck (inclement weather, unexpected price changes for certain products, *etc.*). Under such circumstances, the holders of loans can make an allowance for a normal share of non-performance in the form of bad loan provisions, or they may spread the risk by taking out insurance. Enterprises may well be able to pass a large portion of these costs to customers in the form of higher prices. For instance, the interest margin applied by financial institutions will include a premium for the risk of nonperformance on granted loans.

Fuentes and Maquieira (1998) undertook an in-depth analysis of loan losses due to the composition of lending by type of contract, volume of lending, cost of credit and default rates in the Chilean credit market. Their empirical analysis examined different variables which may affect loan repayment like limitations on the access to credit, macroeconomic stability, collection technology, bankruptcy code, information sharing, the judicial system, prescreening techniques and major changes in financial market regulation. They concluded that a satisfactory performance of the Chilean credit market, in terms of loan repayments hinges on a good information sharing system, an advanced collection technology, macroeconomic performance and major changes in the financial market regulation.

2.3 Causes of Non Performing Loans

According to Gorter and Bloem (2002), non-performing loans are mainly caused by an inevitable number of wrong economic decisions by individuals and plain bad luck (inclement weather, unexpected price changes for certain products, etc.). Under such circumstances, the holders of loans can make an allowance for a normal share of nonperformance in the form of bad loan provisions, or they may spread the risk by taking out insurance. The problem of NPL's is widespread. Nishimura, Kazuhito, and Yukiko, (2001) state that one of the underlying causes of Japan's prolonged economic stagnation is the non-performing or bad loan problem. They explain that some of the loans made to companies and industries by financial institutions during the bubble era became non-performing when the bubble burst. This delayed structural reforms and prevented the financial intermediary system from functioning properly

2.3.1 Internal causes of non-performing loans

The accumulation of non-performing loans is generally attributable to a number of factors, including economic downturns and macroeconomic volatility, terms of trade deterioration, high interest rates, excessive reliance on overly high-priced interbank borrowings, insider lending and moral hazard (Goldstein and Turner 1996). In a context of low equity and absence of diversification, terms of trade deterioration and interbank loans played a key role in the accumulation of non-performing loans in Sub-Saharan Africa. The latter also increased the risks and prospects of moral hazard. Moral hazard in the banking sector context refers to the adverse incentives created by the prospects of implicit coverage of banks losses by governments. It can be particularly high when banks' capitalization is low; in such cases, it often leads to adoption of imprudent lending strategies with direct implications for banks' loans portfolios which tend to be heavily skewed toward high risk projects. When these projects are owned by investors and entrepreneurs directly or indirectly connected with the lenders, the financial transaction is termed as insider lending.

According to a study by Brownbridge (1998), most of the bank failures were caused by non-performing loans. Arrears affecting more than half the loan portfolios were typical of the failed banks. Many of the bad debts were attributable to moral hazard: the adverse incentives on bank owners to adopt imprudent lending strategies, in particular insider lending and lending at high interest rates to borrowers in the most risky segments of the credit markets. According to Brownbridge (1998), the single biggest contributor to the bad banks of many of the failed local banks was insider lending. In at least half of the bank failures, insider banks accounted for a substantial proportion of the bad debts. Most of the larger local bank failures in Kenya, such as the Continental Bank, Trade Bank and Pan African Bank, involved extensive insider lending, often to politicians. The threat posed by insider lending to the soundness of the banks was exacerbated because many of the insider banks were invested in speculative projects such as real estate development, breached large-loan exposure limits, and were extended to projects which could not generate short-term returns (such as hotels and shopping centres), with the result that the maturities of the bank's assets and liabilities were imprudently mismatched. He cites three forces behind insider lending and lists them as political pressure, under- capitalization, over concentration in ownership. He further observes that second major factor contributing to bank failure were the high interest rates charged to borrowers operating in the high-risk segments of the credit market. This involved elements of moral hazard on the part of both the banks and their borrowers and the adverse selection of the borrowers.

According to Kroszner, (2002) human resource management in banks is still planned economy pattern as the quality of personnel in the credit business is not guaranteed, since there is no admittance and exit management of qualification of those people, lack of effective motivation, can’t fully inspire employees' enthusiasm and responsibility. It is difficult to allocate a suitable person to a suitable position because of the so-called “only promotion, no demotion” management system of leaders and the human resource deployment is often behind the actual demand of business development and management function reform, so there are not enough people in credit business, which directly affects the quality and effect of the tasks relative to supporting functions.

Past extensive strategic management mechanism leads to over-extending credit in some regions and industries and exacerbating risk for banks. Firstly, strategic management focuses only on the analysis of market opportunity and neglects huge potential risk, so the business development strategy and risk management strategy are disconnected seriously. Bonin, John, Huang and Yiping (2000) argued that bureaucratic thinking, internal resource distribution and power allocation are entirely based on bureaucratic levels of institutions, not on the real demand and contribution. Some institutions with low growth potential, poor credit environment, and weak management capability, can have large business scale and high credit approval authority, for the sake of their high bureaucratic level. There are separate plans for operation, decentralized information systems, and no uniform management on industries and regional risk, so the capability to resist systematic risk in industries and regions is weak. There is no integration of marketing resources and weak interaction between marketing and business growth among institutions, so it is hard to unify all the resources to marketing the strategic valuable customers for banks (Ding Shandre and Qing 2001).

Meanwhile, different institutions in one bank may even have contrary admittance and exit strategies for the same customers. Capital resource, which is limited and costly, is the constraint to expand the scale. Without capital constraint mechanism, the management will measure the performance only based on scale growth, and even behave irrationally such as attracting savings with interest, and extending credit with high risk and cost (Yousaiken, 2001). Subsequently, the accumulated risk exceeds the expected loss because of over expanded asset scale and large ratio of high-risk asset, so the banks have to use capital to cover risk and face hot water of insolvency.

2.3.2 External factors

The macroeconomic variables such as money multiplier, and reserve adequacy, institutional characteristics and tequila effect have positive influence on NPLs. Fuentes and Maquieira (1998) undertook an in-depth analysis of loan losses due to the composition of lending by type of contract, volume of lending, cost of credit and default rates in the Chilean credit market. They concluded that a satisfactory performance of the Chilean credit market, in terms of loan repayments hinges on a good information sharing system, an advanced collection technology, macroeconomic performance and major changes in the financial market regulation. In another study of Chile, Fuentes and Maquieira (2003) analyzed the effect of legal reforms and institutional changes on credit market development and the low level of unpaid debt in the Chilean banking sector. Using time series data on yearly basis (1960-1997), they concluded that both information sharing and deep financial market liberalization were positively related to the credit market development. They also reported less dependence of unpaid strategic with respect to the business cycle compared to interest rate of the Chilean economy. Altman, Resti and Sironi (2001) analyzed corporate bond recovery rate adducing to bond default rate, macroeconomic variables such as gross domestic product and growth rate, amount of bonds outstanding, amount of default, return on default bonds, and stock return. It was suggested that default rate, amount of bonds, default bonds, and economic recession had negative effect, while the gross domestic product growth rate, and stock return had positive effect on corporate recovery rate

According to Herr and Miyazaki, (1999) lack of difference between Board of Director and Senior Management, so the internal monitor systems on decision making do not exist. The obvious shortcomings of the arrangement are: the quality of important decision making such as strategy planning is not high and the moral hazard risk of senior management is easy to appear. Frankly speaking, there is strong and direct relationship between deficiency in monitoring system, which should be the powerful method to enhance the control power inside the banks, and reduce many serious problems that have appeared. The fundamental reasons are: independent audit and monitor are not strong; monitor, review and post-assessment on subsidiaries are not well-located; risks are not identified timely; qualities of asset are not authentic; provisions are not enough.

In addition, there are also evident flaws, which are important reasons for formation of NPL, in specialization of decision and control on moral hazard risk of decision making process, although most banks have experienced the shift from simple "Three Level Approval" to "Separation between the checking process and the actual lending" in decision making mechanism (Siems 1994).

It's hard to inspire the initiative of institutions at the aspects of different territory loans and group and affiliated enterprises' loans, and post-loan management and monitoring, since the internal revenue distribution process is not perfect. Performance assessment mechanism has obvious orientation effect. Incomplete assessment may lead institutions to deal with operation management mistakenly, wrongly grasp the key points of the task, breed plenty of moral hazard risk, and impair the security of credit assets (Kroszner, 2002). The main disadvantages of past assessment mechanism are as follows: firstly, no deep analysis on macroeconomic trend, characters of regional economy, structure of customers groups, and extent of competition in the same business, and no combination between the above factors and banks' strategic plan when decomposing assessment tasks, institutions prefer growth to risk in order to perform well in assessment, since there is strong relationship between business growth indicators and short-term financial indicators, people tend to pursue short-term performance through expanding market share at the cost of banks' security of credit asset, since there is no assessment on medium and long term benefit and credit business is risk lagged in nature and lastly there is much emphasis on pre-loan during the loan period in assessment indicators, but no enough emphasis placed on post-loan management, so huge amount of NPL appears as the result of incomplete post-loan management (Westermann 2003). The major shortcomings of current accountability system are: some managers are not fearless and determined to take responsibilities, sometimes it is difficult to apply accountability because there are no clearly-defined descriptions of relevant departments and processes in credit business, based on the above analysis of NPL, there are various reasons concerning pre-loan period and post-loan management, but the current accountability measures mainly focus on approval process since the measures are not comprehensive, clear and scientific. And lastly lack of integration between accountability and quality of loans and no dynamic accountability system, so the accountability is often applied late after the actual loss.

2.4 Strategic Responses to the challenge of Non-performing loans

A strategy is a pattern or plan that integrates an organizations major goal, policies and action sequences into a cohesive whole (Porter, 1980). Strategic management is therefore concerned with deciding on a strategy and planning how the strategy is to be put into effect through strategic analysis, strategic choice, strategic implementation and control (Johnson and Scholes, 1993). The strategic management process allows an organization to take advantage of key environmental opportunities to minimize the impact of external threats, to capitalize upon internal strengths and overcome weakness. A large number of research studies have concluded that organization's that have adopted strategic management are likely to be more profitable and successful than those that do not (Fred, 1996).

There are several strategic responses that may be used to respond to the NPL challenge. Turnaround strategy may be used by some firms. Pearce and Robinson (1997) described this as a situation arising from declining performance and profitability of a significant magnitude, which calls for turnaround actions. Ansoff and McDonnel (1990) contended that the objective of this strategy is to arrest and reverse financial and competitive weaknesses quickly. A turnaround strategy allows senior managers to study the firms, to understand the critical causes of poor results, in order to stem losses and restore growth.

The other strategy which could be used by some firms is restructuring. Activities within a business value chain are more critical to the success of the business strategy than others. Business process reengineering popularized by consultants Hammer (1996) is one popular method. Business process reengineering is intended to regularize a company so that it can best create value for customer by eliminating barriers that create distance between employees and customers. It involves fundamental rethinking and radical redesign of business process to achieve dramatic improvements for instance, cost, quality service and speed. Reengineering and value orientation have led to downsizing, outsourcing and self management as themes of influencing original structure.

Downsizing is eliminating the number of employee's particularly middle level management. It results to increased self management, larger span control and more work for those that remain. Outsourcing means obtaining work that was previously done by employees inside organization from sources outside the company who can perform better. It is a source of competitive advantage. Activities that can be outsourced include; information processing, various personnel activities, security among others. Restructuring also entails removal of structural barriers and creation of learning organizations capable of continued re-generation from the variety of knowledge, experience and skills of individuals within a culture which encourages mutual questioning and challenge around a shared purpose of vision.

Adoption of information technology is yet another response strategy which can be used by some firms. The computer and developments in Telecommunication are most important aspects of information technology that have transformed business environment and processes. Automation of business processes has led to a drastic improvement in productivity and reduction in costs while Telecommunications has improved the speed with which information is transmitted thus facilitating speedy decision making. Information Technology has become indispensable ingredient in organizations in several strategic to meet challenges of change they include internet, intranets that support business operations and using it in business process reengineering. Information Technology is also used to develop new products, services, processes and capabilities that give a business a strategic advantage over the competitive forces it faces in its industry (O'Brian, 2002).

Marketing could also be used by some firms although most companies do not embrace the marketing concept until driven to it by circumstances. Various events forcing companies to adopt the market concept includes sales decline and slow growth in sales forces some companies to search for new markets. Most companies therefore realize they need marketing skills to identify new opportunities and to address the issue of changing buying patterns where most companies operate in markets characterized by rapidly changing customer needs. Such companies need more marketing know-how if they are to track buyers' changing values (Kottler, 2000). Increasing competition also force complacent companies to think about marketing. A number of strategic marketing variables can be manipulated in response to a changing competitive situation. They include adjusting of target market, diversification and development of new product, distribution changes, advertising, promotion and establishment of relationship market.

According to (Kotter, 1990), leadership is about copying with change. Leadership has become very important in recent years due to businesses becoming more competitive and volatile. Pearce and Robinson (2002), indicates that organizational leadership involves action in first guiding the organization to deal with constant change by embracing change, clarifying strategic intent and shaping culture to fit with opportunities and challenges that change afterwards.

Organizational culture is a set of important assumptions, often unstated that members of an organization share in common. Organizational culture similar to an individual's personality is an intangible yet ever present theme that provides meaning, direction and the basis of action. Insightful leaders nurture key themes or dominant values within organizations that reinforce the competitive advantages they posses or seek, such as quality, differentiation, cost and speed. Most typical beliefs that shape organizational culture is belief in being the best; belief in superior quality and service, belief in importance of people as individuals and a faith in their ability to make a strong contribution, importance of details of execution and customers should reign supreme.

2.5 Changing nature of Strategic responses

In the past years managers developed and operated according to managerial mindsets formed through years of experience, Prahalad and Bettis, (2004); Bettis and Prahalad (2005). Managers' experiences were often in traditional organizations employing formal strategic planning tools. However, the traditional managerial mindset can no longer produce effective strategies and strategic processes in the new competitive landscape. The watchword in the new competitive landscape is flexibility in strategy and organization. Because of the rapid changes in technology and speed with which new products are introduced to the market, firms must remain flexible in the strategies they employ to respond to competitors' strategic actions. To have strategic flexibility, firms must use a flexible process of strategic decision making to maintain flexibility in the deployment of critical resources, Sanchez (1995).

Managers must also develop a mindset that allows cooperation with competitors as well as traditional economic competition. Because of the need to pool resources to develop more and better new technology in order to remain competitive, firms have been forced in numerous cases to form competitive alliances with current and potential competitors, Bettis and Prahalad (2005). Strategic alliances are particularly prominent between domestic and foreign competitors, but are also numerous between domestic competitors to help fight off foreign competition or achieve, at least, competitive parity in global markets.

According to Banbury and Mitchell (2005), due to the dynamism of the new competitive landscape, firms cannot remain static even if they operate in mature industries. Incremental (and perhaps even radical) innovation may lengthen the product life cycle and change the competitive dynamics within the market. Thus, firms in the new competitive landscape must achieve dynamic efficiency regardless of their industry's life cycle, (Costa 2003). As such, managers must have an entrepreneurial mindset, emphasizing innovation in most industry settings.

The significant dynamism in the new competitive landscape requires that firms concurrently unlearn and learn, (McGill and Slocum 2004). Managers must have a mindset that allows them to unlearn traditional practices, processes, and strategies and to be receptive to new ones. In fact, as argue, they must have a learning-oriented mindset; the ability to learn and unlearn is important. Levinthal and March (2003), further argue that learning can improve organizational performance, but also limit future improvements. Because of the simplified world and the reinforcing nature of success from learned behavior, firms become vulnerable to environmental change. Therefore, the managerial mindset in the new competitive landscape must entail continuous and simultaneous unlearning and learning.

Finally, the managerial mindset must change from a focus on a vertical to a horizontal organizational structure. As Mitroff, Mason, and Pearson (2004) argue, a radical re-conception of organization structure is required. They refer to this change in the managerial mindset as a framebreak. The traditional hierarchical structures slow decision making and implementation processes, Halal (2004). Horizontal structures with decision making decentralized to cross- functional teams unleash creative forces in the organization. These forces are necessary for a firm to respond and operate in the new competitive landscape.

Competition positioning and competitive advantage are two central components of marketing strategy. Managers routinely assess their brand's market position relative to a well defined group of competitors and undertake actions such as evaluating competitive products' key features to gain insights. Yet, in spite of the emphasis on competitive positioning and vying for relative advantage, the scope and nature of condition are not well defined or operationalized. This may be due to the viewpoint, from which competition is defined Day and Nedungadi (1994), because competition typically is characterized from a firm's perspective instead of from a customer's perspective. The optimal design of an organization depends on trade-offs associated with various characteristics such as information, incentives, and coordination which in turn are a function of the environment in which the firm operates, Roberts (2004).

An external shock to the environment, such as an increase in the intensity of product market competition, can cause firms to reorganize along various dimensions. One traditional explanation is that firms are not optimizing and that competition forces firms to eliminate organizational slack, Liebenstein (1966). However, explicit changes to organizational design need not be the result of earlier inefficient behavior, but could be an optimal response to the trade-offs inherent in distinct strategic and design choices. Porter (1980) notes that companies compete with the firms that most resemble them, but leaves open the question of how to identify and assess inter category competitors (i.e., those from different product categories). Aaker (2000) describes three competition categories, which include very direct, less intensive direct and indirect types. (2003) categorizes competition as brand, industry, form or generic, based on price cross-elasticity and substitutability, which again defines competition from a firm's perspective. Also describes a market definition of competition, which are companies that satisfy the same customer need.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the proposed research design, data collection and the techniques for data analysis that will be used.

3.2 Research Design

The study was modeled on a case study design. Bell (1989) explained that the case study approach is very appropriate for individual researchers because it gives them an opportunity to research in-depth one particular aspect of a problem. The merit of using a case study is that it allows an in-depth understanding of the behavior pattern of the concerned unit. Additionally a case study allows a researcher to use one or more of the several research methods depending on the circumstances. The study focused on the strategic responses by commercial bank of Africa to the challenge of non-performing loans. The results provided an insight in understanding how the bank responds to the challenge of non-performing loans.

3.3 Data Collection

The study used both primary and secondary data. The primary data was collected through face to face interview by the researcher in order to ensure in-depth responses from the respondents. An interview guide was used to collect data on strategic responses to the challenge of non-performing loans. The interview guide was divided into two sections, CBA's responses to non performing loans. The respondents consisted of ten members of management team who comprised the managing director, two executive directors, four general managers and three employees of the bank who are involved in the disbursement and collection of loans. Secondary data was collected from organization's documents such as annual reports, strategic plan and end term evaluation.

3.4 Data Analysis

The data collected was qualitatively analyzed by use of content analysis techniques. Kothari (2004) described content analysis as a method of analyzing contents of documentary materials such as books, journals, magazines, newspapers and the most importantly contents of verbal material whether spoken or written. The information was analyzed and evaluated to determine their usefulness, consistency, credibility and adequacy. The content analysis technique was used because it assisted in making inferences by systematically and objectively identifying specific messages and then relating them with their occurrence trends.

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

The research objective was to determine the strategic responses to the challenge of Non-Performing Loans Commercial Bank of Africa. This chapter presents the findings and analysis with regard to the objective and discussion of the same.

4.2 Demographic data of respondents

The demographic information considered in this study included the level of education attained by the respondents and the position currently held in the bank management. The respondents comprised of management of Commercial Bank of Africa (CBA), some of who were instrumental in formulating strategic responses of the bank to the challenge of NPLs. Initially, the intention was to interview ten respondents from the bank. They were to comprise the managing director, two executive directors, four general managers and three employees of the bank who are involved in the disbursement and collection of loans. The researcher did not interview all the respondents as the two executive directors were not available during the period the researcher was carrying out data collection. This resulted to 80% response rate.

The level of education helps an individual to carry out its tasks without much supervision and this is an asset to CBA as the respondents level of education was bachelors' degree level and above. In addition, all the respondents had worked in the organization for over five years. With this solid background, it was felt that the respondents were knowledgeable enough on the research subject matter and thus of help in the realization of the research objective.

4.3 Causes of Non-Performing Loans

In this section, the respondents were to give their independent opinion on the causes of NPL. It was important to understand the causes because the bank response depends with the cause of a challenge. These are the effects which NPLs have to the firms operations if not adequately checked. This therefore necessitates the understanding of causes of internal and external causes.

4.3.1 Internal bank specific causes

Poor credit and risk management practices and use of qualitative methods of debt collection was indicated as an internal cause of NPLs by the respondents. Qualitative methods entails analysis of such factors as the character and reputation of the borrower. Other qualitative aspects considered include over reliance on the collateral granted for the loan, long association of the borrower with the bank, and the historical financial capability, which mostly comprised account turnover. In contrast prudent credit appraisal and credit management emphasizes borrowers projected cash flows, analysis of the audit books, income statement and the balance sheet. Quantitative methods of credit appraisal therefore jeopardized the assessment of the borrower from a past and future perspective. Lack of management accountability for bad debts was also cause of worsening NPLs. No management employee had been held accountable for bad debts. This lack of accountability tended to perpetuate reckless lending despite having an internal audit and supervision team, recommendations arising from these audits carried little weight with the management.

The respondents further identified poor monitoring systems as another cause of NPLs. The central bank guidelines advise that a loan should be downgraded to NPLs, after repayment arrears fall in excess of three months. That notwithstanding, the bank did not adhere to these grading guidelines. Consequently, lack of proper grading of NPLs delayed debt recovery, as the bank continued to consider the NPLs as performing loans. More adversely, the NPLs continued to escalate due to interest application and other charges. Lack of adequate credit policy guidelines by the bank also increased the level of NPLs. For the better part of its inception the bank utilized an old credit policy that had not been updated. Despite the old credit policy guidelines, the environment had continued to change. The policy which has been formulated earlier did not give credence to economic decline. As such the bank failed to mitigate the risk of further decline of the economy and lower purchasing power of borrowers.

The respondents noted that poor management was one of the causes of NPLs. The appointees had limited lending capacity and thus were unable to guide the bank towards prudence in lending. These coupled with inadequate and weak internal controls comprised the bank's lending and credit decisions. Additionally, the interest rates rose sharply from nineties which further affected the borrowers' capacity to repay the debts. While interest rates rose, business turnover stagnated making it difficult for borrowers to repay their loans. The other challenges which were highlighted by the respondents are high level of NPLs adversely affected the banks liquidity position. It's instructive that banks lend depositors money, which they hope to be repaid back with interest. While the borrowers may fail to repay their debts, the banks still retain the obligation to the depositors to pay back their deposits together with interest thereon upon demand or at a specified future time. The huge NPL portfolio at CBA therefore posed a liquidity problem. Another challenge was low and declining profitability. This was due to frequent provisioning of the bad debts that adversely affected the bank's profitability. High and rising NPLs were a costly affair to the bank. Debt collection entails use of external service providers like lawyers, auctioneers, valuers, investigators and court appointed process servers. These service providers charge substantial fees towards recovery of debts.

4.3.2 External causes of NPLs

The respondents identified the economic downturn that persisted for the better part of the nineties and early two thousand as a major cause of NPLs. Customers who had borrowed funds from the bank suddenly found their businesses adversely affected by the general poor economic performance prevailing in Kenya.

Like other government institutions, CBK's operations were interfered with by the government leading to minimal supervision of banks up to the early 2000's. This lead to some banks perpetrating financial irregularities and reckless lending. There is some indication that CBA continued to categorize NPLs as performing loans, thus recognizing interest paid on the NPLs as interest income. The reason behind this action was a desire by the previous management to continue to post profits and to maximize bad publicity regarding the extent of NPLs. Consequently, the NPLs continued to grow unchecked to levels that made it difficult for the borrowers to ever repay fully.

The inadequate government monetary policy was also seen as another cause of NPLs. Faced with weak budgetary deficit the government has resorted to borrowing funds locally from the banks and the public through sale of treasury bills to cover the deficit. Money supply growth was uncontrolled to fund the government budget deficit leading to run away inflationary pressure. This gave rise to the high interest rate regime and high inflation that prevailed in the country. Inadequate and slow legal judiciary system was responsible for the slow execution of recovery cases that had been filed in court. Most respondents lamented how cases filed in court under certificate of urgency by debtors seeking to stop sale of their properties took as long as five years to be determined. This delay made it difficult to diligently execute debt collection and security realization. This is because parties to a suit are restrained from acting on the matter before the court until the cases are determined. Cases filed by the bank seeking judgment against bad debtors for attachment of private property took as long as ten years to determine. More revealing was the fact that some influential debtors were purported to have had a way of influencing the court to delay judgment. These delays in quick determination of cases were seen as a cause of NPLs. This is because some loans that could have been repaid early before they escalated to unmanageable levels were delayed, until the security for the loan far outstripped the NPLs.

Additionally, most respondents described debt collection as a tedious exercise particularly when it involves court matters. The legal system in Kenya is clogged with many unheard cases and it takes over four years on average for a matter not filed under certificate of urgency to be determined. This delay in determination of cases further escalates the cost of debt recovery. Legally these costs should be borne by the debtors. However, given the same debts cannot be fully recovered leaves the bank to bear the same. Difficulties of executing judgment were another challenge. When debt is classified as NPLs, the first action is for the bank to issue statutory notices demanding payment of the debt. Should the letters elicit no response, the bank is at liberty to exercise its statutory power of sale of security properties. Most often the sale proceeds are inadequate to liquidate the NPLs fully and a residue debt ensues. Consequently, unless the bank has investigated the debtor and found his financial capability to be poor, the last recovery action is for the bank to pursue a debtor by filing a civil suit for recovery of the residue debt.

The study found that it is very difficult to collect debts even where judgment had been delivered against a bad debtor and in favour of the bank. This limitation is that the bank can only execute judgment by way of attachment of a debtor's tangible asset or by arrest. This recovery process presents difficulties as most debtors do have enough unencumbered assets to ensure full recovery. To compound matters respondents advised that until recently, some debtors had proved very evasive when it came to arrest as the legal system was prone to corruption. All these challenges needed to be responded to if the bank was to make a comeback.

4.4 Strategic responses to Non-Performing Loans

This section covers the responses which the bank applied to counter the challenge of NPL which has threatened the lifeline of majority of the banks. Strategic responses involve changes to organizations strategy behavior to assume success in transforming future environment. Various measures have been undertaken to overcome the challenges of NPL by the bank towards the realization of its objectives. What follow is the various responses that were identified by the respondents to overcome the challenges.

4.4.1 Turnaround strategy

The respondents said they used turn-around strategy to respond to the challenge of NPL and it involved both retrenchment and restructuring of the bank. Among the activities undertaken were asset rationalization, cost reduction and establishing new sources of revenue generation. The combined turn-around strategies was instrumental in reducing expenditure, Generating revenue and curving out non performing branches or business that had little value to the profitability of the bank. These measures left the bank more agile and able to handle the challenge of NPLs and the competitive banking environment that has persisted since 2005.

Additionally, the bank commenced an aggressive debt collection exercise which involved establishment of a legal department to guide it in debt collection, and assist the bank to maximize the costs of debt recovery. The unit was instrumental in advising the bank on the debts that could be successfully followed through the judicial system. This subsequently enabled the bank to hire external service providers only where chances of success in recovery of debts were high. This not only reduced recovery costs paid to external service providers, but also ensured the firm screen accounts to establish the suitability of filing suit, which saved time. Consequently this reduced the operating cost. More importantly, cost cutting measures were undertaken, which involved the adoption of the open office plan as opposed to formal closed door offices that resulted in more efficient space utilization. In essence managers were brought to sit in the open with their staff and at the easy access of customers. Only senior managers retained their offices, but they were redone with glass sides to signify an open door policy.

Regarding whether the bank has fully fledged credit department, all the respondents were in agreement that the bank has fully fledged department which to deals with very dynamic market, and less customers loyalty and employee poaching by other banks. Crucial to this was the need to have as many employees as possible who deal with NPL so that in case there is employee's turnover then the bank has put in place measures to manage knowledge. All the respondents agreed that the bank did not use credit reference bureaus to guard them against lending to already existing bad debtors. The credit bureaus were not used by the bank due to the fact that it came into force recently and therefore they have initiated measures to ensure that they start using them before advancing loans.

4.4.2 Culture change

The culture change was another response of the bank to the challenge of NPLs. The culture of the bank required to be compatible with the strategies being implemented. The new management of the bank was instrumental in culture change to induce a performance driven culture to enable the bank to compete in a competitive market. Cultural changes further affected credit appraisals making them quantitative in nature, which was achieved through training. To further support this, the bank proposed the introduction of lending committee of different ranks which was required to appraise a credit together so as to minimize reckless lending. This initiative served as empowerment of staff and reduced the extent of centralization in decision making that previously rested in the hands of the managers. All this required change of mindset of the staff and the bank had to manage resistance to change through training. The respondents stated that the organization culture did not support the management on debt collection. Staff appraisals were subjective and the rewards did not reflect performance. In order to encourage collection of NPLs, the bank set annual targets for branches that were linked to individual targets. Any deviations from the set targets required explanation. To achieve this bank ought to employ a senior manager on contractual basis, whose primary task is to collect the NPLs. Renewal of the contract was to be pegged to performance of set targets. The senior manager is credited as having induced a performance culture in debt collection.

4.4.3 Technological change

The bank according to majority of the respondents embraced technological change by embarking on centralization and networking of branches, by acquiring bank master software and automated teller machine. Other technological enhancements included the intranet, automation of the clearing system, an international payment system known as Society for Worldwide Inter-bank Financial Transfer (SWIFT) and internet banking. The respondents unanimously agreed that the bank nowadays subject credit proposals to rigorous risk assessment after having a balance sheet with high NPLs occurring from previous credit advancement and these also prompted the senior management to vet credit proposals for objectivity so that they are sure the kind of project they are funding is actually viable. Regarding debt collection, the interconnectivity allowed centralization, monitoring and reporting debt collection. Moreover the computerization gave debt collection an impetus to speed up the exchange of crucial reports and returns on debt recovery through internet. Most crucial to debt collection, the bank is in the process of acquiring software, which will enhance debt recovery by prompting automation of debt monitoring and recovery. This will assist reduce the workload by providing an automated follow –up diary as well as automatically generating demand letters. The system will allow for more supervision through the computer monitor and help cut costs. The system will not only be useful for debt recovery but also for monitoring performing loans. The bank lastly commenced an aggressive marketing initiative to mobilize deposits so as to reduce the negative effects of NPLs such as liquidity problems the most successful initiative was salary payment to customers. Because of these combined marketing initiatives, large amounts are transacted through the bank that helped to reduce the liquidity problem.

4.4.4 Leadership change

Change of leadership was also used by the bank to respond to the challenge of NPL. When company performance dwindles to alarming levels, change of leadership may be a way to induce confidence and strategic direction. For CBA to make a turn-around, all staff needed to focus their effort in the same direction. Through change of leadership the bank was able to disclose the full extent of NPLs. The heavy provision and subsequent allocation of resources for debt collection sent signals that indicated the top management's commitment to responding to the problem of NPLs. Further the change of the organizational structure of the bank to, besides the creation of the legal department, was seen as a platform to support successful implementation of strategies to minimize the challenge of NPLs.

The pressure to respond to non-performing loans emanated from both the internal and external environment. Liquidity problem were the only internal force identified by the respondents. The real impetus seems to have emanated from external sources. These forces include pressure from shareholders, central bank of Kenya, competitors, bad publicity and economic recession. The major internal pressure to respond was the bank's liquidity problem. The respondents advised that due to liquidity problems, the bank had been paying heavy interest penalties up to the year 2007, arising from its overdrawn account at CBK. The heart of the problem was that the bank was saddled by non-performing debts, and the provisioning of the debts has grave consequences to the liquidity of the bank.

The economic recession and subsequent recovery also created pressure to respond .The economic recession tended to actuate the problem of NPLs, as the problem would have been less severe had the customer's purchasing power not been adversely affected. Additionally, economic decline reduced the business opportunities for the bank and its ability to overcome the challenge. The recovery that came with improved economy after the recession created resurgence in demand for credit thereby allowing the bank to grow its lending book. These combined factors imbued the bank respond to the underlying problem of NPLs.

The most significant force pressuring the bank to respond to the problem of the NPLs came from the external environment namely the shareholders. The banks dismal performance as a result of the NPLs was a course of concern for the shareholders. The respondents were in agreement that the shareholders agreed that as a way of dealing with NPL it was necessary to appoint competent banker as a way to restore confidence, improve the image of the bank and internal practices, provide leadership and turn around the bank. The shareholders have therefore constantly created pressure to collect the debts and ensure that new lending is thoroughly appraised so as to maximize future incidences of NPLs. Financial sector reforms to restore confidence in the whole banking industry enhanced CBK inspection and also created an impetus to respond to the NPLs. Until the 1996 amendment of the central bank act, the bank was criticized as having been ineffective in its chief role of regulation and inspection of banks. After the amendment of its act, Central Bank has been instrumental to the bank in providing pressure for adequate provisioning of NPLs.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The research established that all the respondents' level of education was bachelors' degree and above while at the same time the response on how to deal with NPL was highlighted by the response from different departments as the respondents were managers on different departments. The bank has fully fledged credit department which deals with loans advancement, monitoring and collection. The bank did not use credit bureaus because it did not exist when the bank was advancing the loans but with the introduction in the recent days means that the bank can now use the bureau. The causes of NPLs were both external as well as internal. The external factors contributing to NPLs were economic downturn, Government interference in lending, inflationary tendencies, limited supervision by the central bank of Kenya, inadequate government monetary policies and a slow and inadequate judicial system. The bank specific causes responsible for NPLs were use of qualitative methods of debt appraisals which ignored analysis of the financial performance of the debtors, poor debt follow up, lack of management accountability for NPLs, inadequate credit policy guidelines, imprudent and reckless lending and lack of portfolio diversification. We can therefore conclude that both the internal and external environment had an impact on the genesis of NPLS.

The findings indicate that Non-performing loans were seen to pose serious challenges to the banking sector in Kenya. CBA faced serious challenges such as the projection of negative picture on the banks financial performance. This is detrimental to the future performance of this bank as vied by the share holders. More serious challenges faced by the bank included the non performing loans posing a financial stability risk on the bank and also posing a threat of failure of the bank. The respondents felt that many borrowers were multi banked and thus the access to credit from various banks therefore leaving them overwhelmed. Such challenges were difficult to address as once the loan was disbursed control as to how much more someone could borrow from other lenders such as Sacco's was not possible. The respondents felt that these challenges were serious and needed to be addressed strategically.

The strategic responses cited by the respondents as being applied by the bank included the introduction of new policies and procedures, the subjecting of credit proposals to rigorous risk assessment by the lending officers, the use of informal means to get additional information on borrowers, vetting credit proposals by senior management for objectivity and avoiding lending to seasonal or non performing sectors, use of turnaround strategy, restructuring, adoption of new technology, aggressive marketing, change of leadership and organizational culture change. Central of these responses was the need to turn around the bank through collection, provision and subsequent write-off of NPLs. The objective was for the bank to present a healthy balance sheet and improve its public image before it can commence growth strategies. The respondents however indicated that the responses were not completely adequate as there were problems during the implementation of some of these strategies. They have however observed that the bank had the necessary capability to match the environmental changes. Strict monitoring of accounts operations to identify weaknesses early for corrective measures and critical review of financial information submitted by the borrowers were used to a very great extent. Of the strategies used, subjecting of credit proposals to rigorous risk management as well as the establishment of fully pledged credit department to handle all issues regarding lending risk and strict monitoring of account operations to identify weaknesses early for corrective measures and the review of financial information submitted by borrowers critically before lending were seen by majority of the respondents as a very adequate in addressing the challenges posed by non-performing loans.

5.2 Conclusions

From the research findings and the answers to the research questions, some conclusions can be, made about the study.

Response to the challenge of NPL by a bank is critical to the survival of the bank in this highly competitive environment. For the bank to make a turn around, the whole bank needed to focus their effort in the same direction. The bank should continue with the aggressiveness in debt collection exercise which involved establishment of a legal department to guide it in debt collection, and assist the bank to maximize the costs of debt recovery. The unit was instrumental in advising the bank on the

The bank is charged with the provision of financial services to individuals as well as corporate bodies. By doing so, they grow the assets of the bank and thus increasing profits of the bank. It's necessary that the loan portfolio poses a little risk as possible. This can only be done by the bank ensuring that the loans disbursed are of good quality and will not end up being faulty or non-performing. This study has established that the successful strategic Reponses are those that relate to the actions done before the loan is disbursed for example the critical analysis of credit proposals as well as strict monitoring of the accounts after loans are disbursed. This way, the weaknesses are quickly identified and corrective measures undertaken to prevent the occurrence of the Non-performing loans.

5.3 Recommendations

This study makes a few recommendations that have policy implications for decision makers. The study found out that the bank had responded to the challenge of NPL in a manner that shows that they want to deal with the challenge in order to clean their balance sheet with the exception that in case it is NPL then it should be recoverable or performing. The study recommends that the management of the bank should continue working towards ensuring that the they vet all the loan application thoroughly and not compete with the other banks which have pursued the strategy of offering non secured loans which can be detrimental in case an employee who took loan base on pay slip looses her/his job.

To ensure successful running of the bank, it is recommended that the bank should ensure that the staff are adequately involved so that the staff can own the implementation process. The bank can also adopt negotiations with the debtors in order to provide the way to restructure the NPL to enable them repay the loan.

5.4 Recommendations for further research

The study confined itself to Commercial Bank of Africa which is a private bank. This research therefore should be replicated in other commercial banks and possibly the public banks and the results be compared so as to establish whether there is consistency on the responses to Non Performing Loans.

5.5 Limitations of the study

The study was based on a private bank and therefore the amount of NPL could be different from those of a public bank and therefore the responses which they adopt could be different and also the challenges which they encounter in the process of dealing with NPL could also be different However, the limitation did not have any adverse effects on the findings of the study.

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APPENDIX I

INTERVIEW GUIDE

Goal of the interview process

To establish how Commercial Bank of Africa respond to the challenge of non-performing loans.

Interview Questions

The following sections provide sample questions to be used in evaluating the strategic responses to the challenge of non-performing loans.

4.1 Respondent Background Review

- What is the highest level of education you have received?
- What position do you hold in the bank?
- How long have you worked in this organization?

4.2 Causes of non-performing loans

1. Does each of the following internal causes of NPL's (economic downturns and macroeconomic volatility, terms of trade deterioration, high interest rates, excessive reliance on overly high-priced interbank borrowings, insider lending and moral hazard) affects your firm?
2. If yes, to what extent does each of them affect your bank?
3. Does each of the following external causes of NPL's (money multiplier, and reserve adequacy, institutional characteristics and tequila effect) affects your firm?
4. If yes, to what extent does each of them affect your bank?
5. What are the external causes of NPLs?

6. Does NPL's lead to a decline in income meant for credit thereby reducing its adequacy?
7. How does NPLs pose financial stability risk in the bank?
8. Has NPL led to high costs from debt restructuring?

4.3 CBA responses to non-performing loans

9. What strategies did the bank adopt to counter NPL challenge?
10. In your opinion, has CBA responded effectively to the challenge of non-performing loans?
11. Does the bank have a fully fledged credit department?
12. Have the bank use credit reference bureaus to guard against lending to already existing bad debtors?
13. Does the bank subject credit proposals to rigorous risk assessment? If yes, who does so?
14. Does the bank check the credit worthiness of a client from other lenders if borrower is multi banking?
15. Do CBA monitor strictly the account operations of its customers for early corrective measures?
16. What do you consider to have been the forces bearing pressure on the bank to respond to the problem of NPL's?